

Divorce

How your investments may be affected



If a divorce is in your future, you have a lot on your mind – children, the household, your emotions. But now is not the time to overlook your finances. Each case is different, and there’s no pat answer. But to help reduce the likelihood that a divorce will disrupt your tax and investment strategies, you need to understand a few fundamentals.

Like all tax laws, the rules governing divorce are complicated. The following is intended to provide only an overview of the issues involved. Always consult your attorney and tax advisor about your specific situation.

Your changing tax picture

If you’re faced with a divorce, you need to be aware of a variety of general considerations about your tax situation.

Divorce expenses. Expenses for obtaining a divorce are not deductible; however, you can deduct certain fees paid for tax advice in connection with a divorce or to obtain alimony.

Filing status. Most married couples file a joint return, which provides a variety of tax advantages. A divorce, of course, changes that. In general, you are considered married for the entire year and can continue to file jointly if you have not obtained a final decree of divorce or separate maintenance by the last day of the tax year, Dec. 31.*

Personal exemptions. If you obtained a final divorce decree or separate maintenance by the end of the year, you must file differently (i.e., as single or head of household), and you cannot take your former spouse’s exemption – even if you provided all of his or her support.

Exemptions for dependents. In general, it’s the custodial parent – the parent with whom the child lived for the greater part of the year – who takes the exemption for a child. However, the custodial parent can make a written declaration that lets the noncustodial parent take the exemption.

Alimony. The payer can deduct alimony – payments from a spouse to a former spouse under a decree of divorce or separate maintenance – and the recipient must report the amounts received as income. Keep in mind that not all payments made under a divorce or separation agreement are considered alimony; these rules apply only to alimony payments. Your tax advisor can help determine which payments qualify as alimony.

Managing retirement accounts

If you contribute to your employer’s qualified retirement plan, such as a 401(k), or to an IRA, you’re probably planning to use those funds to finance a significant portion of the expenses you’ll incur in retirement. In a divorce, you need to take measures to help protect these assets.

If you or your spouse has funds in an employer-sponsored retirement plan, it’s usually vital to obtain a qualified domestic relations order (QDRO, pronounced “quad row”). This is a court order, judgment or decree related to child support,

*A decree of separate maintenance is the document that puts the terms of a legal separation into writing.

alimony or property rights that instructs a retirement plan on how to pay benefits to an ex-spouse. QDROs apply to qualified plans covered by the Employee Retirement Income Security Act (ERISA).

A QDRO provides protection above and beyond what a divorce decree offers; don't assume you're protected just because your divorce decree indicates you have a right to your ex-spouse's pension funds. To help ensure your rights are protected, consult with your attorney about obtaining a QDRO.

A QDRO establishes a spouse's right to receive a designated portion of an ex-spouse's retirement plan account balance or benefit payments. However, the important point to remember is that the spouse receiving the money accepts responsibility for paying the taxes.

If you plan to use a QDRO to roll over funds from an ex-spouse's retirement plan into your IRA, keep in mind that an immediate distribution may not be possible. When you receive the money depends on the employer's plan document. If an immediate distribution is possible, take care regarding how the rollover is handled. The most efficient method is to have the money go directly from the retirement plan into your IRA. On the other hand, if you have a check written to you, the plan will be required to withhold 20% for the IRS. So instead of receiving \$100,000, for example, you'll get a check for only \$80,000. You'll then have 60 days to deposit the check into your IRA to avoid incurring a taxable distribution and possible IRS penalties. If you replace the amount withheld (\$20,000 in our example) with other funds when you make your IRA deposit, you may get a refund from the IRS for that amount when you file your tax return.

Keep in mind that with a QDRO, money going from your pension plan to an ex-spouse is considered a distribution to you — which means you would be responsible for paying the taxes.

