Divorce Planning Guide for Federal Employees

By Edward A. Zurndorfer

ABOUT THE AUTHOR

Edward A. Zurndorfer is a Certified Financial Planner, Chartered Life Underwriter, Chartered Financial Consultant, Chartered Federal Employee Benefits Consultant, Certified Employees Benefits Specialist and IRS Enrolled Agent in Silver Spring, MD. Tax planning, Federal employee benefits, retirement and insurance consulting services offered through EZ Accounting and Financial Services, and EZ Federal Benefits Seminars, located at 833 Bromley Street - Suite A, Silver Spring, MD 20902-3019 and telephone number 301-681-1652. Raymond James is not affiliated with and does not endorse the opinions or services of Edward A. Zurndorfer, EZ Federal Benefits Seminars, or EZ Accounting and Financial Services. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. While the employees of Serving Those, Who Serve are familiar with the tax provisions of the issues presented herein, as Financial Advisors of RJFS, we are not qualified to render advice on tax or legal matters. You should discuss tax or legal matters with the appropriate professional.

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Chapter 1. The Financial Reality of Divorce and Some Recommendations

Divorce is something that most people would prefer to avoid. The sometimes-enormous legal costs associated with divorce, the resulting family breakup with its negative consequences on children, and the financial realities of divorce can have a devastating effect on the average person.

Unfortunately, many federal employees have faced – or will – face the experience of a divorce. Most federal employees have built up a significant amount of benefits during their federal working careers, including retirement benefits in the form of CSRS or FERS annuities, the Thrift Savings Plan (TSP) and Social Security, and health insurance and Medicare benefits. During their working career, most employees acquire other financial assets including checking and savings accounts, real estate and brokerage accounts. There are also debts that employees will take on during their working careers, including credit card, mortgages, car loans and student loans. Employees facing divorce need to consider what will happen to their financial assets and debts if they are going through a divorce.

Here are some recommended preliminary financial steps that federal employees facing divorce should take:

- Gather all financial papers and make copies of all documents.
- Investigate the financial and income tax impacts of separation.
- Close or freeze access to joint accounts – in other words, open separate checking, savings and money market accounts before filing for divorce.
- Keep track of debts such as mortgages, car loans, credit card balances, student loans, and home equity loans that incurred before and after separation. Also keep track of joint bills paid and improvements made to jointly owned property during separation.
- Update insurances, as necessary.
- Meet with a tax professional to discuss how income tax returns will be filed in the current tax year (the year pf separation) – married filing jointly or married filing separately.
- Document all temporary alimony payments that have been made and write down any agreements concerning alimony. Alimony payments may be tax deductible provided there is an agreement in writing or a court order concerning the payments.
- Conduct a financial “fact-finding” – complete a budget, net worth and a cash flow statement.

- Analyze assets and debts.
- Make a list of items a divorce settlement will cover. Any offer and counteroffer should be analyzed for their tax ramifications.
- Attempt to do as much of the “leg work” as possible in order to reduce legal fees.

- Keep anger out of financial negotiations.

- Try to settle without the need for a trial.

In short, making one’s financial concerns the centerpiece of his or her divorce and working within the framework of the law are the most powerful positions he or she can take. By thinking financially and acting legally, one will be able to anticipate risks and to assess one’s needs – before a financial disaster hits.

Chapter 2. Court Orders Related to CSRS and FERS Annuities and Survivor Annuities

An "apportionment order" is a legal document that divides an employee's Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS) annuity or a refund of an employee's contributions to CSRS or FERS in accordance with a court order related to a divorce or legal separation.

The Office of Personnel Management (OPM) is authorized to comply with apportionment orders that meet certain specifications. This authorization is detailed in Sections 8345(j) and 8467 of Title 5, U. S. Code. The law requires OPM to apportion an annuity or refund of an employee's contributions to a CSRS or FERS in accordance with the express provisions of a qualifying order, court decree or property settlement. OPM also authorized to make payments directly to the former or separated spouse if the terms of the court order expressly demand for payment in such a manner.

State law governs the division of an employee's paycheck, a former employee's contributions to CSRS or FERS, or a retiree's annuity. A court order should specify what it wants OPM to do. In particular, the court order must expressly provide for payment of a portion of the employee's contributions to CSRS or FERS or a retiree's monthly annuity check. The spouse's share must be stated as a fixed dollar amount, a percentage or a fraction of the annuity or be expressed as a formula whose value is readily apparent to OPM.

If the apportioned amount is derived using a formula, percentage or a fraction, the apportionment order must specify the type of annuity to which the formula, percentage or fraction is to be applied – "gross," or "net" annuity. (See the Appendix for definitions of these types of annuities.)

While there is no percentage limitation on how much of a retirement annuity payment can be awarded to a former spouse, payment under an apportionment order cannot exceed the net annuity in cases involving annuities, or the amount of the lump sum employee contributions in cases involving refunds of CSRS or FERS employee contributions.

Filing an Apportionment Order

Before any benefits can be paid to a former spouse, the former spouse must submit a written request via a court order to OPM and provide proper documentation in order for OPM to establish the validity of the court order..

Chapter 2. Court Orders Related to CSRS and FERS Annuities and Survivor Annuities

With respect to a CSRS or FERS annuity, the former spouse must apply in writing – either personally or through a representative – in order to be eligible for a portion of the retiree's annuity check. No special form is required. But the former spouse must include the following information in the letter requesting these benefits: (1) full name; (2) mailing address; (3) a certified copy – not a photocopy of the court order signed and certified by an official of the court that issued the order, verifying that it is a true copy of the original court order; (4) a signed statement that the court order has not been amended, superseded or set aside; (5) identifying information concerning the employee or retiree including his or her full name, date of birth, civil service annuity (CSA) claim number if retired and a Social Security number; and (6) if the employee is not yet retired, his or her mailing address.

When payments are subject to termination upon remarriage, no payment may be made until the former spouse submits – on a prescribed form – a statement to OPM that he or she: (1) has not remarried; (2) will notify OPM within 15 calendar days of the date of any remarriage; and (3) acknowledges personal liability for any overpayment resulting from a remarriage. OPM may require recertification of these statements.

A former spouse who is awarded a portion of an employee's or retiree's CSRS or FERS annuity by a qualifying court order regardless of whether that benefit is payable now or in the future is eligible to enroll in the Federal Employees Health Benefits Program (FEHBP) under certain conditions. These conditions will be discussed in Chapter 4.

Applications for court-awarded CSRS or FERS benefits and requests for information should be sent to:

Office of Personnel Management
Office of Retirement Programs
Court Order Benefit Section
P.O. Box 17
Washington, D.C. 20044-0017

A "former spouse" is defined as a living person who was married – for at least nine months – to an employee or retiree. To honor a court order from the former spouse requesting a CSRS or FERS survivor annuity, the employee/annuitant spouse must have performed at least 18 months of creditable service under CSRS or FERS. The court order also could be for the benefit of a former spouse whose marriage to the employee or retiree was terminated prior to the death of the employee or retiree.

A former spouse survivor annuity is defined as a recurring benefit that is payable after the employee's or retiree's death to a former spouse who has not remarried before age 55 if the marriage to the former employee or retiree lasted less than 30 years.

Chapter 2. Court Orders Related to CSRS and FERS Annuities and Survivor Annuities

For purposes of awarding a former spouse survivor annuity, the court order must state the former spouse's entitlement to a survivor annuity or to direct an employee or retiree to provide a former spouse survivor annuity**.** There is one exception – a court order is not a qualifying court order awarding a CSRS former spouse annuity if: (1) the marriage was terminated before May 7, 1985; or (2) the marriage was terminated on or after May 7, 1985 and the retiree retired from federal service before May 8, 1985 and did not provide a current spouse annuity for that spouse as of May 7, 1985 (the effective date of Internal Revenue Code Section 1041 in which the IRS rewrote tax regulations associated with divorce).

The former spouse of a separated CSRS employee may be awarded a deferred annuity pursuant to a court order. A separated CSRS employee who is eligible for a deferred retirement is an individual who left federal service before retirement age and will receive a deferred CSRS annuity starting when the individual becomes age 62. A survivor annuity is payable to the former spouse no sooner than when the separated employee becomes age 62, but no survivor annuity will be payable unless the separated employee dies after age 62.

The former spouse of a FERS employee, retiree, or separated employee (with deferred annuity rights) may be awarded a survivor annuity benefit and/or basic employee death benefit pursuant to a court order. A court order that awards a FERS survivor annuity also awards a corresponding share of the basic employee death benefit unless the order expressly provides otherwise.

An employee retiring under CSRS or FERS may voluntarily elect a fully reduced annuity or partially reduced annuity to provide a former spouse survivor annuity. If the employee is married, he or she may request this election, as long as the current spouse consents to the election or OPM waives the spousal consent requirement.

Entitlement to a former spouse's survivor annuity terminates at the end of the month preceding the earliest of: (1) the death of the former spouse; (2) the remarriage of the former spouse before age 55; or (3) the survivor annuity termination date established under the terms of the court order.

If a former spouse annuity terminates under one of the above conditions, any reduction in the retiree's annuity to provide a former spouse annuity will cease the first day of the month after the terminating event unless:

- The retiree elects within two years after the former spouse's death or remarriage to continue the reduction to provide or increase a former spouse annuity for another former spouse or to provide for an increase to a current spouse annuity; or

- A qualifying court order requires the retiree to provide another former spouse an annuity.

Chapter 2. Court Orders Related to CSRS and FERS Annuities and Survivor Annuities

A former spouse who loses entitlement to a survivor annuity because of remarriage before age 55 cannot have the survivor annuity reinstated if the subsequent marriage later ends by death or divorce. A former spouse who loses entitlement to a survivor annuity because of remarriage before age 55 cannot have the survivor annuity reinstated if the marriage ends due to annulment unless: (1) the decree of annulment states that the marriage is without legal effect retroactively from the date of the marriage and: (2) the former spouse's entitlement is based on section 4(b) (1) (B) or section 4 (b) (4) of Public Law 98-61. This provision provides survivor annuities in limited circumstances without any reduction to the retiree's benefits.

Chapter 3. Court Orders Involving Child Support

In general, CSRS and FERS benefits can be garnished only for alimony or child support. Any garnishment court order demanding any amount of alimony or child support must conform to all state law requirements for garnishment actions involving private employers and is subject to the limitations in Title 5, Code of Federal Regulations, section 581.

Public Law 93-647, effective Jan. 1, 1975, and Public Law 95-30, effective June 1, 1977, amended the Social Security Act, title 42 United States Code, to provide that the federal. government comply with the terms of a valid court order for the garnishment of wages or salary where the order is based upon an obligation to provide child support.

Public Law 95-30 also sets up limitations on garnishments issued to enforce a child support obligation. In particular:

- A CSRS or FERS annuitant who has remarried and who is supporting his or her current spouse or a dependent child, other than through a child awarded support garnishment order, may have his or her CSRS or FERS annuity garnished up to 50 percent of the disposable CSRS or FERS annuity, or 55 percent of the garnishment for a child support payment that is more than three months in arrears.

- A CSRS or FERS annuitant who has not remarried or is not supporting a dependent child other than through a child awarded support garnishment order may be garnished up to 60 percent of the disposable CSRS or FERS annuity, or 65 percent of the garnishment order is for a support payment that is more than three months in arrears.

All garnishment orders for child support payments for annuitants must be sent to OPM at the following address:

Office of Personnel Management
Office of Retirement Programs
Court Order Benefit Section
P.O. Box 17
Washington, D.C. 20044-0017

Individuals who are still employed by the federal government must send all court orders involving child support payments to the employing agency.

Chapter 3. Court Orders Involving Child Support

Child Abuse Judgment Enforcement Orders

A "child abuse judgment enforcement order" is a court or administrative order requiring OPM to pay a portion of an employee's CSRS or FERS annuity or a refund of an employee's payroll deduction to CSRS or FERS in order to satisfy a judgment rendered for physical, sexual or emotional abuse of a child. A "child abuse creditor" is an individual who applies for benefits under CSRS or FERS based on a child abuse judgment enforcement order.

The Child Abuse Accountability Act (Public Law 103-358) signed Oct. 14, 1994, requires OPM to comply with certain court orders for the enforcement of judgments rendered against employees or retirees for the physical, sexual or emotional abuse of a child. OPM's regulations affect only benefits payable under CSRS and FERS, not the Thrift Savings Plan which OPM does not administer.

All child abuse judgments against individuals working for the federal government should be sent to the individual's employing agency. All child abuse judgments against CSRS or FERS annuitants should be sent to OPM at the following address:

Office of Personnel Management
Office of Retirement Programs
Court Order Benefit Section
P.O. Box 17
Washington, D.C. 20044-0017

Chapter 4. Court Orders Applying to Federal Health and Life Insurance Benefits

Former spouses may enroll in the Federal Employees Health Benefits Program (FEHBP) as "self only" coverage if they meet the "spouse equity" requirements of the FEHBP law. They also could continue FEHBP coverage for up to three years through the temporary continuation of coverage (TCC) provisions of the law. But former spouses of federal employees or annuitants may not continue to participate in the FEHBP under an employee's or annuitant's "self and family" coverage after a divorce because the former spouse does not meet the definition of a family member under section 8901(5) of Title 5, U. S. Code. OPM cannot honor a court order requiring it to provide FEHBP coverage to a former spouse because section 8902(n) (1) of Title 5, U. S. Code preempts state law in matters relating to the nature and extent of FEHBP coverage and benefits.

The following are the provisions that regulate when a former spouse can continue FEHBP enrollment under the spouse equity provisions of the law as described in section 8905 of Title 5, U. S. Code. There are four requirements that the spouse must meet. He or she must:

- be covered as a family member under the employee/annuitant's FEHBP enrollment for at least one day during the 18 months prior to divorce;

- be entitled to receive a portion of the retirement annuity after the employee retires or a survivor annuity after an employee/annuitant dies;

- apply within 60 days after the divorce settlement to the agency employing office where the federal employee worked at the time of divorce by submitting a written notice that he or she wants to continue FEHBP coverage under the spouse equity provision of the FEHBP law; and

- not remarry prior to age 55.

Under TCC: (1) A separated spouse's coverage is limited - coverage will end 36 months after one's divorce or annulment, or earlier if the spouse does not pay his or her FEHBP premiums; and (2) the spouse must pay both the employee and government share of the FEHBP plan's premiums, plus an administrative charge equal to 2 percent of the total plan premiums.

