GENERATIONAL PLANNING ATTORNEYS

PH: 248-251-1001

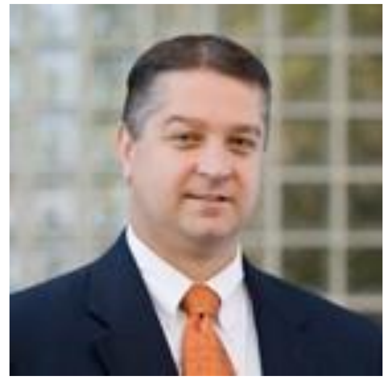
WWW.AXISATTORNEYS.COM

THE IMPACT OF DIVORCE ON YOUR ESTATE PLAN

© AMERICAN ACADEMY OF ESTATE PLANNING ATTORNEYS, INC.

ABOUT THE FIRM

Axis Estate Planning, part of Lambert Leser, has been providing quality estate planning for our clients since 1920s. Whether you need an attorney for Estate Planning, Trust or Probate Law, our team of qualified individuals, are here to help you and your loved ones.



In these turbulent times, if you or your loved ones would like a complimentary consultation to discuss your estate plan or estate administration (Trust or probate), please call us today at **248-251-1001** to schedule an appointment.

We present seminars on a variety of estate planning and elder law topics; call us if you want to be on our seminar mailing list.

FOLLOW US ONLINE

WWW.FACEBOOK.COM/AEPATTORN

WWW.LINKEDIN.COM/IN/VICTOR-VEPRAUSKAS-IV-B5919119

CONTACT US

AXIS ESTATE PLANNING

755 W. BIG BEAVER ROAD,

SUITE 410

www.axisattorneys.com

victor@axisattorneys.com

AXIS ESTATE PLANNING

THE IMPACT OF DIVORCE ON YOUR ESTATE PLAN

The unhappy truth about marriage is that about half[1] of them end in divorce each year. If you're married or you have children or other heirs who are married, perhaps you've considered the effects that divorce could have on your life, the holdings in your estate, and mutual family members. If so, you've done more thinking than most. This report can help familiarize you with some important concepts about being prepared for divorce, should it come your way.

Most people don't consider the types of changes that can occur when the specter of divorce enters their lives or the life of an intended beneficiary. But as you might imagine, divorce makes it that much more important to have legal affairs updated and reviewed. Without strict planning, a divorce could have devastating consequences on your family.

Unfortunately, the sky-high divorce rate continues to rise in America. And it's important to acknowledge this reality. Although emotional upheaval may seem difficult as a result of a divorce, the hard work associated with returning your life to normalcy doesn't end with divorce. It's important to know how divorce dramatically affects your estate plan.

DEFINITION: WHAT IS LEGAL DIVORCE?

Technically, a divorce is the termination of a marriage contract between two individuals. From a legal standpoint, your divorce resolves three issues:

- The divorce gives each person the legal right to marry someone else.
- It divides property (or responsibility for debts).
- It outlines the details of the care and custody of children.

Although the law on these points can be straightforward, with some variation by state, the American legal system can add to the antagonism of divorce by putting a couple at war as each side tries to "win" the divorce. Luckily, "no-fault" divorce laws can simplify the process.

AN INITIAL STEP: REVIEW BENEFICIARY DESIGNATIONS

After you divorce, it is important to update your beneficiary designations on financial instruments such as life insurance policies, stocks, bonds and other assets. You must, however, only make changes that are allowed in your divorce decree. You may be obligated by court order to name your ex-spouse as a beneficiary for a specific amount of life insurance proceeds. In addition, your ex-spouse may be entitled to a portion of retirement benefits accrued while you were married.

[1] https://www.apa.org/topics/divorce/ (*Encyclopedia of Psychology*)

Your estate planning attorney can help you determine which assets can be assigned new beneficiaries.

In general, you should have all estate planning documents reviewed. In particular, you'll have to review your fiduciary designations with the following questions in mind.

- Who is designated as the trustee of a trust?
- Who is the Executor / Personal Representative of a will?
- Who is the Agent under a Property Power of Attorney, Health Care Power of Attorney, or Health Care Proxy?

Many states have statutes which preclude an ex-spouse from inheriting under a will created during marriage. Some of the statutes also apply to trusts and beneficiary designations on life insurance or retirement plans. However, the laws vary tremendously and resolution of the matter can be further complicated where a divorce occurs in one state, but the estate plan or beneficiary designation is governed by the laws of another state or the federal government.

