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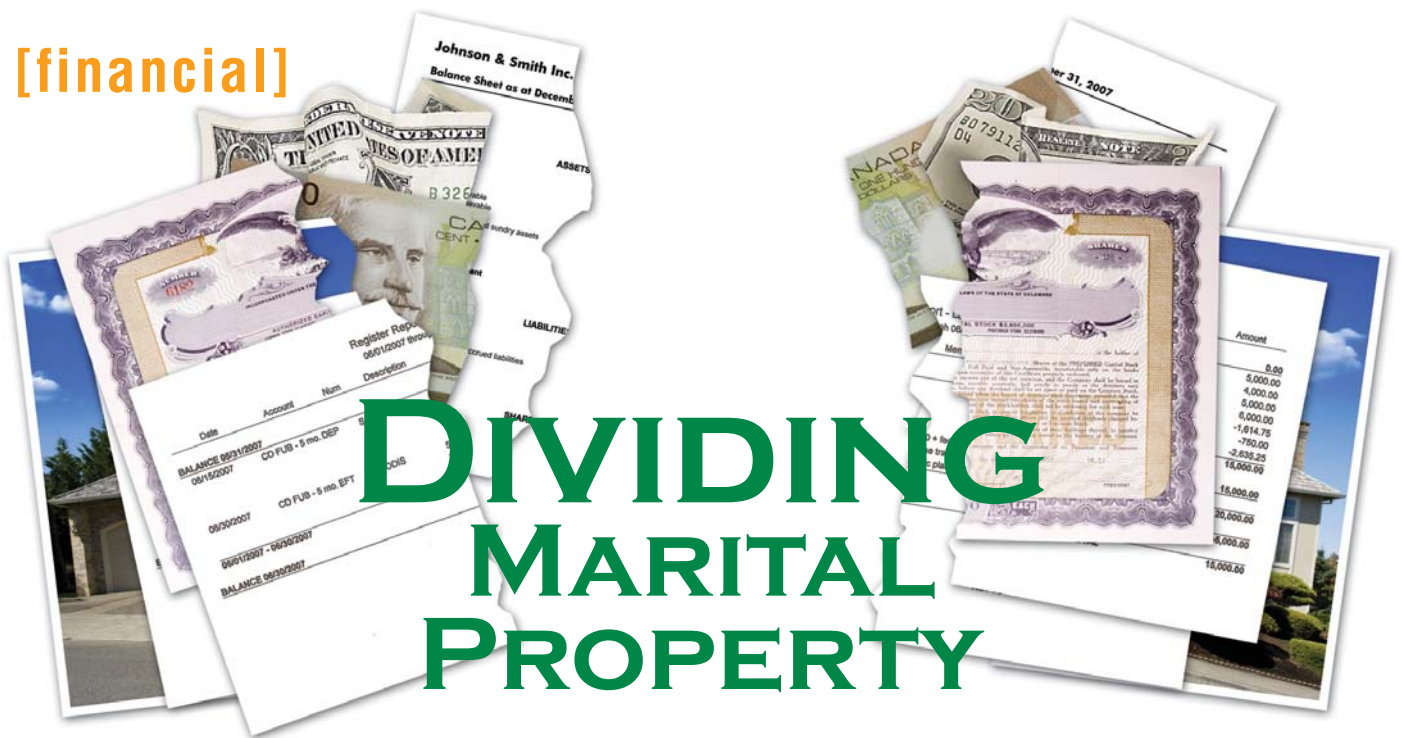
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[financial]



DIVIDING MARITAL PROPERTY

Here's how to deal with complex financial or property issues in a divorce.

By Tracey Manzi, CFA, CDFA and Tim McNamara, CIMA, CDFA

AN important step in the divorce process is an equitable division of your marital property. When a couple has no significant assets or debts, one can resolve property division quickly and cost-effectively. But the task of classifying and dividing property and verifying income are more difficult if complex financial assets are involved.

Could your divorce be financially complicated?

Asset division will be more complicated if you are concerned about hidden assets, or if your spouse is self-employed, has an ownership interest in a closely held corporation, limited partnership or trust, or has an executive-compensation package. Other tricky situations involve pre-marital assets, inherited property, or third-party real estate interests.

While you may be tempted to rush into a quick settlement to mitigate the emotional and financial burdens of divorce, you may be cheating yourself out of significant assets or income. The discovery of any undisclosed or improperly characterized asset that becomes part of your marital estate, or income that could support you and your family, can make a significant difference on the quality of

your life after divorce and have a substantial impact on your future net worth.

The long-term cost of a quick settlement could be significant

Too often, well meaning parties (attorneys, judges, mediators, you and your spouse) involved in a divorce case do not have the requisite financial skills to gain a thorough understanding of the marital estate. Protecting your financial interests once your marriage has ended is rarely discussed. The dissolution of your marriage partnership requires extensive planning and should be treated as any other business transaction.