Under spouse equity rules, an individual who qualifies as a former spouse must enroll for FEHBP coverage in his or her own right and must pay *both* the employee's and the government's share of the premium. There is *no* additional 2 percent administrative charge associated with those who are enrolled in FEHBP through spouse equity coverage. Coverage begins from the first day of the pay period after the employing office receives all properly completed qualifying documents.

In order to avoid a break in coverage, the former spouse may want to enroll in TCC under section 8905a of Title 5, U. S. Code, pending a decision on eligibility for coverage as a former spouse.

Chapter 4. Court Orders Applying to Federal Health and Life Insurance Benefits

Those former spouses who do not meet the criteria for FEHBP coverage under section 8905 of title 5, United States Code may continue coverage for three years from the date of divorce. The former spouse can get information about this through the agency where the federal employee worked at the time of the divorce or through OPM if the former spouse is an annuitant.

A court order acceptable for processing is one that grants the former a spouse a portion of the retiree's CSRS or FERS annuity as a monthly payment after the employee retires and continued FEHBP coverage until the annuitant dies. Another type of court order acceptable for processing is one that permits a survivor annuity for the former spouse with continued FEHBP coverage until the former spouse dies, but the annuity does not begin until the employee/annuitant dies. Yet another kind of court order acceptable for processing is one that provides both a portion of the CSRS or FERS annuity and a survivor annuity. This sort of court order ensures annuity payments from the date of retirement or death and continued FEHBP coverage until the death of the former spouse.

Children's eligibility for FEHB coverage also is controlled by federal law and cannot be affected by any language in a state court order.

Election of Coverage

A former spouse, within 60 days after the dissolution of the marriage or in the case of a former spouse of a former employee whose marriage was dissolved after the employee's retirement, within 60 days after the dissolution of the marriage may elect to enroll in an approved FEHBP health insurance plan as "self only" coverage**. Or** the former spouse may elect "self and family" or "self plus one" coverage– to include a qualifying family member (see below for a listing of qualifying family members). In either case, the former spouse agrees to pay the full amount of FEHB premiums with no federal government contribution. The former spouse should contact OPM for a FEHBP enrollment application and forward the completed application to the human resources office of the agency that employed the former spouse at the time of divorce or annulment. Premium payments are made to the employing agency if the former spouse is an employee. If the former spouse is a CSRS or FERS annuitant, premium payments should be sent to OPM.

A former spouse may elect FEHBP self and family coverage which covers the former spouse and an unmarried dependent(s), natural or adopted, of the former spouse and the employee who are under 22 years of age or incapable of self-support due to a mental or physical disability which existed before age 22.

A former spouse enrolls in self and family coverage by submitting a properly completed Standard Form (SF) 2809 and submitting it to the employee's employing agency or to OPM in case the employee has retired. The effective date of enrollment is the first day of the pay period after the date the employing agency or OPM receives the properly completed SF 2809.

Chapter 4. Court Orders Applying to Federal Health and Life Insurance Benefits

OPM will notify the former spouse of the opportunity to enroll in another less expensive FEHBP plan if the former spouse who is receiving annuity checks cannot afford to pay the monthly FEHBP premiums. The former spouse can make direct payments to meet any differences. Consider the following example.

As part of his divorce agreement, Tom continues FEHBP coverage for his ex-wife, Sue. To accomplish this Tom provides a minimum spousal survivor CSRS annuity of $100 per month in the event of his death. Tom dies five years after he retires. The spousal survivor annuity covered only 50 percent of the FEHBP premiums. Sue was notified by OPM of the additional costs, which she paid out – of – pocket and forwarded to OPM.

Termination of Enrollment

A former spouse's enrollment in the FEHBP terminates, subject to the temporary extension of coverage for conversion, at midnight of the last day of the pay period in which the earliest of the following events occurs:

- a court order ceases to provide entitlement to survivor annuity or portion of retirement annuity under either CSRS or FERS;
- the former spouse remarries before age 55;
- the former spouse dies;
- the employee or annuitant on whose service the benefits are based dies and no survivor annuity is payable;
- the separated employee on whose service the benefits are based dies before the requirements for a deferred annuity have been met;
- the employee on whose service benefits are based leaves federal service before establishing title to an immediate annuity or a deferred annuity;
- there has been a refund of CSRS or FERS money to the separated employee on whose service the health benefits are based; and
- the annuitant or surviving annuitant fails to pay the FEHBP premiums in a timely manner. Not paying FEHBP premiums is considered a voluntary cancellation of FEHBP health benefits.

A former spouse whose enrollment is terminated may not reenroll at a later date. To cancel enrollment a former spouse would have to file a completed health benefits form with the ex-spouse's employing office.

Chapter 4. Court Orders Applying to Federal Health and Life Insurance Benefits

Consolidated Omnibus Budget Reconciliation Act (COBRA) regulations required that employers such as the federal government allow qualified beneficiaries who would otherwise lose their health benefits due to certain qualifying events to continue that coverage for a certain period of time at the group insurance rate. In the case of FEHBP, qualified beneficiaries are entitled to COBRA if FEHBP coverage is lost as a result of a qualifying event.

Qualified beneficiaries under COBRA rules include: (1) a covered employee; (2) a spouse or former spouse of a covered employee; (3) a dependent child(ren) of a covered employee; and (4) a child born to or placed for adoption with the covered employee during a COBRA coverage period.

Qualifying events under COBRA that trigger eligibility for a qualified beneficiary include: (1) a divorce or legal separation; (2) a death of the employee; and (3) voluntary or involuntary termination of employment of the employee.

Under COBRA, coverage in the FEHBP can continue up to 36 months. Former spouses and dependent children who have COBRA coverage must pay the full cost of the FEHBP- the employee and employer portions plus a 2 percent administrative fee.

Federal Employees Group Life Insurance (FEGLI)

Under FEGLI, a federal employee, former employee, or annuitant may make an irrevocable assignment of his or her life insurance coverage to another person or to a trust. Those individuals who assign their FEGLI ownership continue to be insured under the FEGLI program. In assigning the policy, the individual (the "assignor") irrevocably transfers to the assigned (the "assignee") many of the rights, benefits and responsibilities associated with FEGLI basic and optional coverage including standard insurance and additional "multiple of salary" insurance. But the optional "family" life insurance cannot be assigned.

What is the purpose of life insurance assignments? Assignments automatically cancel a prior designation of beneficiary (to be discussed later). They generally are made to comply with the requirements of a court order upon divorce or for personal financial planning purposes.

Why would an employee or an annuitant assign FEGLI coverage? An assignment of FEGLI coverage may be made by a federal employee or former employee to comply with a court order for divorce. The court order will frequently order a federal or former employee to name a former spouse as the beneficiary of his or her life insurance proceeds. But under FEGLI law an insured person - the owner of the life insurance - may change the designated beneficiary at any time, even if a court order directs otherwise. FEGLI pre-exempts state law and court orders are based on state law to the extent that they are inconsistent with the FEGLI contract. Assigning FEGLI coverage to a former spouse provides a means for ensuring that when FEGLI benefits are awarded to a former spouse in a divorce, the employee, annuitant or former employee is unable to circumvent the award by changing the designated beneficiary or canceling FEGLI coverage at some later date.

Chapter 4. Court Orders Applying to Federal Health and Life Insurance Benefits

It should be noted that the law does not authorize OPM to enforce or comply with the provisions of a court order directing OPM or a federal employee or former employee to assign FEGLI coverage. The law merely allows an annuitant, federal employee or former employee to make an assignment of FEGLI coverage, if he or she so chooses. It is the responsibility of the court-designated assignee to ensure that the court order is enforced.

A federal employee also may assign FEGLI coverage for a person ("the insured") assigns his or her ownership rights in an individual or group life insurance policy at least three years before the insured's death, the insurance proceeds will not be included in the insured's gross estate. Current federal estate tax laws allow an unlimited marital deduction for that portion of the gross estate that is passed to a surviving spouse at death. But once an employee or annuitant divorces, there is marital deduction for estate tax purposes. There is no apparent immediate estate tax savings in assigning ownership of a life insurance policy to a spouse. A federal employee or former employee or an annuitant would have to assign all of his or her FEGLI coverage. This includes basic coverage, standard optional and additional (multiple of salary) insurance. An insured may not assign a portion of FEGLI coverage and FEGLI family optional insurance may not be assigned.

Once FEGLI insurance is assigned, the assignee to whom the insured transfers FEGLI ownership may assign to him or her the following rights: (1) designation of beneficiaries; (2) conversion of the group insurance to an individual policy if the insured's eligibility for group insurance ceases; and (3) cancellation of the insurance or the reduction of the amount of coverage. When insurance is assigned to more than one person, these people must agree when exercising the right to cancel or reduce coverage.

A federal employee - the assignor - could retain the right to elect new insurance coverage. But all new insurance, with the exception of family optional, is subject to an existing assignment. An assignor is also responsible for paying the life insurance premiums. Federal employees pay via payroll deduction. For CSRS or FERS annuitants, the premiums are deducted from monthly annuity checks. Former employees must make arrangements with OPM to pay the premiums.

An assignment is effective on the date the insured's employing office receives a properly completed, signed and witness assignment. Each assignee and each beneficiary of an assignee is responsible for keeping the employing office notified of his or her current address. For CSRS or FERS annuitants, assignments should be sent to:

U.S. Office of Personnel Management
Retirement Operations Center
Boyers, PA 16017-0440

Assignments must be made on **OPM Form RI 76-10, Assignment of Federal Employees' Group Life Insurance**, downloadable at **https://www.opm.gov/forms/pdf_fill/ri_76-10.pdf**.

Chapter 5. Court Orders and the Thrift Savings Plan

A Thrift Savings Plan (TSP) account can be divided by means of: (1) a court decree of divorce, annulment or legal separation; or (2) a court order of court approved property settlement agreement incident to such a decree.

A court order may be issued at any stage of a divorce, annulment or legal separation proceeding. The TSP labels this document as a "retirement benefits court order." To be accepted by the TSP, a court order must meet the requirements found in Title 5 U.S. Code and Title 5 Code of Federal Regulations (CFR) part 1653, subpart A.

The TSP will review only a complete copy of a court order containing all pages and documents and must provide or be accompanied by a document that provides: (1) the TSP participant's Social Security number; (2) the name and mailing address of each payee; (3) if the current or former spouse of the participant is a payee, the Social Security number of the payee. If the court order requires the payment to be mailed in care of a third party, it also must provide the state of legal residence of the spouse – payee; and (4) if the court order is written in a language other than English, a certified English language translation of the entire court order.

It should be noted that a Qualified Domestic Relations Order (QDRO) – a court order that applies to private sector retirement plans - does not apply to the TSP. This is because the TSP is not covered by the Employee Retirement Income Security Act of 1974.

A qualifying retirement benefits court order for the TSP must meet four basic requirements, as set forth in the Code of Federal Regulations.

- It must be issued by a court in any of the 50 United States, the District of Columbia, the Commonwealths of Puerto Rico or Guam or the Northern Mariana Island.

- It must expressly relate to the TSP. *This means that it must specifically contain the name "Thrift Savings Plan."* Terms such as "government benefits," "Thrift Savings" or "Thrift Savings Account" are not acceptable.

- If the court order requires a payment from a TSP account, it must clearly describe the payee's entitlement. It can only award a specified dollar amount or a fraction or a percentage of the participant's account as of a specified past or current date.

- A court order can require a payment only to the participant's current or former spouse or to the TSP participant's dependents. The TSP will not honor a court order asking for a single payment to be made jointly. For example, $20,000 to be divided among the former spouse and dependents is not acceptable. The court order must separately specify the dollar amount, percentage or fraction of the award made to each person.

Chapter 5. Court Orders and the Thrift Savings Plan

The TSP will not honor a court order that requires payment in the future. This type of court order is generally applicable to defined benefit retirement plans such as CSRS or FERS. An acceptable court order is one that is used to prevent a participant from withdrawing from his or her account during a divorce action. The TSP will, upon receiving a valid court order and soon as practical, freeze a participant's account. This occurs if the court order names the TSP and provides that the TSP participant may not obtain a TSP loan or withdrawal. The purpose of the court order is to give to the TSP participant's spouse some or all of the participant's TSP account. Once an account is frozen, no new loans or withdrawals are permitted from that account until the action is resolved. All other account activity, including contributions, inter– fund transfers, investments funds or allocations and payments on existing loans may continue.

The freeze will be removed from the participant's TSP account under the following circumstances:

- If the account was frozen upon receipt of an incomplete court order, the freeze will be removed if a complete copy of the order is not received within 30 days of the TSP written request for a complete copy.

- If the account was frozen in response to a court order issued to preserve the status quo (i.e. a freeze order), then the freeze will be removed when the TSP receives a court order that removes the freeze, or, as described below, when the TSP receives a court order that requires the TSP to make a payment.

- If the account was frozen in response to a court order that requires the TSP to make a payment, or in response to a freeze order, then the freeze will be removed as follows:

    - If the court order requires a payment from the TSP, then the freeze will be removed after the payment is made.

    - If the court order is not "qualifying" and is not acceptable to the TSP, then the account will remain frozen for 45 days from the date on which the TSP informs the parties in writing that the order does not qualify. The freeze will be removed sooner if the TSP receives a written agreement, signed by both of the parties involved in the divorce proceedings that it may be removed.

Chapter 5. Court Orders and the Thrift Savings Plan

The TSP processes a court order in four steps:

Step 1. After the TSP receives a document that purports to be a qualifying retirement benefit court order, the TSP participant's account will be frozen.

Step 2. The TSP will then evaluate whether the court order is complete. If the court order is not complete, the TSP will request that the parties submit a copy of the court order. If a complete court order is not received within 30 days of the date of that notification, the participant's TSP account will be unfrozen and no further action based on that court order will be taken.

Step 3. When the TSP receives a complete court order, the TSP will freeze the participant's account and evaluate the court order to determine whether it is a qualifying benefits court order and how the account shall be divided.

Step 4. The TSP will mail a decision letter to the participant and provide a copy to all the other parties having a legal interest in the action. The decision letter will describe the effect the order will have on the participant's account and will state when the freeze will be removed from the account. If the court order is not qualifying, then the decision letter will explain why. If the court order requires a payment, then the letter also will explain how the payment will be calculated and when the payment will be made.

