Investment Styles and How They Play Out In Divorce

Divorce is undoubtedly a harrowing experience emotionally. Splitting up money and investments only adds to the headache. Who wants to actually talk about how to split up the income and assets you've worked so hard to build up, often together as a couple?

With a prenup, you can define your own conditions of separating your individual property without being subject to your states' judicial system. If you don't get a prenup, you may not get as much say as you wanted in what you get out of the divorce because you're bound to state law. You're also creating more back and forth in the divorce process, which only amplifies the mental anguish you're already experiencing.

If you go through a divorce without an existing prenup, you can expect the state to divide your assets with two different methods. First, community property states dictate that property acquired before marriage is separate, and property acquired during the marriage is subject to an even split.

In equitable division states, the separation of money and investments can get a bit more complicated. These states consider other factors like earning capacity to determine the split of assets, which isn't always in line with what each spouse wants. There are several different ways in which money and various investments can play out in divorces without a prenup.

Real Estate

Dividing up real estate can be a bit of a doozy and add more tension to the divorce process. In most cases, if a spouse purchased a home before the marriage, it would be considered their individual property.

The tricky part is when the couple has lived in a home, which is often the case. This circumstance can complicate things as there is a vested, often emotional, interest in the property. Most of the time, the property must be split in an "equitable" way between the two parties, leading to some subjective interpretation. So how do you determine what's fair for a couple living in the same home for a decade?

Perhaps more than any other investment, properties have a particular emotional attachment that usually clouds judgment. Most couples sell the property to avoid fighting about who gets which percentage of which home. In this case, it's crucial to think about getting an accurate appraisal of your home to get a fair value on your sales proceeds. Beyond that, you should have a solid plan on where to live in the short term, too. Call up a friend or relative so you don’t end up in a hotel in the interim.

In cases where both parties want the home, the spouses are subject to a judge's rule. If that judge favors one party in the property split, they may take away other assets to balance the scales in the divorce. This determination can result in unintended consequences for what you get from the divorce, as you may not get what you're expecting. That's why it's always better to resolve property issues amicably, and it helps to get that in writing in the form of a prenup.

If the spouses had a prenup going into a divorce, the spouse who originally bought the property could retain ownership without putting it up for a split. In some cases, this can still happen even without a prenup. As long as the owner has a sole interest in the property, they may end up with full ownership. But why risk it? Getting a prenup can help avoid some dreaded conversations around property division.

Stock Options

If you or your spouse have vested and unvested stock options, you may be wondering how those end up in a divorce. Companies give individuals stock options, so they have the right to purchase a company's stock later at a specific price. This motivates the holder to increase the company's stock price to get a bigger payout at a later date.

If you live in a community property state, your stock options will be treated as separate property depending on the original investment. Spouses that acquired the stock option before the marriage would retain this property. The property would be divided evenly if the spouses invested in a joint account. This decision gets a little murkier in equitable division states where the court considers other factors in splitting up stock options.

As we've seen with booming valuations in Silicon Valley and beyond, your stock options may be one of your most valuable assets while going through a divorce. So taking care of them appropriately only makes sense. In addition, establishing a prenup can go a long way in protecting your valuable stock options, especially in less clear-cut cases.

Retirement Accounts

Divorce can severely impact the long-term success of your retirement accounts. Investment Retirement Accounts(IRA) and 401(k)s are common among married couples and represent a significant portion of their total assets. With 401(k)s and other workplace retirement plans, spouses and their attorneys prepare a Qualified Domestic Relations Order (QDRO), which specifies the division of retirement assets.

While not required by the state, the QDRO process makes the separation of assets more efficient. After the QDRO process, you can select an immediate cash-out of your portion of assets, in which you may face a penalty in the form of a fee. Most spouses choose to transfer their 401(k) account to a separate individual account.

QDROs are tax-free as long as they are correctly reported, and any transfer that isn't classified as QDRO will be subject to taxes and fees. Because of the implications of not reporting correctly, it's vital to delineate which assets belong in which category so the legal team can be more effective.