For example, the U.S. Supreme Court upheld a case involving an award to an ex-wife of the benefits of her ex-husband's life insurance and pension plans because he never replaced her as the beneficiary. A federal law known as ERISA pre-empted a state law that automatically revoked beneficiary designations of ex-spouses after divorce. As you can see, if a situation like this is left unattended, an unintended outcome could result. Extreme turmoil can occur, particularly if a new spouse has entered the picture!

DIVIDING ASSETS: ONE FOR YOU, ONE FOR ME

In the long run, the assets that are awarded to you and the manner by which they were obtained can pose serious tax consequences. Let's look at the assets most likely to cause you grief if not handled properly.

APPRECIATED ASSETS

Like many couples, you and your spouse may have accumulated assets that will need to be disbursed between you as part of your divorce settlement. These assets may include real estate, mutual funds, stocks, artwork, or collectibles. Great care should be taken as you consider who gets what, or you may be setting yourself up for a painful capital gains tax bill in the future.

REAL ESTATE

Dividing real estate is one of the most contentious and controversial areas of a divorce settlement. Because it's such a sticky part of the divorce, it's even more important that both parties try to resolve issues amicably and in a businesslike manner. The divorce language requires many decisions to be made since it dictates which spouse will own and reside on the property, pay the mortgage, taxes, insurance, utilities and repair expenses. This language also outlines how profits from a possible sale of the property will be divided.

Personal Property

Typically, each spouse keeps their own personal property such as jewelry, books and clothes. To avoid issues in this area, these items should be in the possession of the appropriate spouse before the divorce is filed. Otherwise, a list of the items should be included in the marital settlement agreement.

Your Home

For most couples, the home is the most expensive asset and is typically jointly owned. As the details of your divorce settlement are being defined, you and your spouse will probably face three options – each with its own unique tax consequences:

Option 1: The home is sold immediately and the proceeds are split.
There would be no capital gains tax on the sale of the residence, as long as the couple lived in the home for at least two out of the five years immediately preceding the sale and the gain is no more than $500,000.

Option 2: The home is sold at some future date and the proceeds are split at that time.
If the divorce settlement allows one spouse to remain in the home for three years or more before it is sold, adverse tax consequences could be the result. The non-resident spouse will no longer be entitled to the $250,000 exclusion from capital gains to the non-resident because the home no longer qualifies as his or her principal residence.

Option 3: One spouse buys out the other's interest in the home.
If the sale takes place as a part of the divorce, up to one year after the divorce decree, then any gain is not recognized. The person who receives the house would have the income tax basis of both parties in the house. Let's say that Harry and Wanda were married and bought a house together. Harry contributed $75,000 and Wanda contributed $25,000. The home is now worth $500,000 at the time of divorce. Wanda is awarded the entire house as a part of the divorce settlement. Wanda's income tax basis in the house is $100,000.

However, the rules are normally different if it's been more than a year since the divorce decree. If one ex-spouse buys out the other's interest in the property, careful attention must be given to any taxes owed by the selling ex-spouse (after taking into account the $250,000 exclusion) and taxes owed by the purchasing ex-spouse on assets which must be liquidated to buy out the other ex-spouse.

RETIREMENT PLANS

QUALIFIED PLANS

The tax laws governing qualified retirement plans such as 401(k)s are strict and limited not only to whom, but also when and how distributions from the plans may be received. The law is equally stringent about the rights of the plan owner's spouse. It requires your spouse to receive distributions, and it will not allow you to "alienate" or "assign" your qualified pension plan distributions to anyone else.

So, what happens in a divorce? Even though your spouse is about to become your ex-spouse, he or she may still have rights to some portion of your plan distributions. The solution for divorcing spouses is usually the Qualified Domestic Relations Order, or "QDRO." If the QDRO is drawn up properly in accordance with the governing tax laws, it sets aside a portion of the retirement benefit which will be received upon retirement.

INDIVIDUAL RETIREMENT ACCOUNTS (IRAS)

The amount of IRA assets that the divorcing spouse may be entitled to depends on whether you live in a community property or separate property state, the amount of time you have been married, and whether the IRA was established before or after marriage. If properly done, IRA funds can be transferred tax-free from one spouse to another by a written divorce decree. But if improperly done (as one taxpayer learned in a recent Tax Court case) one spouse may end up with half the money and the other spouse with the entire tax bill.

IN THE EVENT OF DEATH

Joint Tenancy Assets — Ascertain whether assets are held in Joint Tenancy with the ex-spouse or a family member of the ex-spouse. One thing to remember is that divorce does not automatically change the Joint Tenancy titling of property. If death occurs before the divorce is final, the entire joint tenancy asset will pass to the remaining joint tenant through the survivorship feature of Joint Tenancy.