All court orders and legal processes relating to the TSP must be submitted to the TSP at:

TSP Legal Processing Unit
P.O. Box 4390
Fairfax, VA 22038-4390

The overnight address is:

ATTN: TSP Legal Processing Unit
12210 Fairfax Town Center
Unit 906
Fairfax, VA 22033

Tax levies and restitution orders must include the participant's TSP account number(s) or Social Security number, as well as the name and mailing address of the payee.

Chapter 5. Court Orders and the Thrift Savings Plan

Garnishment of a TSP account for alimony or child support

A TSP account can be garnished with a writ, order, summons or other similar document in order to satisfy a garnishment order that is brought to enforce a TSP participant's child support or alimony obligation. The TSP calls such a document a "legal process."

The TSP will only review a complete copy of a legal process. A complete legal process includes: (1) the participant's Social Security number; (2) the name and mailing address of each payee; (3) if the current or former spouse of the participant is a payee, the Social Security number of the spouse - payee; and (4) if the legal process is written in a language other than English, a certified English language translation of the entire legal process.

A legal process must also meet three requirements:

- It must be issued by a court or administrative agency of competent jurisdiction in any of the 50 United States, the District of Columbia, or a territory or possession of the United States. Or by a court in a foreign country with which the United States has entered into an agreement to honor such processing or by an official pursuant to an order of such a court or administrative agency, competent jurisdiction or pursuant to states or local law.

- The legal process must expressly relate to the TSP – it must specifically contain the name "Thrift Savings Plan."

- The legal process must either expressly require the payment of a stated dollar amount from the participant's TSP account to satisfy his or her child support or alimony debt, or it must require the TSP to freeze the participant's account pending receipt of an order to make such a payment from the account. The TSP will not honor a legal process that awards a percentage or fraction of an account.

A participant who is liable for alimony or child support can be prevented from withdrawing his or her TSP account.

There are four steps taken by the TSP once a legal process has been received.

Step1. The participant's account will be frozen as soon as possible after receiving a document that purports to be a qualifying legal process.

Step2. The TSP will then evaluate whether the legal process is complete. If it is not, the TSP will remove the freeze within 30 days of the TSP's written request for the complete legal process.

Step3. When the TSP receives a complete legal process, the TSP will evaluate it to determine whether it is a qualifying legal process.

Step 4. The TSP will mail a decision letter to the participant and provide a copy to all other parties having an interest in the action. The decision letter will describe the effect the legal process will have on the participant's account and state when the freeze will be removed from the account. If the legal process is not qualifying, the decision letter will explain why. If the legal process is qualifying and requires a payment from the TSP, the letter also will explain how the payment amount will be calculated and when the payment will be made.

The party who must pay federal (and state, if applicable) income tax on the distribution will receive tax reporting and withholding information.

Some states allow a two-step garnishment process. The first step consists of an order to withhold money. This freezes the TSP participant's account and other assets. The second step consists of an order to deliver, which requires the recipient of the legal process – in this case the TSP – to pay a specified amount of the debtor's assets to a third party.

If a TSP participant's account was frozen upon a receipt of an order to withhold, the freeze will be removed:

• Upon receipt of an order removing the freeze;

• After payment pursuant to a qualifying order to deliver; or

• If the TSP informs the parties in writing that the document is not a qualifying legal process.

How the Amount of an Entitlement is Calculated

A payee's entitlement is determined based on how a court order award is calculated. If a court order awards a percentage or fraction of a TSP account as of a specific day, the payee's entitlement is determined based on that day's end of account balance. The end of account balance is set at the time of the close of the New York Stock Exchange which is 4:00 p.m. Eastern Time, Monday through Friday.

If a court order awards a percentage or fraction of a TSP account and does not specify a date for calculating the award, the payee's entitlement is determined based on the effective date of the order, as of 4:00 pm Eastern Time on that date.

If a court order awards a fixed dollar amount, the payee's entitlement is that dollar amount. If it is a fixed dollar amount and a percentage or fraction of the account, the payee's entitlement is the specified dollar amount, even if the percentage or fraction yields a different amount.

A court order cannot require the TSP to pay more than the participant's vested account balance. The TSP can pay only the vested account balance even if a payee's entitlement is more than the vested account balance.

Chapter 5. Court Orders and the Thrift Savings Plan

A legal process can award only a specified dollar amount. The payee's entitlement is therefore based on the participant's vested account balance at the time of payment. That is, the TSP will pay the lesser of the specified dollar amount or the participant's vested account balance.

A TSP loan may or may not affect an account balance for purposes of calculating a court-ordered award. The dollar amount of an outstanding TSP loan is included in the account balance in computing a payee's entitlement. Funds borrowed by a participant are not considered to be withdrawn from a TSP account and are expected to be reimbursed by the participant.

Interest and earnings will not be included in the amount of an account balance unless a court order or legal process specifically provides for them. If interest or earnings are awarded, the TSP will use the rate of return earned by the Government Securities Investment Fund (G Fund), unless the court order or legal process specifies a different rate.

Method, Timing and Tax Treatment of Payments

TSP payments are made by a U. S. Treasury check directed to the payee or via electronic funds transfer (EFT) to the payee's financial institution. But EFT cannot be used to transfer a payment or a portion of a payment to an Individual Retirement Account (IRA) or eligible retirement plan.

The TSP will make only one disbursement per payee under a court order or legal process. The TSP will not make a series of payments, even if the order or process requires it or if the participant's account is insufficient to satisfy the payee's entire entitlement. The TSP will honor a second order, however.

This payment will be made pro rata from all TSP funds in which the is invested. This prorating is based on the balance in each fund on the date payment is made. Distribution from a participant's account comes from all contribution sources – employee contributions and employing agency contributions in the case of a FERS-covered employee.

Under a court order or legal process, all or part of a payment to a current or former spouse may be transferred to a traditional IRA or to an eligible employee retirement plan. The proper TSP forms must be used to transfer these funds, and the forms are sent to the current or former spouse with the TSP decision letter. The TSP will not accept transfer forms developed by financial institutions but it does need information from these institutions to complete relevant sections of the appropriate TSP forms.

A payment that is properly made cannot be returned to the TSP.

The TSP ordinarily makes payments 60 days after issuing the decision letter. The decision letter describes the effect the court order or legal process will have on the participant's account. The payee can ask to receive the payment sooner by waiving the tax notification period or making a federal income tax withholding election. The payee must fill out **IRS Form W4-P**, **Withholding Certificate for Pension or Annuity Benefits** and send it to the TSP or in the case of a payment to a spouse or former spouse, the payee may request that the TSP transfer the payment to a traditional IRA or an eligible retirement plan. All payments will be made no earlier than 31 days after the date of issuance on the TSP decision letter.

Chapter 5. Court Orders and the Thrift Savings Plan

Payment is included in the gross income of the recipient spouse for the tax year in which payment is made. If payment is made to someone other than the current or former spouse of the participant for example, a child or a support enforcement agency then the payment is included in the gross income of the participant for the tax year in which the payment is made. A payment in response to a retirement benefits court order or legal process is not subject to an early withdrawal tax penalty. Such distributions are exempt from the early withdrawal penalty under the Internal Revenue Code.

Chapter 6. Divorce and Taxes

Federal employees who are in the midst of a divorce must understand that they cannot wait until the next April 15 – when their current year's taxes have to be filed for the current year - to think about how their taxes will be affected by their divorce. Some of the most important tax considerations for divorcing couples are filing status, income allocation, alimony and other income/expense issues such as child support, child-care concerns, property settlement and division of non-retirement benefits such as IRAs. Since the Supreme Court's decision on June 25, 2015 overturning the Defense of Marriage Act (DOMA), federal law recognizes same-sex marriages as legitimate marriages with same sex spouses having the same benefits and rights as in opposite-sex marriages.

A divorcing couple's filing status for federal and for most state income tax purposes is determined as of the last day of the tax year. For most filers this is Dec. 31. This means that even if a couple is no longer considered as "one household" they could still be considered married for tax purposes. A couple is no longer considered married for tax purposes when a final divorce is issued by a domestic relations court, when there is a legal separation under local law that requires the couple to live apart, or when a spouse has been "abandoned." "Abandonment" is defined as when all of the following conditions are met:

- The abandoned individual pays more than half the cost of maintaining the household for the taxable year;
- The individual files a separate tax return;
- The individual's household is the principal home of a dependent child for more than six months of the tax year and the individual is entitled to claim the dependency exemption; and
- The individual lives in a separate residence from the spouse for the last six months of the tax year.

One's filing status can have a significant effect on one's tax liability. If one is considered married, then there are two filing choices – married filing jointly or married filing separately. With many married couples, filing jointly will result in lower overall taxes.

A suggested course of action for couples who are in the midst of a divorce but who can still file for the current year with a filing status of "married" is to calculate their taxes both as a married filing joint return and as two married filing separate returns. This will show which type filing status results in the couple's having the lower overall tax liability.

Chapter 6. Divorce and Taxes

There are other issues that should be considered before a couple decides which filing method to use. They are summarized in the following tables.

Married Filing Jointly

Issue	Consideration
Signing a joint return	Both spouses must sign the return – otherwise it is not considered a joint return
Joint and individual liability	Both spouses may be held responsible, jointly and individually, for the tax and any interest or penalty due on a joint return – even if only one spouse earned all of the income on the return
Tax refund applied to spouse's debts	Any refund shown on a joint return may be used to pay the past due amount on a spouse's debts. This includes a spouse's federal and state income taxes, child or spousal support payment and student loans

Married Filing Separately

Issue	Consideration
Separate liability	Each spouse is responsible only for the tax due on his or her own tax return
Itemized deductions	If one spouse itemizes the other spouse cannot use the standard deduction and also must also itemize, even if the amount of itemized deductions is less than the standard deduction
Separate returns usually result in higher overall taxes because special rules apply in a separate return	1. Tax rates increase at income levels that are lower than those for a joint return 2. One cannot take the child and dependent care earned income and higher education tax credit 3. Income limits that reduce the child tax credit, retirement savings contribution credits, itemized deductions and personal exemptions are lower 4. Capital loss deduction limit is $1,500 instead of $3,000 on a joint return

Chapter 6. Divorce and Taxes

If a divorcing couple who are still considered married cannot agree in which filing status to use – married filing jointly or married filing separately, they should file separately. They can change their filing status within three years of filing their taxes by amending their return and then file as jointly. But they cannot amend a joint return after the due date in order to file separately. Although filing separately may actually cost more in the overall tax dollars, it could save one or both spouses much grief.

Each spouse reports on a separate return his or her income, exemptions and deductions, except in community property states.

Individuals who are considered not married can file as single or as head of household. Individuals who file as head of household generally will pay less in taxes than those who file as single, even if they have the same income. Those individuals who are married but who have lived apart from their spouses since before July 1 of the tax year cannot file as married filing separately**.** If an individual is still considered married but has physically lived apart from his or her spouse since before July 1 of the tax year, then that individual may file as head of household under the following conditions: (1) the individual maintains a home for themselves and a child, stepchild or other dependent living there for more than half of the year; (2) the person is able to claim the child as a dependent or release that claim to the other parent; and (3) the individual pays more than half the cost of maintaining the home. This includes property, utilities, repairs and providing food.

Note that to qualify as head of household, the custodial parent does not have to be entitled to claim a dependency exemption.

It is important to understand that filing as head of household rather than married filing separately provides an individual with additional tax benefits, most likely resulting in lower overall taxes. These tax benefits include:

- Credits for child care expenses, earned income credits and higher education tax credits;
- The ability to use the standard deduction even if the other spouse itemized deductions;
- The ability to exclude interest income from Series EE and I Savings Bonds for higher education;
- The ability to deduct interest on qualified education loans;
- The ability to convert a traditional IRA to a Roth IRA; and
- Having higher adjusted gross income (AGI) phase-out thresholds for various tax deductions and credits.

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Income Allocation

As noted previously, upon the dissolution of a marriage, a couple is no longer eligible to file a joint return. Income for the year of the divorce must be divided according to state provisions regarding community property or equitable distribution rules.

- *Community property states:* Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin

- *Equitable distribution states:* All other states and the District of Columbia

Community property is generally all property acquired by either spouse during the marriage other than separate property. Separate property includes property acquired before marriage and property acquired by inheritance during the marriage. Property acquired during marriage includes both parties' earned income, such as salaries, wages and self-employment income, plus any income generated by community assets, such as rental or portfolio income.

Former spouses report their share of community income up to the time the divorce is final and report their separate income from the divorce finalization date through the last day of the tax year. Here is an example.

Jeff and Eileen, residents of Arizona, officially divorced on June 10, 2019. Jeff is a federal employee, while Eileen works for a private company. On their 2019 tax returns, each will report their allowable share of community income from January 1 through June 10, 2019. Among the community income, Jeff will include all of his federal salary and Eileen's salary. Each will include all their individual earnings and deductions applicable to the period June 11, 2019 through Dec 31, 2019.

The fact that a taxpayer neither received nor enjoyed his or her share of the community property income is irrelevant to it being subject to taxation on the taxpayer's return.

Equitable distribution states – in general, those states that are not community property states – use the following rules of allocation:

- Earned income (salary, wages) is taxable to the person who earned it.

- Income from property is taxable to the property's owner as determined under the rules of state law.

- When property is jointly owned, income is taxed 50 percent to the husband and wife unless the joint ownership is unequal for example 70 percent to 30 percent. In that case taxation follows the percentage of ownership.

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Alimony

Often in a divorce negotiations or mediation spouses reach informal agreement about alimony or child support payments, often on temporary basis. But divorcing spouses often get a written agreement or a court order outlining the agreement. This is a mistake.

While many spouses resent paying alimony, there is one bright side for paying alimony, including temporary alimony, is tax-deductible to the payer if the divorce or separation agreement between former spouses was executed before January 1, 2019. This is because the Tax Cuts and Jobs Act of 2017 modified the rules concerning the deductibility of alimony associated with divorce or separation agreements that become affective after December 31, 2018. But merely specifying payments from one to the other as alimony is not enough according to the U.S. Tax Court. A payment qualifies as alimony only if all seven of the following requirements are met:

Payments are made under a written instrument of divorce or separation.

Payments are made in the form of cash, check or money order made out directly to the former spouse or to a third party. This has to be specified by the former spouse in writing is eligible to receive the payment. An example:

Eugene and Sara divorce in early 2018. Eugene moved into a separate apartment on May 1, 2018. The written agreement orders Eugene to pay Sara $1,000 per month starting July 1, 2018. Eugene paid Sara $1,000 per month from May 2018 through December 2018. Eugene can deduct $6,000 for six payments of $1,000 per month from July through December, on his separately filed tax return. Although Eugene paid Sara a total of $8,000, $1,000 a month from May through December, the written agreement specified $1,000 as alimony from July through December. The extra $2,000 does not qualify as alimony.