Instead of a QDRO, IRAs require a "transfer incident to divorce" process. Whether the investment accounts are traditional or Roth, the taxable amounts will differ. With traditional investment accounts, contributions are made pre-tax, and withdrawals are taxed. In contrast, Roth accounts will have made after-tax contributions, so withdrawals are not taxed. Depending on your IRA preferences, these tax regulations can dictate how much you'll gain at different points in time.

In both of these retirement accounts divisions, the court considers different factors to allocate assets, including each spouse's age, employment, and future economic prospects. This view can dilute the divorcing couple's vision for how a separation would play out, as different parties may see the situation differently. With a prenup, retirement accounts can be allocated according to the couples' agreed-upon preferences, avoiding the difficult-to-understand ins and outs of the legal system.

Taxable Investment Accounts

The payout for investment accounts held by both spouses differs depending on the nature of the investment and its tax structure. Therefore, in going through a divorce, you should first contact your institution to let them know how to allocate the assets.

Because these investment accounts are easier to access and move funds than other investments, they should be carefully monitored. If a spouse makes transfers from a brokerage account, some asset transfers may result in financial consequences. Couples splitting up taxable investment accounts can either sell off their investment assets and split the proceeds or allocate the investment holdings. You might be subject to harsh tax rates and penalties if you sell off early.

In cases where spouses transfer investment holdings, courts will usually allow spouses to maintain the same cost basis or the asset's original purchase price. The same applies to the holding period of the spouses' assets.

Ultimately, what each party gets from splitting the investment holdings depends on how the proceeds are taxed. For example, more extensive holding periods of more than a year are taxed at long-term capital gains rates, and your cost basis determines how much your capital gain represents. These factors come together to determine the taxable amount when splitting up assets, so you'll want to stay on top of them when calculating your investment gains.

A prenup can help make this process go a lot smoother. For example, in dividing up brokerage accounts, feelings can get in the way post-separation, impacting how these allocations are made.

Designating Beneficiaries

If you have your spouse as an existing beneficiary in your investment accounts, you may want to take them out. You shouldn't hold off on doing this. By default, divorce does not change the beneficiary of your investment accounts, so you should proactively look at this once the divorce is finalized.

It would help if you prioritized this because your beneficiaries are designated payment in the event of your death, so keeping them up to date is critical. While it's unlikely that something tragic will happen immediately after the divorce, it's better to be safe than sorry in these situations.

Getting Help from Investment Professionals

We get it, this entire process is a lot. There are so many small details, rules, and regulations that can make divorce seem like an incredibly daunting task. And when it comes to splitting money? Forget it.

That's why we highly recommend the advice of trusted experts. In situations where the regulations are a little fuzzy, it can always help to talk to an expert. On one side, a lawyer can help you get familiar with the many implications of court law and its effect on your division of assets.

A financial advisor can help you better understand the impact of taxes and asset allocations to optimize your goals in a divorce. Furthermore, getting expert advice throughout the divorce can help you navigate the whirlwind of divorce, and it can be even more beneficial when drafting up a prenup.

Prenups Make Investment Splitting More Efficient

As we've seen with several investment styles, splitting up money and financial gains can be tricky. Whether you and your spouse contribute to your 401(k) or have stock options, particular nuances are hard to grasp without an excellent legal team. Prenups allow you to make your own rules and honor your relationship without the messy intricacies of state law and the intense process behind divorces.

With regard to investments, prenups can protect you from having to make difficult decisions for splitting them up. For example, if you and your spouse choose to divvy up your assets 50/50, and that's outlined in the prenup, you can avoid the back and forth of deciding how to split up investments. That way, you honor your commitment without letting a stage judge interfere in a way that might end up against your interests.

While we hope it never ends up in divorce, signing a prenup can provide your legal team with a solid foundation to navigate the divorce process successfully. Beyond that, they're an excellent way for both spouses to know how assets will end up ahead of time to prevent bitterness and disagreements later in the divorce process. Finally, prenups are some of the most powerful tools in keeping a marriage balanced while honoring your commitment to how you and your spouse view your financial investments.