

Getting Settled

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What you need to know before creating a settlement agreement.



YOU'VE sat down with your spouse and hammered out what you think is a pretty great settlement: you get to keep all of the property you really wanted, and your ex gets stuck with all of the debt. But whether or not that agreement will hold up in court depends on a number of factors, including how it is worded, whether or not there was full financial disclosure by both parties, and possibly whether both parties had independent legal counsel.

That being said, you should make every effort to negotiate your settlement agreement rather than fight over every item in court. Such agreements have several benefits over a judge's ruling, including: they take less time; they reduce the financial and emotional costs; and the parties are more likely to abide by the terms of the agreement.

If you're able to put aside your emotions and focus on the issues at hand, your chances of negotiating a settlement are extremely high. A courtroom is simply not the right venue to express your

feelings of anger or loss, so find a counselor or a support group to help you work through your emotions so you can be as clear-headed and as practical as possible during negotiations with your spouse. Some couples will be able to settle all issues; others will be able to settle some issues and have to litigate the rest.

This article will cover property issues only; your settlement agreement will need to thoroughly address spousal or child support as well as custody and visitation issues. As always, you should consult with your lawyer and/or mediator to make certain your best interests, and those of your family, are protected.

Your settlement agreement should be very comprehensive — particularly with regard to how the property is divided. Once you sign an agreement regarding property division, it cannot be changed unless both of you agree to the changes or unless there is some legal basis, such as fraud, for setting aside the agreement. It's up to you to make sure that your lawyer doesn't leave any assets out of

your settlement agreement (unless it's something that you're going to litigate in court).

You don't necessarily have to list every single personal possession in your settlement agreement, but you should list personal items that are important to you. You should also list financial assets, including retirement assets and real estate.

Your agreement should state who gets each asset or how the asset or the proceeds from its sale will be divided. Let's take a look at the most common categories.

Financial Assets

Financial assets include cash, savings accounts, checking accounts, Certificates of Deposit, money-market accounts, stocks, bonds, Real Estate Investment Trusts (REIT), mutual funds, and savings bonds. These assets may be more important to the non-working or lower-income-earning spouse. He or she may need to use these

assets to cover some of his or her living expenses.

Retirement Assets

Not all assets have the same tax consequences; retirement assets are generally before-tax assets. This means that in order to access the money, you have to pay income tax on any distributions you receive. In some cases, you may also have to pay a penalty on the distribution in addition to any income tax that you pay. For example: Mary suggested to Gus, “You keep your retirement assets, valued at \$100,000, and I’ll take the money-market account, valued at \$100,000.” Gus agreed because it was an equal division of the assets. However, when Gus retires in 2009, he will pay tax on the distributions. So if Gus paid tax at a rate of 25%, then he would end up with only \$75,000 versus the \$100,000 that Mary received.

In the U.S., there are many different types of retirement assets, including defined benefit plans, defined contribution plans, IRAs, and Roth IRAs. It is important that you determine how defined benefit plans, such as pensions, will be divided between you and your spouse. This is generally spelled out as a percentage of the retirement benefit at the time of the divorce. It is also imperative for the agreement to state if the employee’s spouse will be entitled to survivor’s benefits if the employee dies. It is important to make sure that the non-employee in fact qualifies for survivor benefits; otherwise, he or she may be better off with another asset.

take the percentage that is awarded and roll it over to an IRA or perhaps maintain it as a separate account in the same plan. The agreement should specify the percentage that you and your spouse will receive.

IRAs or Roth IRAs are also easily divisible. Remember that distributions from Roth IRAs will generally not be taxed, while distributions from IRAs will generally be taxed. As a result, \$10,000 from a Roth IRA is probably a better asset than \$10,000 from an IRA.

In Canada, there are two basic types of pension plans: “Defined Contribution Plans” and “Defined Benefit Plans.” The first type defines who is to make the contributions to fund the plan, how much they are to contribute, and when they are to make the contributions. The second will also specify who is to make what contributions, how much they are to contribute, and when. However, a defined benefit pension plan will also have a formula for determining the amount of annual pension that the member has earned. It is the projection of these future pension payments (which are not at all related to the amount of contributions that have been made) that must be valued.

Depending on the type of plan and which province you live in, a portion of the pension (usually the portion accumulated during your marriage) may be subject to division like any other family asset. If one or both spouses have Registered Retirement Savings Plans (RRSPs), the portion accumulated

for each person. Not all pension plans permit division of the pensions. In any case, it is still important to have the pension valued properly: dividing one pension into two is not a way to avoid the cost of a valuation (or to avoid arguing over which value is the right value for the pension).