- Payments must terminate upon the death of the recipient. Payments do not have to terminate at the payer’s death. The payer’s estate can be obligated to make payments. If so, these payments are deductible from the paying spouse’s estate.

- The divorcing spouses must not live together nor be members of the same household. A physical separation in the same residence, separate rooms, is not enough.

- Payments are neither fixed as child support nor do they give the appearance of relating to a child’s support.

- The parties have not designated in writing as “excluded” from alimony treatment.

- The parties do not file a joint return with each other for the year in which the qualifying payment is made.

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Sometimes payments are made to third parties and treated as alimony. This could be to pay the medical expenses, mortgage payments and property taxes, insurance, utilities paid on behalf or for the "benefit of the other spouse. In order to qualify as alimony, the payer spouse must not derive any benefit from the payments, other than from compliance with the divorce agreement. Here are some examples of directed payment that may or may not qualify as alimony.

Example	Qualify as Alimony
Paying spouse pays the mortgage and property taxes on a house he or she owns but is occupied by the payee spouse	NO
Paying spouse must pay payee spouse's medical bills	YES
Paying spouse must pay payee's disability income and long-term care insurance premiums	YES
Paying spouse pays life insurance premiums cash value or term, and policy that names the receiving spouse as the owner	YES
Paying spouse pays life insurance premiums, cash value or term, on a policy that names the receiving spouse as the beneficiary but keeps the paying spouse's name as the owner	NO

Another issue related to alimony that could affect federal employees is the issue of alimony recapture. In divorce agreements made after 1986, payments made in either of the first two years of the divorce may be subject to re-computation that could revise primary alimony amounts. Re-computation may occur if the purported alimony payment decreases by more than $15,000 in the second or third year of payment.

When the re-computation rule applies, it applies only in the third year. There is no re-computation for any other year. The recapture amount is the sum of the following two calculations:

1. Excess second year payments are calculated first. A second-year payment is considered excessive by the amount it exceeds the sum of the third-year payment plus $15,000.

2. Excess first year payments are calculated next. A first-year payment is excessive if it exceeds the sum of $15,000 plus 50 percent of the non-recaptured second-year payment plus the third- year payment.

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Example: *Under the terms of their divorce agreement, Robert agreed to pay his ex-wife, Julia, $6,000 per month for 24 months, beginning June 1, 2016. In addition, Robert agreed to pay Julia rehabilitee alimony of $58,000 in one payment on July 1, 2016. (Rehabilitative alimony is additional alimony to a spouse who is either lesser-paid or nonworking for retraining or education. It is generally given for a specific time period to allow the spouse to become financially independent.)*

Robert's Payments to Julia

Year	Paid Alimony
2016	$100,000 ($42,000 + $58,000)
2017	$72,000
2018	$30,000
(Payments stopped May 31, 2018)	

Alimony recapture can unexpectedly be triggered by failing to make timely payments, reducing payments after a divorce decree modification, or changing payments due to adverse financial conditions. Some suggestions for avoiding alimony recapture are:

- Avoid second-year payments that exceed third-year payments by more than $15,000.
- Avoid first-year payments that exceed second-year payments by more than $7,500.
- Avoid third-year payments that have little or no amounts payable.
- Begin first-year payments as late in the first year as possible. In this way first-year payments should then be less than the total of second-year payments.

Alimony recapture does not apply if payments terminate as a result of the death of either spouse or the remarriage of the recipient.

A worksheet follows that affected employees can use to determine alimony recapture.

Chapter 6. Divorce and Taxes

Sample Alimony Recapture Worksheet

Tax Year:

1. Alimony paid in 2nd Year..$____________

2. Alimony paid in 3rd Year..$____________

3. Floor..$15,000______

4. Line 2 + Line 3...$___________

5. Recapture for 2nd year payments (Line 1 - Line 4) ....$___________

6. Alimony paid in 1st year...$___________

7. Adjusted alimony paid in 2nd year (Line 1 - Line 5).............................$___________

8. Alimony paid in 3rd year (Line 2) ....$___________

9. Line 7 + Line 8..$___________

10. Average alimony paid in 2nd & 3rd years
    (Line 9 divided by 2)...$___________

11. Floor...$15,000______

12. Line 10 + Line 11...$___________

13. Recapture for 1st year payments (Line 6 - Line 12)...........................$___________

14. Total recaptured alimony (Line 5 + Line 13)...................................$___________

Note: Report recapture only in the 3rd year

Chapter 6. Divorce and Taxes

Sample Alimony Recapture Worksheet

Tax Year:

1. Alimony paid in 2nd Year...$72,000

2. Alimony paid in 3rd Year...$30,000

3. Floor...$15,000

4. Line 2 + Line 3..$45,000

5. Recapture for 2nd year payments (Line 1 - Line 4) $27,000

6. Alimony paid in 1st year...$100,000

7. Adjusted alimony paid in 2nd year (Line 1 - Line 5)............................$45,000

8. Alimony paid in 3rd year (Line 2) $30,000

9. Line 7 + Line 8..$75,000

10. Average alimony paid in 2nd & 3rd years
    (Line 9 divided by 2)...$37,500

11. Floor...$15,000

12. Line 10 + Line 11..$52,500

13. Recapture for 1st year payments (Line 6 - Line 12)...........................$47,500

14. Total recaptured alimony (Line 5 + Line 13)...................................$47,500

Note: Report recapture only in the 3rd year
For alimony paid and deducted, recapture is reported as income on 2007 Form 1040 line
For alimony received and reported, recapture is reported as deduction on 2007 Form 1040, line

Chapter 6. Divorce and Taxes

Child Care Concerns of Divorce

There are several tax planning and compliance issues that arise from child custody decisions, including: (1) dependency exemption for the custodial parent/non-custodial parent; (2) tax credits including the child care, child tax and education-related tax credits; and (3) medical deductions for dependent children.

When is the custodial parent entitled to the dependency exemption? A divorce decree should determine custody. If it does not, then custody is determined by which parent has physical custody of the child for the greater portion of the year. This person may claim the child as a dependent provided that both parents together furnish more than 50 percent of the child's support**.** Once a child reaches the age of majority (18 or 21 in most states) and custody is no longer defined in the divorce or separation agreement, the dependency rules revert to the traditional support tests.

A non-custodial parent can claim the dependency exemption for a child if the custodial parent relinquishes the exemption by completing IRS Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents. Form 8332 must be filed with the claiming parent's tax return. The exemption can be released to a non-custodial parent for a single year, a specified number of years, such as alternate years or all future years.

In general, a parent of a child under the age of 13 is eligible to claim a credit for child care expense while the parent works. Most federal employees have access to a Dependent Care Flexible Spending Accounts (DCFSA) in which pre-taxed dollars are deducted from an employee's gross salary to be used to pay child care expenses. The child care tax credit and the DCFSA are available only to the custodial parent. Both the credit and the DCFSA are not available to the non-custodial parent – even if the non-custodial parent can claim the dependency exemption. Only day care expenses actually paid by the custodial parent qualify for the credit. This credit cannot be claimed if the custodial parent does not spend enough to qualify. The custodial parent cannot augment the claim by using the amounts paid by the non-custodial parent.

The child tax credit, a nonrefundable credit for parents of children under age 17, is available only for the parent entitled to the dependency exemption.

Medical deductions for dependent children can be deducted by either parent. It makes no difference which parent is entitled to the dependency exemption.

If a third party – for example, a grandparent makes a payment to an educational institution to pay tuition – of a student, the tuition is treated as paid by the student for purposes of the Hope and Lifetime Learning tax credits. If the educational expenses relate to a dependent, the expenses are considered as paid by the taxpayer on whose return the dependent is claimed.

Chapter 6. Divorce and Taxes

Child support payments are not deductible by the payer nor are they taxable to the payee and include any payment that is:

- Specifically designated as child support under the divorce or separation agreement; or

- Treated as specifically designated to the extent that the payment is reduced either on a contingency relating to the taxpayer's child or at a time that can be clearly associated with the contingency.

In general, if an agreement requires both alimony and child support payments but does not specifically allocate an amount to either category, the entire payment is considered to be alimony.

Division of Retirement Benefits

A Qualified Domestic Relations Order (QRDO) is a court order that is used to assign the benefits of a qualified retirement plan – but not – CSRS or FERS annuities or the TSP to a non-employee alternate payee. A domestic relations order is any judgment, decree or order that relates to the provision of child support, alimony payments or marital property rights to spouses, former spouses or other dependents of a participant. It also has to be associated with a state domestic relations order.

A valid QDRO must clearly specify the name and last known mailing address of the participant and the name and mailing address of each alternate payee to be covered. It also must state the amount or percentage of the participant's benefits to be paid by the plan to each alternate payee and the manner of determining the amount or percentage. And it must specify the number of payments or period to which the order applies and each plan to which the order applies.

The tax consequences of QDRO payments include:

- Payments that are taxed to the spouse or former spouse when received;

- Lump-sum distribution to a beneficiary may be eligible for special averaging or capital gain treatment if the original participant would have been eligible for that treatment?

- All or part of the distribution qualifies for a rollover to an IRA. The rollover must be completed within 60 days of receipt. This also applies to a TSP distribution; and

- The 10 percent additional tax on premature distributions does not apply.

Note that nonqualified retirement plans, including IRAs and annuities do not require a QDRO.

The transfer of an IRA under a divorce decree is not a taxable transfer. The receiving spouse is treated as the account's owner starting from the date of transfer, and alimony received constitutes earned income for purposes of computing the IRA contribution deduction limit.

Chapter 6. Divorce and Taxes

Generally, there is no recognized gain or loss on the transfer of property between spouses, or between former spouses if the transfer is due to divorce. This is also true for the transfer of property from one spouse to or in trust for the benefit of one's spouse or one's former spouse. This is only true when the transfer is caused by a divorce. This rule applies even if the transfer was in exchange for cash, the release of marital rights, the assumption of liabilities or other considerations.

Exceptions to the non-recognition of gain or loss rule with respect to the transfer of property between spouses occur:

- When a spouse or former spouse is a nonresident alien.
- In the case of certain transfers in trust.
- When certain stock redemptions under a divorce or separation instrument, or a valid written agreement, are taxable under applicable tax law.

Property subject to non-recognition rules include all property whether real or personal, tangible or intangible, or separate or community. It includes property acquired after the end of your marriage and transferred to your former spouse. It does not include services.

Chapter 7. Divorce and Real Estate

Many federal employees own a principal residence or a "home" - a house or a condominium, perhaps a rental property and/or a vacation or second home. For most individuals, a home represents one of the major financial assets that they will acquire during their lifetimes. For married couples, a home can represent the real commitment between the couple and is perhaps the place where the couple raises their children. A home could be a house, a condominium or a mobile home.

There are four options available to prevent a federal employee in the midst of a divorce from possibly losing his or her home as a result of the divorce. These options are:

1. Buy out the spouse's share of the home and either keep it or sell it,

2. Sell his or her share of the home to the divorcing spouse,

3. Sell the house together and split the proceeds with the divorcing spouse, or

4. Continue to own the home jointly with the spouse and sell it in the future to the spouse or to a third party.

It is important to note that the laws in one's state may affect one's options regarding the sale of the home. For example, a judge may presume that the custodial parent will stay in the family home until the children reach the age of majority. In that case, the spouse who is not living in the home will not be able to sell the house and split the proceeds with the spouse who continues to live in the home.

Buying Out a Spouse's Share and Either Keeping the Home or Selling the Home in the Future

This option can be financially risky. Individuals who decide on this option must take into consideration as many factors as possible. There is the issue of affordability: Can the individual afford by himself or herself the monthly housing costs? Also, what future profit, if any, can be expected once the home is sold? What will be the tax consequences when the home is sold? What would happen if the home were to be sold now in terms of profit and taxes? (See the Appendix for more information on the tax consequences of selling a principal residence.)

Selling One's Share of the Home to the Other Spouse

To make sure one is receiving a good offer for one's share of the home from the other spouse, one must understand what the home's current fair market value is.

The current fair market value of a home is the amount one could realistically expect to get if the residence were listed for sale on the open market. Real estate agents can provide fair market value estimates free of charge.

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Selling the Home Now and Splitting the Proceeds with the Spouse

Before choosing this option, one will need to know the: (1) the current housing costs and market trends; (2) equity value of the home;(3) the costs of selling the home; and (4) amount of profit one realizes after paying capital gains taxes.

The reason for knowing the current housing costs is to determine if there would be any cheaper alternative when one considers the after-tax cost of homeownership. Consider the following table for calculating monthly costs:

Item	Monthly Cost
Mortgage	___________
Second mortgage, or home equity loan, if any	___________
Property Taxes	___________
Maintenance	___________
Insurance	___________
Utilities	___________
Repairs	___________

Total Gross Housing Costs per Month

An individual should not overlook the tax benefits of home ownership. Under current tax laws one can deduct most, if not all, of one's mortgage interest payments and the paid property tax. The actual housing costs can be less than the sum of one's gross monthly housing costs.

To calculate one's tax savings, use the following steps.

Step 1. Add the total amount of interest paid on one's mortgage during the year and the total paid property taxes.

Step 2. Multiply the result in Step 1 by one's marginal tax bracket, federal and state, if allowed.

Step 3. Divide the result in Step 2 by 12 to obtain the monthly tax savings.

Step 4. Subtract the result in Step 3 from one's gross monthly housing costs to determine one's net housing costs.

Here is an example.

John and Stephanie own a house that is worth $325,000. They have a mortgage of $260,000 and their monthly principal and interest mortgage payment is $1,560 a month, or $18,700 per year. Their property taxes are $3,600 per year. Of the $18,700 in mortgage payments, $18,000 per year - or $1,500 per month - is interest. John and Stephanie's combined federal and state marginal tax bracket is 33 percent. Assume their gross monthly housing costs equal $3,200.

Annual Mortgage Interest		$18,000
Annual Property Taxes		+ 3,600
Total Deduction	$21,600	
Marginal Tax Bracket		x .33
Tax Savings	$7,200	÷ 12
Monthly Savings		$600
Gross Monthly Housing Costs		$3,200
Less Monthly Tax Savings		(600)
Net Monthly Housing Costs		**$2,600**

The question therefore becomes: If John and Stephanie were to sell their home, could they each find an equivalent place to live, the same type of home, at a "real" cost of $2,600 per month?

