

The Complexities of Divorce

Divorce is challenging no matter what the circumstances. Important decisions need to be made under stressful conditions, many of which carry significant long-term consequences. These decisions tend to be particularly difficult for divorcing ultra high net worth couples, given the complexity of their financial lives. The sheer volume of information that needs to be analyzed and issues that need to be addressed can be overwhelming. For higher-profile couples, it may be difficult to protect your privacy while you are grappling with very personal issues. The learning curve can be exceptionally steep for the spouse who was less directly involved in managing a family's business and/or personal finances.

There's a reason why divorce ranks second only to the death of a loved one on the list of most stressful life events. The best antidote is to regain a justifiable sense of control. That starts with getting the right advisors on your side. You and your team can then gather the documents needed to assess your full financial and legal situation, and identify those issues that should be relatively simple to settle and others that may require more work. You can also start working on a plan to support your future ambitions. Divorce doesn't have to be about starting over. It can be about moving forward.



KEY TAKEAWAYS

- One of the most important decisions you will make is the composition of your advisory team. Your divorce attorney, CPA and wealth advisor should have extensive experience working with ultra high net worth clients and be able to work as a well-coordinated team.
- One of the best ways to help your advisory team perform most effectively is to gather all of the necessary documents and provide the team with clear and complete information.
- While the natural inclination may be to get your divorce settled as quickly as possible, don't be rushed into making rash decisions. You may be living with the consequences of those decisions for a long time to come.
- What you will give or get varies greatly depending on where you live and whether or not you have a valid prenuptial agreement in place. Make sure you understand those implications.
- Have a wealth advisor model the financial implications of your pending negotiated settlement so you understand how it will impact your daily budget and long-term goals.
- Pay close attention to any tax liabilities that may reduce the value of your settlement. As with most financial negotiations, it isn't what you get, but what you keep.
- Divorce is almost invariably stressful, but it also offers an opportunity for a new and exciting chapter in your life.

Get the right people on your side

While you are going through your divorce, the most important people are your family, friends and others who provide emotional support. Your advisory team picks up where they leave off. The core of your team comprises your divorce attorney, CPA and Private Wealth Advisor. Each of these professionals should have extensive experience working with ultra high net worth families and come with stellar references. Just as importantly, your team must be able to collaborate effectively, coordinating their efforts to ensure that you reach a fair and equitable conclusion to your divorce that supports your ambitions moving forward.

YOUR DIVORCE ATTORNEY takes on the responsibility of safeguarding your best interests, dealing objectively and assertively with the many complex legal issues that may arise.

YOUR ACCOUNTANT advises you on the potential tax implications of a proposed settlement, as well as any residual tax issues that may linger from your marriage.

YOUR PRIVATE WEALTH ADVISOR works with the CPA to guide the discussion on how to divide assets in a joint portfolio to minimize tax liabilities, and helps you develop strategies to address your needs for short-term liquidity and long-term objectives, such as educating a child or planning for retirement. These strategies can be modeled prior to finalizing your divorce so that you understand the financial impact of your pending settlement.

Other professionals may also be needed depending on the complexity of your holdings, the nature of your prenuptial

agreement and the degree to which you can reach an amicable agreement without court interventions. These additional members of your team may include:

A FORENSIC ACCOUNTANT to provide valuations of matrimonial assets, including illiquid assets, and explain the tax implications of their disposal. They can also identify hidden assets when there is suspicion that one party in the divorce is falling short of full disclosure.

A PRIVATE INVESTIGATOR, operating within strict legal limits, can be engaged to collect information about personal and legal problems that may pertain to a financial or custody settlement. They are typically engaged in more contentious divorces.

A PRESS RELATIONS PROFESSIONAL to help those with high public profiles manage the reputational risk associated with divorce.

No. 1 Mistake To Avoid:

Do not delay financial planning until after a divorce is final. You want to understand what you're up against financially before you agree to any settlement.