Federal government pensions qualify for division under the Pension Benefits Division Act (PBDA). This Act provides that the member may transfer a portion of the value of the pension to a retirement vehicle for the spouse. This is known as the Maximum Transferable Amount (MTA).

The Canada Pension Plan (CPP) recognizes that married persons, common-law couples, and same-sex partners share in the building of their assets and entitlements, including their CPP credits. When a relationship ends, CPP credits built up by the individuals during the time they lived together can be combined and then divided equally between them by means of “credit splitting”. As a result, the person with fewer credits — that would normally be the lower income earner — receives some credits earned by the other — normally the higher income earner — so that they both have the same number of credits accumulated during the marriage or other relationship.

You should be aware that there is more than one way to value a pension; if the amounts are significant, you should consider having an expert valuation done.

Employee Benefits

In addition to retirement plans, many employers provide other fringe benefits and incentives to their employees. These benefits include year-end bonuses, accrued vacation time, accrued sick time, health insurance, life insurance, disability insurance, expense accounts, stock options, and more unusual benefits such as Phantom Stock, Stock Appreciation Rights, and Restricted Stock.

Some of these benefits may be included in your list of assets; other benefits may be included as income, and some may not be included at all.

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Defined contribution plans include 401(k) plans, profit-sharing plans, simple IRAs, and other types of contributory plans. Generally, these can be divided today, and the non-employee spouse can

during marriage will also be subject to division.

Some people will want to divide the pension into two separate pensions: one

Determining if a benefit should be treated as a marital asset, income, or nothing at all can be very subjective. Different jurisdictions and judges may view the benefits differently. As a rule of thumb, if the benefit is guaranteed, then it should be included as an asset or as income. A year-end bonus could arguably be an asset, an income item, or nothing at all if it is not guaranteed. For example: Barbara and Jeremy were married for 15 years. Jeremy, the employee-spouse, received a bonus every year. Barbara could certainly make a reasonable argument that it is an asset or income for purposes of calculating child support and alimony. Vested stock options would also be an asset; with the changes in the market, they may not have any value, while unvested stock options, on the other hand, may not be an asset.

Personal Property

List your personal possessions, particularly those that are important to you,

and note how they are going to be divided. This would include big-ticket items, such as cars, boats, and motor homes, as well as items such as jewelry, furniture, photos, and personal papers.

Keep the value of these assets in perspective — and recognize when it’s time to give up the fight. We’ve all heard of those cases where parties spend thousands of dollars fighting over an asset that’s worth less than \$100.

Each spouse should keep copies of joint tax returns. We recommend that you keep at least the past five years; in addition, you will need records to calculate the cost basis for any assets that you keep.

Real Estate

Real estate includes your marital home and any other homes, vacation properties, timeshares, and rental properties — commercial and residential —

as well as any business property. The properties should be listed, and the settlement agreement should address how they are going to be divided.

If the property is going to be sold, the following issues need to be addressed:

- Who is going to pay the expenses until the property is sold?
- How will the proceeds be divided?
- If one spouse pays the expenses, will he or she be reimbursed, from the proceeds, before they are divided?

Debts

Generally, the person who takes the property will be expected to pay the mortgage or debt related to the property. Does this mean that the other spouse has no financial obligation for a joint debt? Absolutely not. Unless the spouse who takes the property refinances the mortgage, both spouses will still be obligated to pay the debt. The divorce decree cannot terminate your financial obligation to your creditor. For example, Bob and Amy are dividing their assets as shown in “Table One”.

After the divorce, Bob would be liable for the car payment and Amy would be liable for the mortgage. If either failed to make these payments, the other spouse would still be liable. But if Amy or Bob refinance after the divorce, the other spouse will no longer be liable for the debt.

Requiring the other spouse to refinance after the divorce is something that should be put in the settlement agreement. They could, for instance, allow a certain time period to refinance. If they do not refinance or do not qualify to refinance, then the asset could be sold and the loan could be paid off with the proceeds from the sale.