Continue to Own the Principal Residence with the Spouse and Sell It in the Future
(To the other spouse or to a third person)

When a divorcing couple holds onto a home, it is usually because a custodial parent stays in the home with the children or because the housing market is so weak that the couple does not want to sell the house.

Owning the house together can be complicated - both emotionally and legally. There should be a written agreement ensuring that the capital gains exclusion of the spouse who does not live in the home is preserved. (See Appendix for information about the tax break on capital gains upon the sale of a principal residence.) This agreement must be pursuant to a divorce or separation instrument - a divorce judgment or a related document that discusses the arrangement concerning the family home. This can be a written separation agreement or a decree requiring one spouse to make payments for the support or care of the other spouse.

Chapter 7. Divorce and Real Estate

If the agreement does not meet the strict requirements of Internal Revenue Code Section 121, then the spouse who no longer lives in the home could lose the $250,000 capital gains exclusion when the home is sold. (See the Appendix for a general discussion on the home sale capital gains exclusion.) It may be possible for one spouse to buy the home from the other spouse in the future. Before making any such agreement, both spouses should check with their tax advisers concerning the consequences of such a decision.

Below are some other potential financial and tax considerations to consider when selling an interest in a home to the other spouse as a result of an impending divorce: Possibilities include:

- *Refinancing the home mortgage and using the proceeds to buy out the other spouse.* In practice, when one refinances a previously jointly owned mortgage, one becomes the only holder of the loan. A lender may not allow this if the original mortgage was obtained based on a two-income qualification. The lender may allow a refinancing, but at a lesser amount, resulting in insufficient cash to buy out the other spouse. This may necessitate a second mortgage secured by the home.

- *Selling: to the spouse using an installment loan.* Spouses often agree - or a court order demands - that the custodial parent continue to live in the family home with the minor children. The custodial parent could purchase the home from the other, who accepts a secured installment rate with payment over a fixed period of time. An installment note secured by the home allows the buyer to deduct interest and protects the seller in case the buyer defaults.

- *Keeping the house in exchange for other assets.* Couples often "trade" assets and debts depending on needs and affordability.

<u>Questions for One's Attorney</u>

1. Is a portion of a home considered "separate property?" How does the court treat a separate property interest in the family home in my state?

2. Should I get divorced before or after the house sells?

3. If we continue to hold the house as joint tenants with rights of survivorship, does the right of survivorship continue after the divorce?

4. What would happen if the bank forecloses on the mortgage?

Chapter 7. Divorce and Real Estate

<u>Questions for One's Tax Adviser</u>

1. If our house sells and we are still married, should we file a joint tax return?

2. If we own it jointly and I then buy out my spouse's share, how do I report this for tax purposes?

3. Who gets the mortgage interest deduction and property tax deduction if the title is held as tenants in common? If it is held as joint tenants?

Chapter 8. Divorce and Debts: Who is Responsible for the Debts?

It is important for divorcing couples to understand that when they divorce, they divide up not only their assets, but their debts as well. Federal employees who are in the midst of divorcing their spouses should ideally reach an agreement regarding how their debts will be divided up and which spouse is responsible for paying which debt.

Divorcing couples usually divide up marital jointly acquired assets and liabilities. If one spouse is to assume full responsibility for payment on a debt, that spouse ideally should ask for something in return from the other spouse - such as a bank account, some or all of an IRA, a piece of furniture, or a car - in exchange for paying off that debt.

Spouses will want to know what the state laws are with respect to who is responsible for paying various debts in their states. Another question is: What happens if one spouse ends up declaring personal bankruptcy, defaulting or failing to live up to an agreement regarding who pays which debts? Here are some general rules for spouses regarding which spouse is responsible for which debts.

- In most states, a spouse is responsible for paying only the debts that he or she incurs during the marriage. Both spouses are usually responsible for paying debts incurred: (1) in joint accounts such as jointly owned credit cards; (2) in accounts in which the creditor was looking to both spouses for repayment; (3) for paying for family's necessities such as medical care, food, clothing and shelter; and (4) for paying for the children's education.

- Debts incurred after the separation date but before the divorce is final are usually the responsibility of the spouse who incurred the debt and must be paid by that spouse.

- A spouse is generally not responsible for paying the debts that the other spouse incurred before marriage or after the divorce becomes final.

- Any joint debts in general, debts incurred in both names are the responsibility of both spouses even if there is an agreement or court decree that states only one spouse is responsible for paying back the debt. If the individuals were married at the time the joint debts were incurred, then the collector has a right to collect from either spouse.

- Separately owned property of one spouse usually cannot be taken by a creditor to pay the separate debt of the other spouse. Separate property is defined as property owned prior to the marriage, property accumulated after divorce and property received during marriage by one spouse through a gift or inheritance. In a few "equitable distribution" states, separate property also includes wages earned by a spouse during marriage.

Chapter 8. Divorce and Debts: Who is Responsible for the Debts?

Community Property States

The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Federal employees who are married and live in these states should understand that all property acquired and debts incurred during marriage, whether community property or community debts, respectively are joint. These are rules regarding debts for divorcing couples who live in community property states:

- Both spouses are generally liable for all debts incurred during marriage, unless the creditor was looking to only one spouse for repayment.

- Spouses are generally not liable for the separate debts the other spouse incurred before marriage or after permanent separation. But the debting spouse's share of all community property, including the spouse's half of the non-debtor income, can be used to pay debts incurred before marriage**.**

- Separate property is limited to property owned prior to marriage, property accumulated after divorce and after separation in a few states, and property received during marriage by one spouse only, either by gift or by inheritance.

It is important for individuals who are the midst of a divorce to list all of their debts including the type of debt for example, credit card, student loan, vehicle loan, mortgage or home equity loan and the balance due in each loan, and to list the spouse who is responsible for paying the debt, or who will pay the debt if it is a joint debt. See a sample chart below.

Spousal Debt Chart Date: _______________

Nature of Debt	**Current Balance**	**In Whose Name is the Debt?**	**Which Spouse is Responsible for Payment?**

Chapter 8. Divorce and Debts: Who is Responsible for the Debts?

Here is an example.

Joseph, a federal employee, is in the midst of divorce proceedings with his wife, Sally. They have the following debts: (1) a jointly held mortgage with a current balance of $175,000; (2) Joseph's car loan with a current balance of $15,000; (3) Sally's student loan of $28,000; and (5) a home equity line of credit with a current balance of $95,000.

Joseph and Sally Spousal Liability Chart Oct. 1, 2008

Nature of Debt	**Current Balance**	**In Whose Name(s) is the Debt?**	**Which Spouse is Responsible for Payment?**
Mortgage	$175,000	Joseph and Sally	Joseph and Sally
Car loan	$!5,000	Joseph	Joseph
Student loan	$28,000	Sally	Sally
Home equity line of credit	$95,000	Joseph and Sally	Joseph and Sally

Bankruptcy

Excessive debts unfortunately can serve as a catalyst for ending a marriage. When one spouse moves out of the family home as a result of an impending divorce, the couple may experience an economic pinch. While their expenses may double, their individual incomes will not increase sufficiently to pay their increasing expenses.

Separating couples or recently divorced individuals overwhelmed by debt may consider declaring bankruptcy. Bankruptcy in some cases allows an individual to erase his or her debts in exchange for giving up certain property. Every state declares certain assets - such as clothing, certain equity in a home and a car - as personal assets that cannot be liquidated in a personal bankruptcy.

If a married couple files for a joint bankruptcy, they can eliminate all separate debts of the husband; separate debts of the wife and all jointly incurred marital debts.

Chapter 8. Divorce and Debts: Who is Responsible for the Debts?

But certain debts cannot be discharged in a personal bankruptcy. These include student loans, restitution for a crime and support related debts for child support and/or alimony.

A new law went into effect in October 2005 tightening the rules on child support and alimony. Child support and alimony can no longer be discharged in a bankruptcy. Such financial obligations will go to the head of the line taking priority over the need to repay almost every other kind of debt besides the bankruptcy trustee's fees.

The spouse receiving alimony and or child support payments will be protected under the new bankruptcy law. If the paying spouse files for personal bankruptcy, the alimony and/or child support payments must still be made.

Many of the laws regarding family bills will be decided through a state court, while bankruptcy laws are governed by federal law. Sometimes laws can overlap when one spouse files for bankruptcy after a divorce settlement. This results in a complex and confusing situation. The bankruptcy court's job is to allow the debtor to have a "fresh start" after declaring bankruptcy while at the same time protecting the rights of the non-debtor spouse and any minor children.

After a divorce, an ex-spouse who has been responsible for paying joint debts may file for bankruptcy. If the petition is successful, the bankruptcy court may release the ex-spouse from having to pay the assigned debts. A creditor can no longer collect from the ex-spouse. This means that a creditor will, in most cases, seek payment from the other spouse. There is little the other spouse can do to avoid having to pay or get reimbursed from the defaulting ex-spouse.

To reduce the likelihood of facing this situation, the other spouse should structure the separation agreement to take into consideration the possibility of bankruptcy. Individuals whose spouses may be filing for bankruptcy should discuss the situation with their attorneys.

It is best to pay off the balance on all jointly-held credit cards from marital assets before the divorce proceedings go before a judge. If there is a sale of the marital home, credit cards should be paid off shortly after funds are dispersed from the real estate settlement.

In case credit card debts are not paid off when the marital home or assets are sold, and one spouse files for bankruptcy, the credit card company will typically go after the other spouse for payment of jointly-held credit cards. One spouse should not assume that the other spouse will pay the credit card debts assigned by the divorce decree. In short, any property settlement should contain provisions that address how credit card debt will be handled if one spouse files for bankruptcy.

Chapter 8. Divorce and Debts: Who is Responsible for the Debts?

The following obligations that are classified as “support” cannot be discharged in bankruptcy: (1) alimony, spousal support or maintenance; (2) child support; (3) attorneys’ fees connected with a divorce or with modifying alimony, child support or child custody orders; (4) periodic payment that end upon the death or remarriage of the support spouse; (5) agreements to pay marital debts in exchange for lower alimony or child support; and (6) debts paid to a spouse who is maintaining the primary residence of the children while there is a serious imbalance of incomes.

Dividing Debts

When an individual divorces there are three basic options for allocating the couple’s marital debts:

- The spouses can sell jointly owned assets to raise the cash to pay off marital debts.

- One spouse can agree to pay the bulk of the debts in exchange for receiving a greater share of the marital property or a corresponding increase in alimony.

- The spouses can divide joint property equally and divide the debts equally. Each spouse gets half of the property and each spouse agrees to pay half of the debts.

But consider what would happen if one spouse agrees to pay all even half of the debts and then gets fired from a job, refuses to pay a debt, or files for bankruptcy. The other spouse will be responsible for paying all of the debts if they are joint debts. If this spouse does not pay these debts then their credit rating will be damaged. It is therefore better to sell jointly owned property and use the proceeds to pay off the joint debts.

Chapter 8. Divorce and Debts: Who is Responsible for the Debts?

Questions for One's Divorce Attorney Regarding Debts

1. Who is legally responsible to pay which debts?
2. What can be done legally to make sure the other spouse pays the debts according to the marital agreement?
3. If the other spouse is thinking about filing for bankruptcy before the divorce agreement, should I also file for bankruptcy?
4. How can the other spouse be stopped from spending marital assets until the divorce is final?
5. Can I be held responsible for repayment of a loan the other spouse, while married, signed and then defaulted on?
6. Once a divorce becomes final, can a creditor come after my assets to pay the other spouse's debts?

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Chapter 7 discussed what happens to the family home when spouses divorce. Married couples accumulate other non-retirement financial assets such as bank and brokerage accounts while they are married. When a couple divorces, the question becomes: Which spouse will receive which assets? In dividing up these assets, it is important for each spouse to realize that in the division of assets it is doubtful that each spouse will receive what he or she wants. But it is more important that each spouse receive what each will need in order to survivor financially once the divorce takes effect.

Many federal employees during the course of their marriage acquire financial assets such as stocks, bonds, mutual funds, gold, collectibles, and limited partnerships that make up their non-retirement portfolio holdings. If these employees divorce, it is important for them to objectively analyze their portfolio in order to be put in the best financial position to build their financial futures after they divorce.

With respect to investments, an individual who is in the midst of a divorce should ask two questions regarding a particular investment, namely: (1) Is the investment performing well; and, if so (2) will the investment serve his or her financial needs?

It may be necessary to consult with a financial expert before making decisions because certain investments carry complications. Tax professionals and stockbrokers may be particularly useful. But it is important for divorcing individuals to gather as much information as possible about their investment portfolios.

To best achieve their investment objectives, these individuals should follow these steps and also using the chart below:

Step1. Make a list of all investments owned by each spouses individually and jointly, and insert in column 2 of the chart. If unsure, it may be necessary to call one's stockbroker, discount brokerage firm, financial planner or accountant. It may be possible to get this information online if one has access to electronic brokerage services.

Step 2. Insert (H) for husband, (W) for wife or (J) for jointly in column 1 of the chart. If the investments are held jointly, then these are divided during the divorce.

The name of the person on the investment does not necessarily determine the ownership.

Most states divide marital property, even when assets are only in one spouse's name. During a divorce settlement it is possible that each spouse's separate investments will be considered joint in terms of income needs or alimony.

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Step 3. List is the "equity value" of each investment. With investments, the equity value is defined as the fair market value– - the amount the investment is currently worth less any debts. The equity value– - sometimes called the "legal value" –– is generally the dollar amount an attorney uses in trying to arrange a divorce settlement. There may be problems in determining which date to use in valuing assets. For example, real estate can be valued from the date of the divorce or the date of settlement, but not the date of separation. Even if a particular state value assets at the date of separation, divorcing spouses can agree to another date. Ideally, assets should be values as close as possible to the date that a spouse is to take control of them. Otherwise, if assets' values are determined as of the date of separation but not transferred until months or years later, their value could go down due to market forces. Here is a breakdown of the most common investments and who to contact for current values:

• Cash and cash equivalents such as certificates of deposits or money market accounts. Look at one's statement or call the bank.