Understand where you stand

The members of your advisory team can walk you through all the steps needed to assemble a complete picture of your marital finances. You can accelerate that process by tracking down key documents. This exercise should straddle both sides of your personal balance sheet: your

expenses as well as your sources of income, and your liabilities as well as your assets.

These documents may include:

- Prenuptial agreement
- Bank account statements
- Brokerage account and mutual fund statements
- Tax returns for the prior three years
- Retirement (IRA, 401(k), etc.) and pension plan statements (both yours and your spouse's)
- Trust documents (for trusts established by you or your spouse, and for trusts of which you are a beneficiary)
- Social Security benefits statements
- Employee benefits coverage (health, dental, short-term disability and long-term disability for you and your spouse)
- Military benefits
- Credit card statements
- Mortgage statements (including first and second mortgages and home equity credit)
- Car, boat and other loans
- Loans you or your spouse may have obtained or guaranteed
- Pending loan applications
- Lease agreements
- Purchase and sale agreements
- Employment agreements
- Partnership agreements
- Estate planning documents
- Will
- Living will
- Powers of attorney
- Durable medical powers of attorney
- All property/casualty insurance coverages
- Life insurance policies
- Umbrella liability policies
- Long-term care insurance

Steps you can take prior to your divorce

- 1 Check your credit report.

- 2 Contact creditors to explain your situation and, if appropriate after conferring with your counsel, to ask to stop any future charges by your spouse.

- 3 Review and make any needed changes to your estate documents.

- 4 Open credit card, checking and savings accounts in your own name. (In community property (CP) states, accounts in your own name will not change the character of the funds they hold.)

- 5 Have your paycheck deposited directly into your checking account. (In CP states, each spouse has an undivided one-half interest in combined income. So this is only appropriate if you are living separate and apart, and have established a separation date.)

- 6 Open an interim account to manage interim family expenses during the period between separation and divorce. (Not needed for community property in CP states, as each spouse has an undivided one-half interest in any community property accounts.)

No. 2 Mistake To Avoid:

Do not agree to a settlement out of guilt or to just get it over with. Think of the financial aspects of your divorce as you would the dissolution of a business.

Key Issue: The Division of Marital Property

In most jurisdictions, marital property includes everything of value that you and your spouse acquired during the marriage: real estate, investments, bank accounts, art collections, cars, boats and so on.¹ Almost anything owned by you and your spouse may be included, except property that was:

- Acquired before marriage
- Given to either of you
- Inherited by either of you
- Acquired using property that was gifted, inherited or already owned before the marriage
- Excluded by a prenuptial or other agreement

While this division may seem straightforward, it can become very complex depending on how nonmarital assets were combined and used during the marriage. Appreciation of nonmarital property during your marriage may be considered marital property in some jurisdictions.

DETERMINING EQUITABLE DIVISION

More than 40 U.S. states rely on the concept of equitable distribution when dividing marital property. The goal is to achieve a division that is fair based on a range of considerations, including the contribution of each spouse to acquiring and maintaining the marital property; the length of the marriage; child custody expenses; and the financial needs, circumstances and future prospects of each spouse.

Another system that exists for dividing marital property is the “community property” approach, which is used in nine states. Generally, community property is property acquired during the marriage except for property that was:

- Acquired before marriage
- Given to either of you
- Inherited by either of you
- Acquired using property that was gifted, inherited or already owned before the marriage and any appreciation on such assets
- Excluded by a prenuptial or other agreement

Community property states include:

- | | |
|---------------|---------------|
| 1. Arizona | 6. New Mexico |
| 2. California | 7. Texas |
| 3. Idaho | 8. Washington |
| 4. Louisiana | 9. Wisconsin |
| 5. Nevada | |

¹ Source: Journal of Accountancy. <https://www.journalofaccountancy.com/issues/2013/apr/20126248.html>. Accessed Jan. 13, 2023.