Naming a Guardian — In most cases, your ex-spouse will get custody of your children, if he or she isn't already the custodial parent. In rare cases, the surviving parent may not be suitable or able to assume full-time guardianship of your children. In that case, you should make sure you've worked with your attorney to nominate someone else to serve as their guardian.

Controlling Distribution of Assets — If you leave assets to your minor children outright, keep in mind that your ex-spouse will probably be the one to control and manage them. Like most divorced parents, you may find it completely unthinkable that your ex-spouse will have discretion over how your assets are spent. You may also have reason to fear that your children will not enjoy the full benefit of your legacy as you intended. But without effective strategies incorporated into your estate plan, these are two very possible outcomes.

DIVORCE, TAXES AND YOUR ESTATE PLAN

Fortunately, some good news does exist within the arena of divorce, and it comes from no other than the IRS. Here's the benefit. The IRS generally does not consider the transfer of assets between divorcing spouses a taxable event. This includes cash that one spouse pays another as part of the divorce settlement. There are a few restrictions to this rule, but as long as you can demonstrate that you are divorcing for legitimate reasons not related to tax savings, you and your soon-to-be ex could transfer cash and assets without fear of a tax gain or loss to either party. At least, not in the short-term future.

FILING STATUS

Couples whose divorce won't be concluded by December 31 of a given year will have to make a difficult decision regarding the filing status they choose on their tax returns. Married filing separate is the most costly filing status available. That's why, if you and your spouse can agree to it, you may want to continue filing jointly until your divorce is final. There are two notable exceptions to this rule, however.

> ***Exception 1:*** You probably shouldn't file jointly if your spouse has incurred taxes that he or she won't be able to pay. By filing jointly, you assume liability for your spouse's taxes as well as your own. If the IRS can't get satisfaction from your spouse, it will turn to you for payment.
>
> ***Exception 2:*** You may not want to file jointly if you suspect that your spouse isn't fully disclosing income or is falsifying deductions. Once again, you may be held liable for your spouse's tax liability, plus associated penalties.

WHO GETS THE CAPITAL GAINS?

Let's assume that you and your spouse own stock that has appreciated substantially since you bought it. Purchased for $50,000 five years ago, the stock is now worth $100,000. If the two of you decide to sell the shares today, the gain would be $50,000, or the difference between your original investment and the selling price. If you decide you'd like to keep the stock, and pay your spouse $50,000 (half the current market value) for full ownership, your total investment becomes $75,000. However, if you sell the shares, the cost basis used to determine your capital gains taxes won't be the $75,000 you've actually invested in the stock. Instead, the government will look at your original cost basis – $25,000 – and your spouse's original cost basis – also $25,000 – and deem that your actual cost basis is just $50,000! Therefore, the $50,000 cash you paid your ex-spouse for the stock goes to him or her tax-free, while you are left with a hefty capital gains tax.

Which Estate Planning Strategy is Best?

Fortunately, all the problems described above can be neatly countered with a well-designed tax and estate plan. If you already have an estate plan in place, your main concern will be having it updated as a result of the new changes that your divorce has introduced into your life. For most, these estate planning issues are of greatest concern during a divorce:

- Controlling to whom, when and how assets are divided today, and how they will be distributed after death.
- Capturing every tax break available during the divorce transition.
- Maintaining control and management of certain assets.
- Renaming beneficiaries.

Here are three estate planning strategies that may help you achieve these objectives:

- ***The Revocable Living Trust*** — This popular estate planning tool is unlike a will in that it allows you to avoid probate which brings on potential delays, expenses and public exposure. Instead, upon your death, your designated successor trustee assumes responsibility for management and distribution of your assets, which are owned by your Revocable Living Trust. Your trustee will follow the directions you have provided in your trust documents, including when you want assets distributed, to whom and by what means.
- ***The Children's Trust*** — Another estate planning strategy popular among parents is the Children's Trust. It allows you to set aside funds which may be used at a later time to pay for college education or purchase a first residence.
- ***The Irrevocable Life Insurance Trust*** — The Irrevocable Life Insurance Trust, or ILIT, accomplishes several important objectives. First, it lets you remain in control of the distribution of your life insurance policy's proceeds long after you're gone. As with the Children’s Trust, the ILIT disperses policy proceeds to your beneficiaries when and how you want. Because the trustee of the ILIT is your designee, you also ensure the proceeds remain out of your ex-spouse’s reach.