• Stocks, bonds or mutual funds. One can check with a stockbroker, discount brokerage firm or an online service. Or one could call a brokerage firm's trading department to check the current price of stocks and mutual funds, or at find prices in the business section of most newspapers. For stocks, one will look at the stock market tables for the price of the column labeled " close", to find the price the stock sold for at the close of the market, the day before. Multiply this number by the number of shares one owns to obtain an approximate value of the stock on a given day. Brokers and brokerage firms can give an estimate on bonds. For U.S. Savings bonds Bonds (EE and I bonds), one can go to www.savingsbonds.gov and go to the "Savings Wizard" to find out what a particular savings bond is worth. For mutual funds, the business sections of most newspapers list the "net asset value" of every mutual fund.

• Real estate. For income or rental property, one will probably need an appraiser. For the values of real estate investment trusts (REITS) one should check with a broker or brokerage firm. To find the value of raw land, check with some real estate agents in the area. It is also helpful to know if there is a balance due on the mortgage or if the property is free and clear of debt.

• Insurance. To find out the current value and surrender value of a cash life insurance policy, one should call or write the insurance company.

• Limited partnerships. Investments in businesses that operate as limited partnerships are more difficult to value than day investments in stocks or bonds. Unlike stocks or bonds, there is no conventional trading market for interests in limited partnerships. But certain "secondary" markets buy and resell limited partnership interests. However, these markets may assign widely divergent values to limited partnership interests. It is therefore recommended that individuals who need to get a market value for their limited partnership interests should ask a stockbroker or financial planner for the names of several secondary market firms who can give a price at which the partnership interest could be sold – and whether additional costs will be incurred in selling it. Most limited partnerships were very popular investments in the 1980's but are worth significantly less now.

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

•Collectibles. These items – including coins, jewelry, art and stamps – must be appraised. It is important to find the wholesale or resale value of these items and not the retail cost.

Step 4. What is Find out the financial - "after- tax/after- sale" financial value - of each investment? It is important to know the tax basis of any investment asset in order to calculate the gain or loss and the potential tax liability in the event these assets are sold. The IRS requires that when property is transferred between spouses in the course of a divorce, the spouse who is transferring the assets, the "transferor," must provide tax- basis information to the receiving spouse, the "transferee." It is important that individuals in the midst of negotiations related to divorce should not make any decisions about which investments to accept or sell in the settlement unless they know their potential tax liabilities before any property transfer takes place. Knowing the tax basis of an investment will help find the financial value or after sale/after tax value.

But there may be other costs or charges that will affect the financial value of an investment asset. These charges must be deducted from the financial value to arrive at the real "after- sale" value. These charges include: (1) account charges for maintaining an account with a broker, brokerage house or firm; (2) redemption fees that the investor will pay to redeem or sell the investment; (3) trading fees or commissions for buying or selling stocks or bonds and: (4) early withdrawal penalties incurred for early withdrawals on certificates of deposits, life insurance annuities and other investments.

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

The following is a summary worksheet for calculating the financial value for the most common investment assets.

• Stocks and mutual funds:

(1) Purchase price ____________________
Add:
(2) Dividends and capital gains reinvested ____________________
Add:
(3) Commissions and transaction Fees ____________________

Tax Basis ________________

(4) Sales price

____

Less:
(5) Commissions and transaction fees ____________________

(6) Adjusted sales price _________________

(7) Gain (Loss) - subtract (4) from (6) _________________

(8) Find the taxes due, or saved, by multiplying the gain or loss on (7) by the capital gain tax rate based on one's tax bracket _________________

(9) Find the financial value by subtracting the taxes due (or adding the taxes saved) from (to) the adjusted sales price. _________________

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Here is an example:

In 2016 Jody buys 100 shares of ABC stock at $50 per share and it has grown to $75 per share in 2017. What would be the financial value of the ABC stock should Jody sell the stock in 2018?

(1) Purchase price	$5,000		
Add			
(2) Dividends and capital gains reinvested	$500		
Add			
(3) Commissions and transaction fees	$100		
Tax Basis		$5,600	
(4) Sales price	$7,500		
Less			
(5) Commissions and transaction fees	($200)		
(6) Adjusted sales price			$7,300
(7) Gain (loss) - subtract (4) from (6)			$1,700

(8) Find the taxes due, or saved, by multiplying the gain or loss on (7) by the capital gain tax rate based on one's tax bracket x 15%

Taxes due $255

(9) Find the financial value by subtracting the taxes due ($255) from (to) the adjusted sales price ($7,300). <u>$7,045</u>

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

To apply the formula for any stock, bond or mutual fund sold, use the following worksheet.

1. Find the tax basis by adding the purchase price, reinvested dividends and commissions and transaction fees (paid at purchase).

Purchase Price		$______________
Dividend Reinvested	+	$______________
Commissions & Transaction Fees	+	$______________
Tax Basis	=	$______________

2. Find the adjusted sales price by subtracting commissions and transaction fees (to be paid when you sell) from the equity value.

Equity Value		$______________
Commissions & Transaction Fees	–	$______________
Adjusted Sales Price	=	$______________

3. Find the gain (or loss) by subtracting the tax basis from the adjusted sales price.

Adjusted Sales Price		$______________
Tax Basis	–	$______________
Gain (or Loss)	=	$______________

4. Find the taxes due by multiplying the gain by the capital gains rate based on your tax bracket.

Gain		$______________
Capital Gains Tax Rate	x	$______________
Taxes Due	=	$______________

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

5. Find the financial value by subtracting the taxes due from the adjusted sales price.

Adjusted Sales Price		$_______________
Taxes Due	–	$_______________
Financial Value	=	$_______________

Keep in mind that the above formula calculates only federal income taxes. In most states, you will have to pay state taxes as well.

Real Estate

• Real Estate. These investments can include the family home, real estate investment trusts (REITS), raw land, and income or rental properties.

▪ REITS invests in a variety of holdings ranging from apartments and hotels to office buildings and shopping centers. RIETS are publicly traded and their value is easily identified by referring to the stock tables in the newspaper or asking a stockbroker.

▪ Raw land values are based on the value of raw (undeveloped) land on current "comparables" – the amount at which comparable parcels of land are currently selling. Other factors may influence the financial value of raw land including: (1) how the land will be affected by a city's general plan; (2) the kind of building permits that have been issued in the area; and (3)how the raw land surrounding the land in question will be used.

▪ Family homes was were discussed in Chapter 7. The family home is one of the largest financial assets acquired by couples in the course of a marriage. The question is: What will be the financial value of a family home if one spouse sells his or her portion to the other spouse in the course of a divorce.?

There are two tax laws that will have an effect on the after-sale/after-tax value of the home. The first law involves the exclusion from capital gains tax of up to $250,000 of profit or $500,000 if one files a joint return. The second law affects homeowners who claim a home office deduction. The aforementioned $250,000/$500,000 capital gain exclusion does not include the amount of capital gain profit attributed to depreciation for home office use. Any depreciation associated with home office use after May 6, 1997 will be taxed at a 25 percent capital gain tax rate.

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

To determine the financial (after-sale/after-tax) value of one's house, follow these steps.

Step 1. Find the amount realized:	
Fair market value of house	____________________
Less	
Cost of sale (closing costs)	(____________________)
Amount realized	____________________
Step 2. Determine gain or loss	
Amount realized from Step 1	____________________
Less	
Basis of house (amount paid plus improvements)	____________________
Gain or Loss	____________________
Step 3. Find the taxable gain	
Gain (from Step 2)	____________________
Exclusion	$500,000
Taxable gain	____________________
Step 4. Determine the taxes on taxable gain	
Taxable gain (from Step 3)	____________________
Multiply by	
Capital gains tax rate	x 15 %
Taxes on taxable gains	____________________
Taxes to pay for home office use (Depreciation times 25%)	____________________
Total Taxes	____________________

Step 5. Find the Financial Value

Amount realized	___________________
Less	
Current debt	___________________
(Mortgage, Home Equity Loan, etc)	
Less	
Taxes on capital gain	___________________
Less	
Taxes on home office use	___________________
Less	
Improvement expenses	___________________
Financial Value	___________________

Example:

Amount realized on sale of house	$440,000
Less	
Current debt on house	– $100,000
Less	
Tax on taxable gain	0
Less	
Taxes on home office use	0
Less	
Improvement expenses	– $5,000
Financial Value	$335,000

The same calculations are used to determine the financial value of rental real estate - such as apartments, condominiums or houses. The difference between this and the financial value of a primary residence is that one has to add the total depreciation for the rental real estate. Total depreciation is the amount deducted and saved in taxes to account for the declining value of the property.

While rental real estate that is sold at a profit is taxed at a “preferential” (15 percent) tax rate that went into effect in 1997, there is one exception to the preferential rate. In the case of any depreciation that was taken on the rental property, any gain attributed to the depreciation will be taxed at a maximum rate of 15 percent. For example, if one bought a rental property several years ago for $100,000, took $20,000 worth of depreciation and sold the property for $250,000, there would be a long-term capital gain of $250,000 less $80,000 or $170,000. Of the $170,000, $20,000 would be taxed at a 25 percent rate and $150,000 at a capital gains tax rate of 15 percent.

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Use the following formula to find the financial value of rental real estate:

Fair market value of property	___________________
Less	
Debt on property	___________________
Add	
Total improvements	___________________
Less	
Total depreciation	___________________
Less	
Cost of sale	___________________
Tax Basis	___________________
Adjusted Sale Price	___________________
Less	
Tax Basis	___________________
Gain on Sale	___________________
Taxes Due	___________________
After-tax/After Sale Value	___________________

Other considerations concerning rental properties and divorcing spouses:

1. Which spouse is responsible for paying the mortgage in case the renters move out?

2. Which spouse is responsible for making any repairs?

3. Who will be reimbursed for capital improvements to the property?

4. Which spouse is responsible for making any required improvements before selling the property?

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Life Insurance

A common mistake made by many employees is buying more insurance than needed and paying too much in premiums during a divorce. This is the opportune time to look at one's life insurance policies and making make sure one is not "over-insured".

One should keep only those life insurance policies that are truly needed. Term life insurance policies may be terminated at any time. If one has a life insurance policy that is essential, then one should not let it lapse (terminate) without having a replacement policy.

Any life insurance policy with a cash value is often called "cash value" or "permanent" life insurance. If one has a cash value life insurance policy which is not the most cost-effective policy, then any cash value can be used to purchase another insurance policy that is more suitable. The benefit of buying another policy rather than taking the cash out of one's current policy is that taxes owed on the accrued interest can be deferred (Internal Revenue Code Section 1035). The only drawback is that a commission will have to be paid when a new policy is purchased and these commission costs will decrease the initial cash value of the new policy.

The following chart can be used to estimate the financial value of one's cash value life insurance.

Value of Life Insurance

Cash Value	______________
Less	
Surrender charge	______________
Cash surrender value	______________
Less	
Premiums paid	______________
Gain or loss	______________
X	
Marginal tax bracket	______________
Taxes Due	______________
Cash surrender value	______________
Less	
Taxes due	______________
Financial or After-Tax/After-Sale Value	_______________

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Here is an example:

Jack has a whole life insurance policy with a current cash value of $200,000. If he were to cash in the policy there would be a surrender charge of $1,000. Through the years Jack has paid a total of $40,000 in premiums. Jack is currently in a 30 percent tax bracket.

The financial or after-tax/after-sale value of Jack's policy is calculated as follows:

Cash Value	$201,000
Less	
Surrender Charge	(1,000)
Cash Surrender Value	$200,000
Less	
Premiums Paid	(40,000)
Gain or Loss	$160,000
X	
Marginal Tax Bracket	x 30%
Taxes Due	$48,000
Cash Surrender Value	$200,000
Less	
Taxes Due	(48,000)
Financial or After-Tax/After-Sale Value	$152,000

Which Assets Should be Kept

Once divorcing spouses know the financial or after-tax/after- sale value of their investments, they have a starting point for negotiation. Spouses need to decide what to do with these assets; in particular whether should they divide them or sell them among each other themselves.

Of course, there is much negotiation that is involved. If, for example, a federal employee gives up all or a good portion of his or her TSP account, then it is only fair that they should receive something in return that can replace its value. The ultimate decision to keep or sell one's investments depends on several factors, including one's age, risk tolerance, income needs and investment experience. Asking the following questions may help one make sound decisions about one's investments.

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

1. Has this investment performed well? If yes, go to question 2. If no, consider these options:

• Sell the asset before the divorce so that both spouses can share in the cost of the sale, taxes and other expenses; and
• Offer to sell the asset to the other spouse in the divorce settlement.

2. Is this investment appropriate for me? In other words, is it providing income, growth, liquidity and/or security? If yes, how long will it be kept? If the investment is not appropriate not, consider these options:

• Long term –- buy out your spouse's interest and keep this investments;
• Short term –- consider selling the asset before the divorce becomes final, sharing the proceeds, taxes, and other costs with the spouse. Use the proceeds to purchase a similar investment.

The following chart can be used to split the investments in a divorce. The last column shows which spouse keeps the asset or if the asset will be divided up.

Investment Chart

Investments	**Who Owns It?** **H - Husband** **W - Wife** **J - Jointly**	**Legal or Equity Value (Fair Market Value - Debt)**	**Financial (After-Tax/ After-Sale) Value**	**Husband Keeps (H)**	**Wife Keeps (W)**	**Sell and Split Proceeds**
Cash & Cash Equivalents						
Bank Checking Account 1. 2. 3. 4.						
Bank Savings Account 1. 2. 3. 4.						
Certificates of Deposit 1. 2. 3.						

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Investments	**Who Owns It** **H - Husband** **W - Wife** **J - Jointly**	**Legal or Equity Value (Fair Market Value - Debt)**	**Financial (After-Tax/ After-Sale) Value**	**Husband Keeps**	**Wife Keeps**	**Sell and Split Proceeds**
Money Market Funds 1. 2. 3.						
Money Market Mutual Funds 1. 2. 3.						
Personal Notes Payable to You 1. 2. 3.						
Other 1. 2. 3.						
Stocks and Bonds						
Common Stocks 1. 2. 3.						
Preferred Stock 1. 2.						
Mutual Funds 1. 2. 3.						
Treasury Bills 1. 2. 3.						