If your situation requires valuing a business, tracing assets, reconstructing income, or untangling third-party financial interests (such as when a family member co-owns your home), or if you have tax-related questions, you should get a financial professional on your divorce team. Otherwise, costly and permanent mistakes are likely.

Case 1: Pre-marital assets

Assets acquired prior to the marriage or inherited are often not part of the marital estate. A common issue we see is

pre-marital assets that have been commingled with marital assets. Many couples do not maintain proper records at the time of the marriage. These innocent mistakes can cause your separate assets to be part of the marital estate, and you potentially risk losing a substantial part of your wealth.

Case 2: Self-employed

You may have a rough idea of what your spouse earns, but how much do you know about their business? It would be unusual if some investigation into the financial records is not warranted. If you plan to receive child support or alimony, you need to verify your spouse's income. One common situation where income is understated occurs when one spouse controls a closely held business or is self-employed. While not all spouses are dishonest, business owners can and do control their expenses and, to a certain extent, their income.

Business owners have an incentive to minimize their taxable income. To the untrained eye, using their taxable income to establish a support award will result in less money available to support you and your family. A financial professional can review your tax returns and other financial documents to adjust your spouse's

income. Some common expenses that may be adjusted are any personal expenses run through the business (such as an automobile, landscaping, or utility bill), depreciation and depletion expenses, or meals and entertainment. Any shortfall between this adjusted income and your marital lifestyle expenditures should sound a warning bell.

Deceptive spouses can also manipulate their accounting records to disguise the profitability of their business or to hide assets. Beware of delayed business contracts, a sudden increase in accounts receivable, large one-time business expenses, or salaries paid to “ghost” employees such as a family member or a paramour.

A major piece of financial information needed in a divorce is the lifestyle analysis. This analysis proves the marital standard of living, reconstructs financial statements, and identifies how much you need to sustain your lifestyle after divorce. It will also document when marital expenditures exceed stated income. With this, your attorney can negotiate an appropriate spousal support award or conduct further discovery.

Case 3: Trust

If your spouse has set up a trust, a careful review of the trust documents should be conducted. Any property held in the trust will need classification as either marital or separate, as divorce courts can only divide marital property. Assets that a third party owns, whether an individual or another business entity, typically cannot be divided in divorce. If you are concerned with your legal rights, consult an attorney. Your financial advisor may also be able to help you locate your trust documents.

Case 4: Family limited partnership

Family Limited Partnerships (FLP) can be difficult to untangle during a divorce. In order to equitably divide this asset, one must first establish a standard of value. If you have a significant amount of your net worth placed in a FLP and your divorce is acrimonious, the value of the underlying assets will be contested.

Your soon-to-be ex-spouse will likely have a financial expert apply a “fair market value” approach to the valuation of this asset. Then the assets placed in the FLP will be substantially discounted from their current market value. Protect your interests by using your divorce team to prepare counter-arguments and an alternative valuation.

Case 5: Corporate executive

If your spouse is an executive at a Fortune 500 Company or a start-up, they likely have a highly complex compensation package that consists of a salary, bonus, perquisites, equity-based compensation, and possibly even a long-term incentive plan. Be certain you understand the details of the package.

We have seen the equity-based component represent more than 80% of an individual’s income in any given year. If you plan to receive alimony or child support, consider preparing a historic analysis of your spouse’s compensation package. This analysis can prove that annual grants of stock options, restricted stock, or other forms of equity compensation will likely occur after divorce. Your attorney can use this information to negotiate that these future income sources should be included in the definition of income. Also, make sure your separation agreement includes how you define income, to avoid future misunderstandings and protect your financial interests.

Case 6: Stocks and stock options

Executive pay packages are likely to include equity based compensation. Be sure your spouse properly discloses all vested and unvested options, restricted stock, and stock appreciation rights before you discuss the division of marital assets. While most family courts will include vested options in a property settlement, there is no uniformity on how one should handle unvested options.

If your spouse received options during your marriage, but the options have not vested by the time of your divorce or divorce filing, do not rule out that these options may be, in part, a marital asset. A financial expert can

prepare an analysis to calculate how much, if any, of the unvested option is marital by using a simple coverture fraction or time-rule formula.

While a myriad of issues comes up in any divorce, your finances will be among the most important ones you need to resolve. Proper planning can help you avoid financial issues that come up before, during, or after your marriage. Regardless of where you are in the divorce process, you need to protect your financial interests. Surrounding yourself with a competent team of advisors, including ones with advanced training in divorce finance, will improve your chances of an equitable settlement. ■

Tracey Manzi and Tim McNamara are co-founders of New England Divorce Solutions, a firm dedicated exclusively to matrimonial finance issues. They are among the country’s leading experts in wealth management and divorce finance. They work with individuals and their attorneys throughout North America to help families protect and grow their assets before, during, and after divorce. www.nedivorgesolutions.com

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