When Divorcing, $500,000 is not always $500,000!

Divorce is an emotional and financially stressful time. Financial decisions have to be made that will affect your long-term stability. It is very important to carefully consider your particular needs and circumstances when deciding ***what an asset is really worth to you.***

Let's look at typical marital assets and assume they are each valued at $500,000. Your attorney has asked you to determine which assets you would prefer.

1. Marital residence – (Current value $650,000 - $150,000 mortgage)	$500,000.
2. Husband's 401k	$500,000.
3. Wife's IRA	$500,000.
4. Joint Brokerage account (Purchase Price $272,000)	$500,000.
5. Joint CD (certificate of deposit) at Bank	$500,000.
6. Rental property (No debt, fully depreciated, $15,000/year net income)	$500,000.

Now let's examine the tax and cash flow characteristics of each asset (This is for illustration only and not to be used in lieu of specific personal advice)

1. Although you may have an emotional attachment to the **Marital residence** or may want to stay there for the children to remain in the same school, you need to consider the cost of the mortgage, taxes, utilities, maintenance etc. A home is an illiquid asset and costs money to run. It does not provide cash flow. For this to be a viable option you need to have enough income to support the costs.

2. The **Husband's 401k** is a tax deferred asset. Most likely the account is 100% taxable at ordinary income rates (as high as 28-35%) when distributed. The husband generally cannot access this until he retires or reaches age 59 ½ without incurring a 10% penalty in addition to income taxes. On the other hand, there is a specific exception relating to divorce in which the wife could transfer part of the account to an IRA for herself without incurring taxes. **In addition, there is a one-time provision for her to take a taxable distribution from his 401k, avoid the 10% penalty and just pay the related income tax.**

3. The **Wife's IRA** is also a tax-deferred asset and could be transferred to an IRA for the husband without taxation. Note: IRAs are treated differently than ERISA retirement plans and cannot avoid the 10% penalty for an outright distribution.

4. **Brokerage accounts** often hold stocks, bonds and mutual funds. In this case, the cost basis for tax purposes is $272,000. If this account were sold, the estimated tax consequence would be about $42,000. You would actually receive $458,000. instead of $500,000.

5. **Bank CD's** have no built-in tax consequences, so this CD is truly worth $500,000.

6. This **Rental property** may appear attractive because it is fully paid for and produces a 3% cash flow after expenses. The downside here is that a sale would be 100% taxable since the building is fully depreciated and this would dramatically reduce the final cash proceeds.

Personal factors should be considered to develop an appropriate strategy for you. If you need current income, you would want an option that allows for ready access to cash. Someone in a high tax bracket may value tax deferred assets. When evaluating the family home or the rental property, you may want to consider potential appreciation and weigh that against costs for repairs, mortgage, taxes etc. Rental income is not guaranteed, a renter could miss payments or the property could become vacant.

There is no one set answer in terms of which assets are the most attractive and viable. Each individual must carefully weigh their goals in relation to their specific short and long term needs. Your age, income sources, children, and proximity to retirement are critical issues that help determine which assets are the most valuable to you.

Often, it is best not to make these decisions on your own. A Certified Divorce Financial Analyst (CDFA™) can provide an objective look at the pros and cons of various options, educate and guide you to make the best decisions. This planning helps you to visualize a workable settlement and can illustrate the danger of emotional decisions and dissipating assets in the early years post divorce.

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