GETTING HELP

Any of these solutions, or a combination of all three, may help you achieve the tax advantages and control you seek. Equally important is the peace of mind you'll gain when you know that, come what may, your children will be well provided for.

Because your goals and your family's situation are unique, seek out the counsel of an attorney who concentrates on these estate planning strategies. Only he or she will be able to show you how you can best employ them for your children's benefit.

TAKE A MOMENT AND BREATHE

In addition to the emotional turmoil you're experiencing, it's difficult to digest all the information concerning the legalities of divorce. Impulsive changes during a divorce must be avoided at all costs.

To begin with, a hasty asset transfer could violate the applicable Uniform Fraudulent Transfer Act or the Uniform Fraudulent Conveyance Act, as well as state marital or community property laws. Additionally, it is necessary to comply with the terms of the divorce decree. In general, a divorce decree takes priority over differing provisions in an estate plan.

Since divorce is usually a difficult and emotional time, it is imperative to find the strength to fully arrange your financial affairs. Before any action is taken, consult with a qualified estate planning attorney. Failure to do so could result in an undesirable outcome. Inaction could result in unintended asset transfers, while premature action could lead to fraudulent transfer penalties. However, with the guidance of a knowledgeable estate planning attorney, organizing an estate plan can bring you proper closure and set a good foundation for a new beginning.

ABOUT THE ACADEMY

This report reflects the opinion of the American Academy of Estate Planning Attorneys. It is based on our understanding of national trends and procedures, and is intended only as a simple overview of the basic estate planning issues. We recommend you do not base your own estate planning on the contents of this Academy Report alone. Review your estate planning goals with a qualified estate planning attorney.

AMERICAN ACADEMY
of Estate Planning Attorneys
Since 1993

The Academy is a national organization dedicated to promoting excellence in estate planning by providing its exclusive Membership of attorneys with up-to-date research on estate and tax planning, educational materials, and other important resources to empower them to provide superior estate planning services.

The Academy expects Members to have at least 36 hours of legal education each year specifically in estate, tax, probate and/or elder law subjects. To ensure this goal is met, the Academy provides over 40 hours of continuing legal education each year. The Academy has also been recognized as a consumer legal source by *Money Magazine, Consumer Reports Money Adviser* and Suze Orman in her book, *9 Steps to Financial Freedom*.

ADDITIONAL REPORTS

Request any reports of interest to you or your family. Simply call our office at **(248) 251-1001** or visit our website at **www.axisattorneys.com.**

- A Child With Special Needs, Needs Special Planning
- Aid & Attendance: Special Care Pensions Wartime Veterans
- Are Your Bank Accounts Safe? FDIC Insurance Can Cover You – With the Right Planning
- Asset Protection: Reducing Risk, Promoting Peace of Mind
- Beware of Living Trust Scare Tactics
- Charity Begins at Home: The Charitable Remainder Trust
- Creating a Lasting Legacy: The Best Things in Life Aren't Things
- Dangers of Do-It-Yourself Wills and Living Trusts
- Estate Planning Basics For Families with Young Children
- Estate Planning with Individual Retirement Accounts (IRAs)
- Family Farm: The Next Generation
- Family Wealth Trust: Calculating the Benefits
- Fifteen Common Reasons to Do Estate Planning
- Finding the Right Estate Planning Firm
- Funeral Planning: Options for You and Your Family
- Getting the Most Out of Your Life Insurance: The Irrevocable Life Insurance Trust
- Grandparents' Guide to Second Generation Planning
- Keeping Up With the Ever Changing Estate Tax
- Living Trusts: Calculating the Benefits
- Paying for Nursing Home are: A Guide to Medicaid Planning
- Peace Of Mind: Planning For All Of Life's Contingencies
- Planning It Right The Second Time Around
- Probate: A Process, Not a Problem
- Probate: An Executor's Role and Responsibilities
- Protecting Your Assets with the Family Limited Partnership
- Protecting Your Assets with the Limited Liability Company
- Set the Stage for Medicaid Eligibility
- Should You Trust Your Estate Plan – Estate Plan Reviews Ensure Protection for Your Family and Assets
- Special Valuation Benefits for Farms and Other Business Real Property
- The Impact of Divorce on Your Estate Plan
- The Nightmare of Living Probate
- The Trouble with Joint Tenancy
- To My Dog Lucky I Leave $10,000
- Trust Administration: Prior Planning Prevents Problems
- What Every Senior Should Know About Probate
- Where There's a Will, There's Probate
- Your Life, Your Final Say