Take care when dealing with IRA transfers. If your divorce decree calls for you to transfer funds from your IRA to your ex-spouse's IRA, you can do so without incurring taxes if your divorce decree includes appropriate language addressing the transfer; however, your ex-spouse will owe taxes when taking withdrawals from a traditional IRA. (Qualified withdrawals from a Roth IRA are tax-free.)

If your divorce decree does not include the appropriate language, you could owe taxes and a 10% IRS penalty if you're younger than 59½ when the transfer occurs. Consult your attorney to make certain you are protected.

Stock options and restricted stock create complications

Stock options and restricted stock have become increasingly popular elements in many employees' compensation packages. Although these can be valuable benefits, they can add complexity to divorce proceedings.

Dealing with stock options is complicated by a variety of factors, including whether:

- The options are vested or unvested
- You live in a community-property state
- You hold incentive stock options (ISOs) or nonqualified stock options (NSOs)

Vested versus unvested options. If you hold unvested stock options, you can claim that they're worthless (because they cannot be exercised) and therefore should not be considered property acquired during the marriage, potentially giving your spouse a claim to them. However, the court may rule that your stock option became marital property on the grant date (when they were issued) rather than when they become vested.

If your unvested options are deemed marital property, your divorce decree must include language stipulating what will happen when the options become exercisable. For example, the court may rule that you and your spouse hold the unvested options as "tenants in common." When the options become vested, your ex-spouse would then have the right to exercise the options through you.

If you hold vested options, the court could rule in a number of ways, for example:

- If your option program permits transfers, you could be required to transfer a portion of your options to your ex-spouse.
- If your program does not permit transfers, the court may:
 - Require that you exercise the options and divide the proceeds with your ex-spouse
 - Let you maintain ownership of the options after the divorce and exercise them at a time agreeable to you and your ex-spouse and divide the proceeds
 - Give your ex-spouse other assets of comparable value to the options in exchange for relinquishing any claim to the stock options

Community-property states versus other states. If you live in a community-property state, you and your spouse are each entitled to 50% of the stock options acquired during your marriage. In virtually all other states, stock options are treated like the rest of your property and are subject to equitable division by the divorce court.

ISOs versus NSOs. ISOs provide tax advantages that NSOs lack. However, if you transfer ISOs to your spouse, the options will become disqualified — in other words, they lose the tax advantages — which won't help either party. As a result, if you hold ISOs, it may be to your benefit to negotiate an agreement that will let you hold on to these options and, perhaps, provide your ex-spouse with other property of comparable value.

The IRS will also let you keep the ISOs in your name while the legal and beneficial ownership goes to your ex-spouse. You would then exercise them according to his or her direction and transfer the purchased shares to him or her. It would then be your ex-spouse's responsibility to pay the exercise costs and taxes, including the alternative minimum tax (AMT), if applicable.

You can count on us

Divorce is hard enough without having to worry about how it will affect the financial security you've worked so hard to build. Make sure you understand the issues pertaining to your situation. In addition, your Financial Advisor will work closely with your attorney and tax advisor throughout the proceedings to help ensure that your rights and your investments are protected.

Restricted stock. Because restricted stock is also subject to a vesting schedule, it presents many of the same challenges as stock options. If the plan allows, unvested restricted stock can be transferred to your ex-spouse without incurring taxes. At vesting, your ex-spouse can sell the stock, and he or she would be responsible for paying any taxes. If the plan does not permit transfers, your divorce decree can stipulate that you give your ex-spouse other property of comparable value to the restricted stock, or you could agree to transfer the shares when they become vested.

To deal with the complex issues involved with stock options and restricted stock in a divorce, you may want to use a QDRO (if your company permits) to stipulate how these assets are to be treated. Keep in mind, however, that QDROs for stock plans are not registered in the way they are for pension plans. For stock plans, companies provide sample QDRO formats for use in the transfer as the parties agree.

Review estate strategies and beneficiary designations

Think about any estate strategies and documents that you have in place, including a will, power of attorney and/or trust. Discuss with your attorney how you may need to revise these documents after your divorce to accommodate your single status and, perhaps, provide instructions for your children's ongoing care and protection if something were to happen to you.