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Investments	**Who Owns It** **H - Husband** **W - Wife** **J - Jointly**	**Legal or Equity Value (Fair Market Value - Debt)**	**Financial (After-Tax/ After-Sale) Value**	**Husband Keeps**	**Wife Keeps**	**Sell and Split Proceeds**
Government Bonds (such as Ginnie Maes) 1. 2.						
Municipal Bonds 1.__________Mutual Funds __________Unit Trusts __________Individual Bonds 2. __________Mutual Funds __________Unit Trusts __________Individual Bonds						
Corporate Bonds 1. 2. 3.						
EE U.S. Savings Bonds 1. 2. 3.						
Zero Coupon Bonds 1. 2. 3.						
Other 1. 2. 3.						
Real Estate						
Income or Rental Properties 1. 2.						
Real Estate Investment Trust (REITs) 1. 2.						
Raw Land 1. 2.						
Other 1. 2.						
Insurance Investments						
Cash Value of Life Insurance Policies 1. 2.						

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

Some Special Problems Associated with Cash Value Life Insurance

There is more to consider than just the financial value of a cash value life insurance policy. The following should be considered before keeping a life insurance policy in a divorce settlement.

• What is the quality of the insurance company? Its rating can be obtained from Standard and Poor's, & Moody's and A.M. Best.

• What interest rates is one receiving on the premiums accruing on the cash value? Would an alternative –- a "safe" investment such as federal government bonds –- yield more?

• Are there any loans outstanding in the policy? A loan will reduce the death benefit. Before taking this asset as part of a divorce settlement, one should make sure that the loans are paid back or recognize that the death benefits will be reduced.

Some Special Problems Associated with Rental Property

The financial value of a rental property is not the only consideration with the such property. Here are some other questions that should be asked about a rental property before choosing to keep this asset in a divorce.

1.Where is the property located and what is its potential for appreciation?

2. What is the quality of the neighborhood? Is it improving or deteriorating?

3. How will the property be affected by changes in the local economy?

4. Are Is the property's rent above or below market pricing?

5. What does it cost to maintain and manage the property? Is there positive or negative cash flow?

6. What happens if the renters vacate the property?

7. Is the property affordable?

8. What are the tax incentives or disincentives to keeping the property?

9. What type of loan is on the property –- fixed or adjusted adjustable rate? Will the adjustable rate increase affect the affordability of the property?

10. When would be a good time to sell the property?

Chapter 9. How Are Non-Retirement Financial Assets Divided Up?

The answer to these questions will help one reach one of three conclusions:

- The property has strong potential for growth –- a good asset to keep.

- The property has some potential but it is uncertain. Other investments using the same amount of money may outperform the property. Sell now and split the proceeds with the other spouse or one spouse will can buy out the other spouse.

- This property has little potential –- high operating costs, negative cash flow, and high vacancy rates. Other investments have a higher probability of investment return.

- Sell now and split the proceeds

Chapter 10. Divorce and Social Security Benefits

All federal employees who are covered by the Federal Employees Retirement System (FERS) pay into Social Security and will be eligible for Social Security retirement benefits as soon as they reach age 62. Those employees covered by the Civil Service Retirement System (CSRS) do not pay into Social Security but may have earned the minimum number of Social Security credits outside of federal service to be eligible for Social Security retirement benefits.

While an "insured" worker – a worker who has earned at least 40 credits of Social Security – is eligible for Social Security benefits, so is the worker's spouse even if the spouse never contributed to Social Security. The question is: What about a divorced spouse? Can a divorced spouse, one who has never worked or has not accumulated a sufficient number of Social Security credits to qualify on his or her own collect Social Security retirement benefits based on the work record of the ex-spouse? The answer is yes, provided certain requirements are met by the ex-spouse.

A divorced spouse of an insured worker can receive retirement or disability benefits on the basis of the insured worker's (the other spouse's) earnings record. This occurs if the divorced spouse: (1) formally applies for benefits; (2) is at least 62 years old; (3) is not married; and (4) is not entitled to his or her own retirement or disability benefits or is entitled to retirement or disability benefits in an amount that is less than 50 percent of the primary insurance amount (PIA) of the insured worker.

There is one other requirement for the divorced spouse to collect Social Security benefits based on the record of a working ex-spouse. In order for the divorced spouse to collect on the other spouse's work record the former couple must have been married for at least 10 years before the divorce becomes final. Social Security is "gender neutral" and it does not matter whether it is an ex-husband or an ex-wife. What does matter is that the divorce spouse has not remarried and that he or she earned a smaller paycheck and did not pay that much into the Social Security system, if anything at all.

It is also not necessary for the working ex-spouse to collect benefits in order for the divorced spouse to collect benefits. As long as the working ex -spouse is at least age 62 and eligible for benefits – even though he or she is not receiving them – the divorced spouse can receive spousal benefits if the couple has been divorced for at least three years and meet the other requirements. To apply for benefits based on a former spouse's earnings record, the divorced spouse will need either the ex-spouse's Social Security number, or the ex-spouse's date and place of birth and parents' name. The divorced spouse's benefits as an ex-spouse do not reduce or otherwise affect benefits available to a former spouse.

A divorced spouse's benefits end in the first month preceding the month in which: (1) the divorced spouse dies; (2) the working ex-spouse dies; (3) the divorced spouse becomes entitled to retirement or disability benefits based on a primary insurance amount (PIA) that is equal to or greater than the PIA of the worker; (4) the divorced spouse marries someone other than the worker whom they divorced before turning 60; (5) the divorced spouse remarries the insured worker and the insured worker is not yet entitled to retirement benefits; or (6) the insured worker loses his or her fully insured status.

Chapter 10. Divorce and Social Security Benefits

The size of the divorced spouse's benefit will depend on the age he or she first files for Social Security, as well as the size of the ex-working spouse's benefit (PIA) at his or her full retirement age. To get the largest monthly check possible, the divorced spouse should wait until his or her own full retirement age to start collecting. Full retirement ages are presented on the Social Security Web site at www.ssa.gov.

The divorced spouse is also eligible for widow's benefits after the ex-working spouse dies. Social Security calls those "divorced survivor benefits." To be eligible for widow(er) benefits the (1) surviving divorced spouse and working ex-spouse must have been validly married or deemed validly married; (2) the marriage lasted for at least 10 years immediately before the divorce became final; (3) the surviving divorced spouse must apply for benefits; (4) the surviving divorced spouse is at least 60 years old or is at least 50 years old and is disabled; (5) the surviving divorced spouse is not entitled to retirement benefits or is not entitled to retirement benefits in an amount that is equal to or greater than the insured worker's PIA; and (6) the surviving divorced spouse is not married unless the surviving divorced spouse remarried after turning 60.

A divorced spouse or surviving divorced spouse may not be eligible for Social Security benefits or survivor benefits if the divorced spouse is a Civil Service Retirement System (CSRS) annuitant. This is because CSRS annuitants are subject to an offset called the Government Pension Offset or GPO. The GPO reduces a spousal or former spousal Social Security entitlement by $2 for every $3 of CSRS annuity benefits. It is intended to ensure that spousal and former spousal Social Security benefits are paid only to those who are financially dependent on their husband's or a wife and who has little or no Social Security benefits or other pension benefits of their own.

Here is an example to help illustrate:

Francine, age 66, is a retired federal employee. She is entitled to a CSRS annuity check of $3,000 per month and Social Security divorced spouse benefits of $400 per month. This is based on the fact that Francine was married to Joseph for 22 years before they divorced three years ago. Francine's Social Security former spousal benefits are reduced by two-thirds of her CSRS monthly benefit or $2,000 (two-thirds of $3,000). The result is that Francine will receive Social Security benefits of $400 less $2,000, or $0. If Joseph were to die, Francine is then entitled to Joseph's full Social Security benefit of $800 per month. But the GPO reduces the $800 Social Security survivor benefit by 2/3 of her CSRS annuity benefit, or $800 less $2,000 or $0.

The GPO also affects individuals who worked for a state or local government and who were not covered by Social Security throughout their last 60 months of employment. Like CSRS annuitants, these individuals can receive a former spousal or a surviving ex-spousal Social Security benefit that exceeds two-thirds of a government pension. The GPO was enacted to treat retired federal employees similarly to other retirees who did not work in Social Security-covered employment.

Chapter 10. Divorce and Social Security Benefits

An ex-spouse can get more details about the benefits to which he or she is entitled by calling the Social Security Administration at 800-772-1213 or visiting a local office. For women in particular, there is also a pamphlet, “What Every Woman Should Know,” that addresses divorce and remarriage. This publication can be downloaded at https://www.ssa.gov/pubs/EN-05-10127.pdf

Chapter 11. Divorce and Estate Planning Issues

Many individuals believe that once they have paid an estate attorney to write a will or trust, a living will and an advanced health care directive to name beneficiaries for their life insurance, IRAs and their qualified retirement plans: and perhaps to write a durable power of attorney, that their estate planning needs have ended. This is a misconception. There is no such thing as a "permanent" estate plan. Certain events in one's life – marriage, births, death, inheritance, legislative changes and divorce – may necessitate revising an existing estate plan or creating a new one.

Divorce is one of those life events that will necessitate both spouses' consideration of the effects of the divorce on: (1) wills; (2) beneficiaries for one's IRAs and TSP accounts; (3) life insurance; (4) property rights; (5) gift tax aspects of property transfer; (6) estate tax; and (7) prenuptial agreements.

Effects of Death on Wills and Guardians for Children

When most married couples write their wills, they direct the estate attorney to draft documents that, at the death of one spouse, all or most of his or her assets will go the surviving spouse. The federal estate tax marital deduction provides the attorney with a tool to minimize or eliminate federal estate taxes when the surviving spouse is the primary beneficiary in the will. Internal Revenue Code Action 2056(a) provides that subject to certain limitations, any interest in property passing to a surviving spouse may be deducted from the value of the decedent's estate.

It is important to understand that with proper estate planning, property qualifying for the marital deduction will avoid a double estate tax. The property that passes estate-tax-free to the surviving spouse will be subject to federal estate tax, and possibly to any state estate tax, only upon the death of the surviving spouse.

When a married couple divorces, this important estate planning tool is lost. Other estate planning issues also arise. Following a divorce, many individuals either fail or forget to revise their will or living trust arrangements. Some states have enacted provisions that supersede or control the disposition of the estate of a divorced person of his or her former spouse.

In many states a final divorce judgment revokes part or all of one's will. Most states' statues provide that only the will provisions benefiting the former spouse are revoked. Some state statutes provide that the Will provisions benefiting a former spouse will stand if the will does not have special provisions for this contingency.

No matter what state a federal employee or retiree lives in he or she should make a new will shortly after a divorce judgment becomes final.

It is extremely important for every individual to have a will or trust to ensure that, upon the individual's death, property is distributed according to the individual's wishes. If one does not have a

Will or has not arranged to transfer property by other means, such as joint tenancy or a living trust, then property will be distributed according to state law.

Chapter 11. Divorce and Estate Planning Issues

If one has children, it is especially important to have an estate plan. In particular, some considerations for children should be in place in case both parents are deceased**.** Some questions for divorcing couples with children to consider: Who will physically care for the children, how will the children be supported and – in case property is left to the children – who will manage the property if the children are younger that the age of majority (18 in most states)?

When couples divorce, it makes sense to name each other as personal guardians of the children, in case one spouse dies. This person obviously could manage any property that the children will inherit. Divorcing spouses each should name "contingent" guardians for their children in the event the other spouse dies simultaneously.

Effect of Divorce on IRA and TSP Beneficiaries

In a divorce, the spouse without much saved in the form of a retirement account such as an IRA, a 401(k)-retirement plan or the TSP frequently will demand, as part of the divorce, for some or all of the other spouse's retirement account. If the other spouse has monies remaining in these retirement accounts after a divorce agreement, then that spouse should name new beneficiaries for these accounts. Retirement accounts for which new beneficiaries should be named include: (1) traditional IRAs; (2) Roth IRAs; (3) 401(k) retirement plans: (4) 403(b) retirement accounts; (5) the Thrift Savings Plan; and (6) non-qualified annuity accounts, including fixed and variable accounts.

Effect of Divorce on Life Insurance

Some states hold that a divorce decree will not affect the rights of the parties (policyholder or owner/beneficiary) under a life insurance policy. In these states, if a divorced party fails to name a new policy beneficiary in place of the former spouse, then the former spouse will be entitled to the life insurance proceeds on the policyholder's death. In the states that follow this rule, the broad language of a property settlement agreement between the spouses – the purpose of which is to divide all property rights – does not act to revoke a beneficiary designation under the policy. Courts in these states require a spouse to waive explicitly his or her interest in the insurance proceeds in the property settlement agreement.

Other states follow an opposing rule – a property settlement agreement in a divorce under which a spouse releases all right, title and interest in all property owned by his or her ex-spouse. This includes the rights as a beneficiary of the former spouse's life insurance. Some states have enacted provisions within their prelate code statues that, upon divorce, there is an automatic revoke of non-prelate property such as life insurance policies, IRAs, payable on death accounts, transfer on death accounts, and dispositions made for the benefit of a former spouse.

Another aspect to consider with life insurance is the manner in which life insurance proceeds are received by the beneficiary spouse. This will determine if the life insurance proceeds received by the former spouse are tax-free.

Chapter 11. Divorce and Estate Planning Issues

The proceeds of life insurance policies usually are not taxable income to the beneficiary. Proceeds received as alimony can be included in the gross income of the beneficiary–spouse. If the policy is transferred to the spouse for valuable consideration, part of the proceeds will be includable in the beneficiary-spouse's gross income. While the courts have not decided what happens when one spouse transfers an insurance policy is in return for the other spouse's property or support rights, the recipient of the policy is considered to be a purchaser of the policy**.** As such, the recipient of the policy cannot exclude from taxation all of the life insurance proceeds at the death of the insured. If the recipient can prove that the policy was received partly as a gift, the proceeds could be fully excludable.

Effect of Divorce on Property Rights

A divorce's effect on the property rights of a husband and wife depends on the state the couple resides in and can be complicated.

Most couples will own non-retirement assets – such as checking and savings accounts, certificates of deposits, real estate and brokerage accounts – as "tenants by the entireties," sometimes called joint tenants by the entireties or JTTEN. With JTTEN, each spouse has a right of survivorship in the property. That means if one spouse dies, his or her entire right, title and interest in the tenants-by-the-entireties property automatically passes to the surviving spouse. This is the case even if a spouse puts in his or her will something to the contrary.

Neither spouse can unilaterally sever the tenancy by the entireties, partition the property, or unilaterally act to defeat the other spouse's survivorship rights. In some states that recognize JTTEN, creditors are unable to attach an individual debtor-spouse's JTTEN interest; in some states, creditors may attach the debtor-spouse's interest subject to the nondebtor-spouse's right of survivorship. A small number of states allow creditors of either spouse to attach, levy and sell JTTEN property.