DIVISION OF A CLOSELY HELD BUSINESS

As with any other asset, the court can determine whether a business is to be considered marital property (or whether the business, or part of the business, is considered community property). This determination will depend on the date of establishment, the source of initial investments in the business, the contributions of the two spouses and the skill set needed to operate the business going forward.² Once this is determined, the business must be valued by qualified professionals, and expert witnesses may be required to defend those valuations in case of a dispute. Of course, the ownership interests of other partners must often be considered.

If both spouses wish to remain active in running the business, or even if both retain a significant voting interest, a whole new set of issues comes into play. If this is the intent, it is wise to consider adding a consultant to your team to help you remain productive partners in business after you are no longer partners in marriage.

DIVISION OF REAL ESTATE

If a spouse purchases real property with separate property, and community property is used for improvements, the community is entitled to reimbursement of those funds. If a spouse purchases real property with separate property, and community property is used to pay the mortgage, such payments can give the community an interest in the property.

DIVISIONS OF ASSETS HELD IN TRUST

If you are a beneficiary of an irrevocable trust created by someone else and you use funds to support the marital lifestyle, the assets in the trust can be factored into the alimony and/or child support equations.

The Limitations of Prenuptial Agreements:

Among the most important conversations you will have with your attorney are those that concern the provisions in your preup and any enforcement issues related to them. A court can invalidate a prenuptial agreement if it finds that there was, among other things, fraud, duress, coercion, mistake, undue influence or unconscionability in the terms or circumstances surrounding the prenuptial agreement.³

Key Issue: Child and Spousal Support

CHILD SUPPORT

The amount of child support custodial parents receive varies considerably depending on the state of residence. Each state is required by federal law to establish guidelines to calculate a range of child support based on the parents' respective incomes and expenses. Some states allow their judges considerable discretion within that range and others do not. Among the factors that are typically considered in calculating child support are:

- The needs of the child, including health insurance, education, day care and special needs
- The income and needs of the custodial parent
- The paying parent's ability to pay.
- The child's standard of living before divorce or separation

While courts will generally attempt to maintain the pre-divorce standard of living for children, this is more of a goal than a guarantee. While not

common when highly affluent parents are divorcing, some accommodation may be given for the cost of supporting two households.

ALIMONY

Alimony laws also vary considerably from state to state, largely concerning the factors that go into determining the amount of monthly payments and the duration of support. There are four types of spousal support:

TEMPORARY SUPPORT is paid during a separation before the divorce is final. It is likely to change, or cease altogether, depending on the final agreement.

REHABILITATIVE SUPPORT is also temporary in that it is designed to last until the receiving spouse becomes self-supporting.

PERMANENT SUPPORT lasts until the death of either former spouse, or until the receiving spouse remarries or begins living with another person. (Keep in mind that permanent alimony can be increased or decreased by a court, and that there has been recent discussion of reducing alimony when the paying spouse reaches retirement age.)

² See, e.g., Cannon v. Cannon, 384 Md. 537, 865 A (2005).

³ Source: HG.org. Available at: <https://www.hg.org/legal-articles/do-i-have-a-right-to-a-family-business-in-divorce-37439>. Accessed Jan. 13, 2023.

REIMBURSEMENT is designed to repay the receiving spouse for specific expenses they helped pay during the marriage, such as the cost of medical or law school for the paying spouse.

Courts award alimony based on a number of factors, including how long you were married, your pre-divorce lifestyle (which makes a pre-divorce budget important), the disparity in earnings between spouses and the health of the receiving spouse. It's important to note that the disparity of income calculations goes well beyond base salary. Bonuses, incentive compensation and a variety of perquisites may also be considered, as are dividends, interest and passive income.

No. 3 Mistake To Avoid:

Do not be shortsighted.

While the division of physical property and financial assets is an important issue, also consider future tax consequences, child support and tuition, and other future expenses for which you will be liable.