You'll also want to think about the beneficiary designations on your continuing employer benefits, such as employer retirement plans, stock-based benefit programs, stock purchase plans, group life insurance, etc. Be sure to update these beneficiary designations as well as those on your IRA and personally owned life insurance policies to ensure that these assets transfer to the persons you want.

Use this worksheet

The following worksheet may be helpful in gathering the information your Financial Advisor, attorney and tax advisor may need as the divorce process moves forward.

Income

	You	Your spouse	
Sources	_____	_____	\$ _____
	_____	_____	\$ _____
	_____	_____	\$ _____
	_____	_____	\$ _____
	_____	_____	\$ _____

Expenses

	You	Your spouse
Housing and utilities	_____	_____
Food and clothing	_____	_____
Medical care	_____	_____
Insurance	_____	_____
Charities	_____	_____
Entertainment	_____	_____
Child care/tuition	_____	_____
Other	_____	_____
	_____	_____
	_____	_____

Assets

	Value	Owner	Marital/separate
Bank accounts	\$ _____	_____	_____
Savings	\$ _____	_____	_____
Checking	\$ _____	_____	_____
CDs	\$ _____	_____	_____
Safe deposit box	\$ _____	_____	_____
Other	\$ _____	_____	_____

Investments

	Value	Owner	Marital/separate
Stocks	\$ _____	_____	_____
Bonds	\$ _____	_____	_____
Mutual funds	\$ _____	_____	_____
Life insurance (cash value)	\$ _____	_____	_____
Other	\$ _____	_____	_____

Retirement funds/employee benefits

Defined contribution [401(k), etc.]	\$ _____	_____	_____
Defined benefit	\$ _____	_____	_____
IRAs	\$ _____	_____	_____
Pension	\$ _____	_____	_____
Stock options	\$ _____	_____	_____
Other	\$ _____	_____	_____

Property

House	\$ _____	_____	_____
Second home	\$ _____	_____	_____
Land	\$ _____	_____	_____
Commercial real estate	\$ _____	_____	_____
Other	\$ _____	_____	_____

Household items

Furniture	\$ _____	_____	_____
Clothing	\$ _____	_____	_____
Crystal	\$ _____	_____	_____
Silver	\$ _____	_____	_____
Jewelry	\$ _____	_____	_____
Books	\$ _____	_____	_____
China	\$ _____	_____	_____

	Value	Owner	Marital/separate
Art	\$ _____	_____	_____
Collectibles	\$ _____	_____	_____
Electronics	\$ _____	_____	_____
Tools, guns, hardware	\$ _____	_____	_____
Other	\$ _____	_____	_____

Vehicles

Cars	\$ _____	_____	_____
Boat	\$ _____	_____	_____
RV	\$ _____	_____	_____
Trailer	\$ _____	_____	_____
Motorcycle	\$ _____	_____	_____
Other	\$ _____	_____	_____

Miscellaneous

Memberships	\$ _____	_____	_____
Tax refunds	\$ _____	_____	_____
Business partnerships	\$ _____	_____	_____
Copyrights	\$ _____	_____	_____
Time-shares	\$ _____	_____	_____
Other	\$ _____	_____	_____

Debts

	You	Your spouse	Payment schedule
Mortgage	\$ _____	\$ _____	_____
Car loan	\$ _____	\$ _____	_____
Credit card(s)	\$ _____	\$ _____	_____
Personal loan(s)	\$ _____	\$ _____	_____
Other	\$ _____	\$ _____	_____

Investment and Insurance Products: ► NOT FDIC Insured ► NO Bank Guarantee ► MAY Lose Value

Wells Fargo Advisors is the trade name used by two separate registered broker-dealers: Wells Fargo Advisors, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, non-bank affiliates of Wells Fargo & Company.
©2010 Wells Fargo Advisors, LLC. All rights reserved.