If only one spouse is obligated on the debt during the marriage, then the other spouse cannot be held liable. This occurs most frequently with credit-card debt. However, if you have a credit card that is a joint debt, then just like the mortgage, if one spouse is responsible for paying the joint credit-card debt pursuant to the terms of the settlement agreement,

TABLE ONE:	Equity	Value	Bob	Amy
Cash and Checking		\$13,000	\$13,000	
Mutual Funds		\$17,000	\$17,000	
Amy’s Car		\$ 5,000		\$ 5,000
Bob’s Car	\$25,000			
Debt on Bob’s Car	(\$10,000)			
Car Equity		\$15,000	\$15,000	
Home	\$200,000			
Mortgage	(\$160,000)			
Home Equity		\$40,000		\$40,000
Total Value		\$90,000	\$45,000	\$45,000

TABLE TWO:	Value	Mike	Julie
Home (Equity)	\$ 40,000		\$ 40,000
Cash and Checking	\$ 3,000		\$ 3,000
Mutual Funds	\$ 7,000		\$ 7,000
Mike’s Business	\$150,000	\$150,000	
Total Value	\$200,000	\$150,000	\$ 50,000
Property Settlement Note		(\$50,000)	\$ 50,000
Revised Total		\$100,000	\$100,000

this does not mean that the other spouse is no longer responsible for the debt. Unfortunately, both spouses will remain liable to the creditor. If one spouse refuses to pay, then the other spouse will have to pay off the debt. If you can afford it, paying off credit-card debt with liquid assets is the best way to deal with unsecured debt.

Closely Held Business

A closely held business can be in the form of a sole proprietorship, corporation, general or limited partnership, or limited liability company. Before one spouse agrees to take a business interest, he or she has to make sure there are no restrictions on owning the interest. There could be legal or contractual restrictions on which spouse could own the business interest.

If the business, for instance, is a professional corporation, as defined by state or provincial law, then one spouse may be legally restricted from maintaining an ownership interest. For instance, if Joe is a physician and Barb is an accountant, in many states or provinces, only Joe could own his medical practice and only Barb could own her accountancy practice. Another restriction may exist if there is a liquor license or taxicab medallion that is only transferable with government approval.

A “buy-sell” agreement is an example of a contractual restriction that may preclude a transfer to a spouse. If the “non-owner” spouse is awarded the business interest in the divorce, then the spouse may be forced to sell the business interest at a substantial discount. For example: Joe owns 25% of a business that has a total value of \$100,000; his share is valued at \$25,000. If the buy-sell agreement requires Barb to sell her interest at 50% of the value, and if she were awarded the stock in the divorce, she would be required to sell her interest for \$12,500.

Property Settlement Note

A property settlement note is generally used to equalize the assets. For instance, Mike and Julie have the following assets (shown in “Table Two” on the previous page).

To equalize the division of assets, Mike should pay Julie an additional \$50,000. This can be structured as a note payable to Julie in the amount of \$50,000 at an agreed-upon interest rate. If Mike and Julie agree that the note would be payable over five years at a 5% interest rate, then the annual principal and interest payments would be \$11,549.

A property settlement note has some significant drawbacks, however, including:

- If the agreement isn’t followed, it becomes another issue to fight over.
- What happens if Mike doesn’t pay?
- Should Mike pay interest on the note?
- If the note is unsecured, it would probably be discharged in bankruptcy.
- What happens if Mike dies or becomes disabled before the note is paid in full?

Life Insurance

Some life-insurance policies have cash value. This means that the owner could borrow money from the policy or trade the promise to pay a future sum at death for the current cash value, less any costs or charges.

Other policies, such as term insurance, have no cash value. Term insurance may still be valuable, though, particularly if the insured person is now uninsurable.

The settlement agreement should address who will own the existing life insurance policies. Naming an ex-spouse or child as the irrevocable beneficiary of a group policy is minimally effective, since the designation can be changed unilaterally by the employee when the carrier changes, or indeed at any other time. If the non-insured spouse is supposed to be the beneficiary, then the best way to protect his or her interest is to have the non-insured spouse own the policy. Using the above example, if Mike owns a policy and is the insured, and they agree that Julie should be the beneficiary, then he should transfer ownership of the policy to Julie. She should verify that she is the beneficiary of the

policy. They can structure it so that he pays her the premiums as alimony. That way, she can be sure that the payments are made and that she remains the beneficiary. Otherwise, she is at risk if he lets the policy lapse or changes the beneficiary.

Other Assets

Some other assets to address in the settlement agreement include: Frequent Flyer Miles, lottery winnings or other prize winnings, club dues and annual membership fees, inheritance and gifts, and trusts naming one spouse as a current beneficiary.

Keep in mind the assets listed here are not by any means exhaustive; you and your spouse may have assets in addition to those listed in this article. They can make a huge difference in your post-divorce life, so take the time to list them carefully and discuss them fully before you settle things, once and for all. ■

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