Key Issue: Tax Planning and Divorce

With divorce come significant and complex changes to your income tax filing status and your tax return. It is very important that you discuss these changes with your own tax advisor or accountant. These issues begin with the division of marital property and continue as long as there is any financial relationship.

Transfer of assets from one divorcing spouse to the other does not cause the recognition of gain or loss, if the transfer occurs within one year after the date on which the marriage ceases or is "related to the cessation of the marriage," which requires that the transfer⁴:

- Is pursuant to a divorce or separation instrument, and
- Occurs not more than six years after the date on which the marriage ceases.

A transfer from one divorcing spouse to the other is not subject to federal gift and estate tax if the transfer is:

- Made prior to the divorce, or
- Made pursuant to an agreement that was entered into not more than one year before the divorce was granted or two years after the divorce was granted and the transfer was either:
 - In settlement of the spouse's marital or property rights, or
 - To provide a reasonable allowance for the support of minor children of the marriage.

While the transfers are not taxable, the tax liabilities associated with any assets are a paramount concern. For example, let's say that a spouse receives

full ownership of an art collection in a settlement. The artwork was purchased over the years for \$3 million and is now worth \$10 million. The net value of that collection is \$10 million minus the tax liability on the \$7 million capital gain. The same general rule applies to most other types of assets, with some exemptions for primary residences.

TAXES, ALIMONY AND CHILD SUPPORT

Thanks to a 2017 change in the federal tax laws, alimony payments are not taxable to the recipient and are not tax-deductible for the payor. Child support payments have always been treated in the same manner.

The impact of the change can become a point of contention in a divorce, as it materially impacts the after-tax cost of payments. A variety of other issues pertain to who gets to claim certain tax credits and deductions. These may include:

- Who can file as head of household depending on where children reside
- Who can claim children as dependents (generally, the primary custodial parent)
- Who can file for child care and other work-related tax credits for children under 13
- Who can take deductions for children's medical expenses

⁴ Source: Journal of Accountancy. <https://www.journalofaccountancy.com/issues/2013/apr/20126248.html>. Accessed Jan. 13, 2023.

⁵ Source: Journal of Accountancy. <https://www.journalofaccountancy.com/issues/2013/apr/20126248.html>. Accessed Jan. 13, 2023.

No. 4 Mistake To Avoid:

Do not attempt to hide, devalue or utilize assets prior to your divorce. Attempts to transfer assets may significantly harm your standing in a divorce court and ultimately lead to a less advantageous settlement.⁵

Key Issue: Estate Planning

A thorough review of your estate plan and estate-planning documents should be conducted as an integral part of your pre-divorce planning. As you may not wish to leave or name your spouse as your beneficiary, you will likely need to make changes to your will and change the beneficiaries on accounts that are not community property. You may also wish to revoke powers of attorney and name someone else as your health care proxy. It's important for you and your advisory team to review any trusts that

you and your spouse have established, or that have been established for you. Prior to a petition for divorce being filed, you can change the terms of a revocable trust, revoke a revocable trust and/or create a new revocable trust, though you should be cautious about making changes to your finances in anticipation of filing for divorce. Once a petition for divorce has been filed, however, you generally cannot revoke or change the terms of a revocable trust or fund a new revocable trust before the divorce is finalized unless you receive permission from your spouse. More broadly, this review should include the impact on commingled family assets, as you may not want to leave your spouse assets that are connected to your family.

Moving Forward

When coping with the emotional stresses of divorce, it may be difficult to focus on the important practical considerations of creating separate households and independent financial lives. Make sure you have the proper support and advice needed to achieve a fair division of assets so you do not create long-term difficulties as a result of your short-term concerns. Hire a competent divorce attorney, utilize the services of your Private Wealth Advisor and your accountant, and make sure you understand the full implications of any agreements you make.

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- Simplify your financial situation to help you achieve clarity and control
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