Divorce severs JTTEN and converts it to "tenancy in common." Until the divorce is final JTTEN remains in effect, unless a court orders a partition.

Tenants in common do not have rights of survivorship. Consequently, former spouses – as newly converted tenants in common – lose the rights of survivorship. Each tenant in common has an undivided one-half interest in the whole of the property. This means that each tenant has the right to use and enjoy the entire property. Either tenant may dispose of their one-half interest in any way they see fit. As a practical matter after divorce, either tenant may unilaterally bring a partition action to have the property sold and have the proceeds divided equally between them –an option not available to JTTEN.

In some states, mutual agreement between spouses to sever a JTTEN will be implied and granted. This means that when a spouse who possesses a JTTEN wrongfully excludes the other spouse during a period of separation – but before the divorce decree is entered – the court deems this to be an offer from the spouse in possession to sever the JTTEN. The excluded spouse is deemed to accept this offer by filing an action to partition the property.

Chapter 11. Divorce and Estate Planning Issues

One consequence in states with "no-fault" divorce is that the courts will divide marital property equally, and have uniformly held that these partition actions cannot be brought. These courts strictly interpret their "equitable division" statute. This means that the courts in these no-fault divorce states have ruled that marital property will be protected from indulgence, removal or waste during the course of divorce actions. This gives divorce courts total control over marital assets for purposes of equitable distribution.

Gift Tax Consequences of Property Transfers in Divorce

Under the Internal Revenue Code, transfers of properties between spouses under the terms of a written agreement in settlement of their marital or property rights or to provide support for minor children, are not subject to the federal gift tax if the spouses obtain a final decree of the divorce written within two years of the agreement. If this transfer of property is made at the transferor's death, the value of the property will not be included in the decedent's gross estate.

Timing of the transfer is very important because the gift taxes can be lessened – if not avoided altogether – by making the transfers of property before the divorce decree is entered. The transfer will qualify for the unlimited gift tax marital deduction if it occurs while the parties are still married and before the written agreement is completed.

Estate Tax Consequences of Property Transfers in Divorce

Could property transferred between spouses under a written settlement agreement pursuant to divorce be includable in the transferor's gross estate? Yes, if the transferor retains certain powers over the transferred property. If the transfer is made pursuant to a bona fide contract, settlement agreement, for adequate and full consideration in money or money's worth, the value of the property transferred may be deducted from the transferor's gross estate.

To be considered "adequate and full consideration in money's worth," the transfer pursuant to divorce must be made pursuant to a settlement agreement and divorce must have occurred within two years of the agreement,

Federal employees and annuitants must therefore take care in making their attorney aware of the need to draft a property settlement agreement that ensures the transfer qualifies as a bona fide contract for adequate and full consideration in money or money's worth.

Sometimes the situation arises in which spouses are separated, but not divorced, and one of the spouses revises his or her will to exclude the other spouse. Under many statutes it is impossible to completely exclude the surviving spouse because that person has vested rights in the decedent's property.

Chapter 11. Divorce and Estate Planning Issues

These state statutes provide for the proper support of a separated spouses and prevent disinheritance of either spouse. In general, a surviving spouse can take under a will or can elect against the will to obtain a share in the decedent's real and personal property. This can be done unless the surviving spouse waives, releases or forfeits the election right. The surviving spouse cannot be deprived of these rights by the testator – the deceased spouse who wrote the will.

Prenuptial Agreements and Estate Planning

Property division pursuant to dissolution of a marriage – whether by divorce or death – is generally subject to state statutory requirements that place decisions concerning the "equitable" division of marital property into the hands of the court. This also provides a surviving spouse with an elective share that if exercised may frustrate the provisions of an existing estate plan. Prenuptial agreements allow couples contemplating marriage to predetermine property divisions in the event of a divorce.

Many courts will enforce the prenuptial agreement only if the agreement was written in a fair manner and the provisions were considered substantively reasonable at the time that they were written. These agreements will then be reexamined at the time of divorce to see if they are still considered substantively reasonable.

All federal and state laws that would affect a client's property in the absence of a prenuptial agreement and the state law requirements for validity of prenuptial agreements must be analyzed to ensure that the provisions of the divorce agreement can be carried out for both spouses.

It is therefore imperative that married individuals experiencing difficulties in their marriage have their estate plan reviewed during separation, as well as after divorce. If feasible, the execution of a prenuptial agreement would eliminate many of the estate planning uncertainties and problems that might occur at the dissolution of the marriage.

Chapter 12. Divorce and Military Pensions

Many federal employees have served in the uniformed services and have retired – or will be retiring – from the uniformed services. These employees are entitled to retirement benefits from the uniformed services. These benefits include eligibility for commissary, exchange and health care benefits, as well as for military retired pay.

If these employees are married, their spouses may be entitled to benefits should the couple divorce. The Uniformed Services Form Spouse Protection Act (USFSPA) addresses the entitled benefits of divorced spouses of retired uniformed service members. The USFSPA is discussed in more detail in the Appendix.

If is important to understand that the USFSPA does not automatically give a former spouse any of the uniformed service member's retired pay. The law instead permits a state to treat military retired pay as marital property and therefore divide it in a divorce action. Disposable military retired pay is a service member's monthly retired pay, minus qualified deductions.

USFSPA allows a state or local court to treat military retired pay just as it would treat a civilian pension plan, including the CSRS and FERS annuities and the TSP. Military retired pay may be divided for property settlement purposes. Military retired pay may also be garnished to satisfy child support and alimony obligations. State law decides whether military retired property will be treated as marital property and how the service member's military retiree pay will be divided between the two parties upon divorce. For example, Maryland, Virginia and the District of Columbia courts have treated a uniformed service member's military retired pay as a marital asset which can be divided in a divorce action

Under the USFSPA a former spouse – like a current spouse – can be designated as a Survivor Benefit Plan (SBP) beneficiary. The SBP annuity allows retired service members to provide continued income to a named beneficiary in the event the retiree predeceases the beneficiary. A retiring service member will be enrolled in the SBP unless he or she declines to participate. If divorce occurs after retirement – and the service member had initially elected to participate when retiring – the divorce terminates the initial beneficiary designation in favor of a spouse. But coverage may be continued in favor of a former spouse – either voluntarily to honor an agreement between parties or to comply with a court order. The former spouse must elect "former spouse coverage" from the appropriate military finance center within one year of the date of the final divorce decree.

The USFSPA also permits former spouses to continue receiving commissary, exchange and health care benefits after a divorce in certain cases. To qualify for continued benefits, a former spouse must show: (1) that divorced spouse – the uniformed service member – served at least 20 years of creditable service; (2) that the marriage to the former spouse lasted at least 20 years, and (3) that the period of the marriage overlapped the period of service by at least 20 years. A former spouse who meets these requirements is known as a "20/20/20" former spouse.

Former spouses who do not meet the 20/20/20 requirement lose their commissary and exchange privileges once the divorce is final.

Chapter 12. Divorce and Military Pensions

If a uniformed service member had at least 20 years of creditable military service and was married to someone for at least 20 years, but the period of the marriage overlapped the period of military service by 15 years, the former spouse is entitled to "full" military medical benefits only for a transitional period of one year following the divorce. After this year of coverage, the spouse may purchase a DoD-negotiated conversion health policy. The former spouse could also be eligible for health insurance through the FEHBP if the uniformed service member is or was covered by the FEHBP (See Chapter 4).

Full coverage through TRICARE or a DoD-negotiated conversion health insurance policy requires that the former spouse neither remarry nor enroll in an employer-sponsored health insurance plan. Former spouses who are neither 20/20/20 nor 20/20/15 are not entitled to any military health benefits after a divorce. But they *are* eligible for the DoD continued Health Care Benefit Program, a premium-based temporary health care program for 36 months of coverage until alternative coverage can be obtained. To be eligible for this a former spouse must enroll within 60 days of losing full military health care benefits.

Eligibility of Former Spouse for Retired Pay

A former spouse is eligible to receive direct payment from a uniformed service member's retired pay if the former spouse has a court order that satisfies the requirements and conditions specified for such payment as set forth in this chapter.

In the case of a division of property, the court order must specifically provide that payment to the former spouse be made from disposable retired pay. To establish eligibility for a court-ordered division of retired pay as property, the former spouse must have been married to the uniformed service member for at least 10 years during which time the uniformed service member performed at least 10 years of creditable service. Court-ordered payments for child support and/or alimony do not require a specified length of marriage.

As a result of a court order the former spouse could receive civilian retirement benefits. This includes CSRS and FERS annuity benefits and a court-ordered TSP retirement benefit. There are no offsets or reductions to a former spouse's civilian retirement benefit if the former spouse is receiving direct payment from a uniformed service member's retired pay.

On June 26, 1981, the U.S. Supreme Court ruled that military retired pay could not be treated as community property in divorce cases. In response to that ruling, Congress and the USFSPA decreed that state courts treat military retired pay as property in a divorce if the courts so choose.

Appendix

Glossary of Terms

Alimony: Monetary payments made by one spouse to another for support of that spouse following divorce. The number of years a person receives such payments is usually determined by a fact-finder. Other terms for this payment may include spousal support and maintenance.

Alternate Payee: The person, generally the non-employed spouse, who receives certain benefits under a pension plan.

Annuity: A form of benefit in which payments are made at regular intervals for a specific time period.

Assets: All property owned by either spouse that has a monetary value.

Attachment: The act of seizing a person or property under the authority of a judicial order. An attachment results in the property being brought before the court for the court's judgment.

Beneficiary: The individual or other entity named to receive a benefit upon the death of owner.

Civil Service Retirement System (CSRS): The retirement system for federal and postal employees described in subchapter III of chapter 83 of Title 5, U.S. Code.

COBRA: Consolidated Omnibus Budget Reconciliation Act of 1985. This federal law enables a spouse to continue health care coverage under an existing policy for up to 36 months following a divorce.

Community Property: Property acquired by both spouses during a marriage, exclusive of gifts or inheritance.

Court Order: Any judgment or property settlement issued or approved by any court of any state, District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, or the Virgin Islands, or any Indian court in connection with or incident to, a divorce, annulment, or legal separation of a federal or postal employee or retiree.

Custodial Parent: The person who is given primary parental rights and responsibilities to raise children under a divorce decree or parentage order.

Domestic Relations Order: Any judgment, decree, or order that provides child support, alimony payments, or marital property rights to a spouse, former spouse, child or other dependent. The order is made pursuant to a state domestic relations law.

Employee Annuity: The recurring payments made under CSRS or FERS to a retiree. It does not include payments of accrued and unpaid annuity benefits after the death of a retiree under § 8342(g) or § 8424(h) of Title 5, U.S. Code.

Equitable Distribution: The method used by the majority of states to divide property which takes into account approximately 11 factors to reach a "fair" split.

ERISA: Employee Retirement Income Security Act. This federal law sets certain minimum standards for pension plans provided by employers in private industry.

Federal Employees Retirement System (FERS): The retirement system for federal and postal workers described in chapter 84 of Title 5, U.S. Code.

Former Spouse: Define in connection with a court order affecting employee retirement benefits, a living person whose marriage to an employee or retiree has been subject to a divorce, annulment, or legal separation resulting in a court order.

Former Spouse Survivor Annuity: A recurring benefit under CSRS or FERS, or the basic employee death benefit under FERS that is payable to a former spouse after the employee's or retiree's death.

Garnishment: A method of payment of child support whereby a spouse's employer deducts the child support payment from an employee's paycheck and sends it into the court. The court, in turn, mails out a check to the recipient of the child support order.

Gross Annuity. The amount of a self-only annuity less any applicable survivor reduction, but before any deduction

Interlocutory Decree: A temporary court order pending the final decree. Has enough weight to qualify alimony payments as deductible by the payer for income tax purposes.

Joint Property: Property held in the name of more than one person.

Joint and Survivor Annuity: Payments made over the recipient's lifetime and over the lifetime of the person named as beneficiary.

Liabilities: Debts owed by either spouse.

Marital Estate: The assets or property and accumulated income acquired by spouses during marriage.

Net Annuity (CSRS). The amount of annuity payable after deducting from the CSRS gross annuity deductions for:

- health insurance premiums;
- life insurance premiums;

- long-term care insurance premiums;
- dental insurance premiums;
- vision insurance premiums;
- Medicare Part B or Part D premiums;
- amounts already payable to another person based on a court order actable for processing or a child abuse judgment enforcement order;
- state or local income taxes, and
- federal income tax.

Net Annuity (FERS). The amount of annuity after deducting from the FERS gross annuity any amounts listed for the CSRS gross annuity.

Non-marital Property: Separate property, property owned before marriage or property acquired during the marriage by gift or inheritance.

Normal Retirement Age: The age that a pension plan participant can retire on full benefits

Order: The court's ruling on any matters before it.

Plan Custodian: The individual or institution that manages a pension plan. For CSRS and FERS, the U.S. Office of Personnel Management has that role.

QDRO: Qualified Domestic Relations Order. The written document provided for by federal law that directs or orders retirement benefits to be divided between spouses in divorce matters.

QMCSO: Qualified Medical Child Support Order. The written document provided for under federal law that requires group health insurance providers to give health coverage to children of an insured parent who is going through a divorce.

Reduction to Provide Survivor Benefits: The amount required to reduce the gross annuity of the retiree in order to provide a survivor benefit for a spouse, former spouse, or person with an insurable interest in the plan.

Refund of Employee Contributions: A lump-sum payment of the pension contributions made by a worker who separates from service and is not eligible for an immediate pension annuity.

Rehabilitative Alimony: Money paid by one spouse to a lesser-paid or non-working spouse for retraining or education. It is generally given for a finite period of time to enable the spouse to become financially independent.

Separated Employee: A former employee who has separated from a position in the federal government and was covered by CSRS or FERS.

Settlement Agreement: The written version of the agreement reached by the parties. Generally, it is best to reduce to writing the terms of any agreement reached between the parties as to how the property will be divided (or the terms of child custody, if applicable).

Single Life Annuity: A payment of benefits based over the recipient's life time. Also referred to as a straight-life annuity. Once the recipient dies, there are no more payments.

Spousal Consent: A spouse's agreement to waiver current and/or future entitlement to survivor payments to a pension plan.

Trial: A formal court hearing in which all the outstanding disputed issues can be decided.

URERSA: Uniform Reciprocal Enforcement of Support Act. All 50 states now are subject to this law. It is designed to assist people to receive child support from non-custodial parents living in other states.