Understanding How Assets Get Divided In Divorce

By Jeff Landers

Dividing the family's property during divorce can be quite difficult, especially if there are significant assets such as houses, rental property, retirement and pension plans, stock options, restricted stock, deferred compensation, brokerage accounts, closely-held businesses, professional practices and licenses, etc. Deciding who should get what can be quite a challenge, even under the most amenable of situations. If your divorce is contentious, then this can be especially complicated.

Assets should not necessarily be divided simply based on their current dollar value. You need to understand which assets will be best for your short and long-term financial security. This is not always easy to discern without a thorough understanding of the asset itself – its liquidity, cost basis and any tax implications associated with its sale.

However, before we go any further, we need to discuss the differences between Separate and Marital Property and why that's critically important to you. In my experience, this is an area that is not well understood by most people.

States differ in some of the details, but generally speaking, Separate Property includes:

- Any property that was owned by either spouse prior to the marriage
- An inheritance received by the husband or wife (either before or after the marriage)
- A gift received by the husband or wife from a third party (your mother gave you her diamond ring)
- Payment received for pain and suffering portion in a personal injury judgment

Warning: Separate property can lose its separate property status if you commingle it with marital property or vice versa. For example, if you re-title your separately owned condo by adding your husband as a co-owner or if you deposit the inheritance from your parents into a joint bank account with him, then that property will most likely now be considered marital property.

All other property that is acquired during the marriage is usually considered marital property regardless of which spouse owns the property or how the property is titled. Most people don't understand this. I've had many clients tell me that they were not entitled to a specific asset, because it was titled in their husband's name – such as his

401K. This is not true! This is worth repeating because it is that important. All property that is acquired during the marriage is usually considered marital property regardless of which spouse owns the property or how that property is titled.

(State laws vary greatly, especially between Community Property & Equitable Distribution States, so please consult with your attorney).

Marital property consists of all income and assets acquired by either spouse during the marriage including, but not limited to: Pension Plans; 401Ks, IRAs and other Retirement Plans; Deferred Compensation; Stock Options; Restricted Stocks and other equity; Bonuses; Commissions; Country Club memberships; Annuities; Life Insurance (especially those with cash values); Brokerage accounts - mutual funds, stocks, bonds, etc; Bank Accounts - Checking, Savings, Christmas Club, CDs, etc; Closely-held businesses; Professional Practices and licenses; Real Estate; Limited Partnerships; Cars, boats, etc; Art, antiques; Tax refunds.

In many states, if your separately owned property increases in value during the marriage, that increase is also considered marital property. However some states will differentiate between active and passive appreciation when deciding if an increase in the value of separate property should be considered marital property.

So what's the difference?

Active appreciation is appreciation that is due, in part, to the direct or indirect contributions or efforts of the other spouse (e.g. your husband helped you grow your business by giving you ideas and advice; he entertained clients with you; he helped raise the kids and did some household chores, which allowed you to work late, entertain clients, travel to conventions; etc.).

Passive appreciation is appreciation that is due to outside forces such as supply and demand and inflation. For example, a parcel of land increases in value even though you and your husband made no improvements to it. However, if you used marital income and/or assets to pay the mortgage and/or taxes on this parcel of land, you might have a very good argument that this property, or at least the increase in value during your marriage, should now be considered marital property. As you can see, this can get quite complicated and convoluted. Hiring a good divorce financial planner can help you sort this out.

It is also very important for you to know if you reside in a Community Property State or an Equitable Distribution State. There are nine Community Property States - Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Community Property states consider both spouses as equal owners of all marital property (a 50-50 split is the rule).

The remaining 41 states are Equitable Distribution states. Settlements in Equitable Distribution States do not need to be equal, but they should be fair and equitable. In

Equitable Distribution, several factors are taken into account, including the financial situation of each spouse when dividing assets.

Some of the factors considered are:

- The length of the marriage
- The income or property brought into the marriage by each spouse
- The standard of living established during the marriage
- The age and physical/emotional health of each spouse
- The income and earning potential of each spouse
- The financial situation of each spouse when the divorce is finalized
- The contribution of a spouse to the education, training or earning power of the other
- The needs of the custodial parent to maintain the lifestyle for the children

In addition to these, a court can consider any other factors that it feels might be relevant. This makes it very difficult, if not impossible, to predict the outcome. The bottom line here is that you want to stay out of court, if possible. There's a good reason why more than 95% of all divorces are ultimately settled out of court.

Also, please remember that debts usually get divided in divorce as well. However, Community Property states treat debt differently than Equitable Distribution states, so please make sure that you consult with an experienced divorce specialist.

Hopefully this basic description of how assets get divided in divorce will help you as you are going through your divorce. But as you can see, this can be an extremely complicated process filled with unseen potholes. Having a competent divorce financial professional on your team can help you get your fair share of the assets that you've worked so hard to accumulate.

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