

The Top 16 Financial Mistakes *Not to Make* in a Divorce

Making irreversible financial decisions during a divorce can cost not only tens of thousands of dollars, but financial security as well. In talking with other professionals in this business, the same errors are seen over and over again. Here is a list of the biggest financial mistakes:

1. **Not knowing how much it costs you to live each and every month.** Most people know how much income they have each month, but having an accurate idea of where their money goes is really hard for most people. Most people underestimate their expenses by a significant percentage. It's imperative to know these costs, and we can help you identify where the money is going. You need to know your past history of spending, as well as what your spending will look like after you are divorced. This very important piece of your finances can impact alimony awards and more significantly your long-term financial security.

2. **Not understanding that the custodial parent should not always keep the house.** Without a doubt, deciding to keep the house is usually an emotional decision instead of a financial decision. If you keep the house, only to find out in a couple of years that you can't afford it, it will prove to be a poor financial choice. This is closely tied to the first mistake of underestimating or not knowing what it costs you to live.

3. **Believing that a 50/50 division of property is the same thing as a fair division of property.** Each spouse getting the same dollar amount of assets is rarely an equitable settlement. What did you pay for the house, the stocks, or the business? Your original cost plus improvements or investment expenses is your basis, what you have invested in that specific asset. The basis affects the tax impact of the asset if and when you sell it. If a certain asset generates income, the income on this asset can be taxed differently than income or gains on another asset of equal value. The timing of the asset sale or receipt of income will also affect the present value of the transaction (i.e. what is the value in today's dollars). During a settlement, you want to compare apples-to-apples. Without knowing the basis of each asset and the tax impact, an apples-to-apples comparison is not possible, meaning you could end up with less than you thought. In addition, future earning potential of each spouse can be a big factor in equitably splitting your assets. There are other factors that play a role into reaching a fair or equitable settlement. It is our job to assist you and your attorney in understanding those factors and their long-term impact on your financial security. Fifty-Fifty does not mean fair.

4. **Not understanding the link between length of alimony and child support.** An IRS rule says that alimony cannot end or be reduced within 6 months before or after the date at which the child reaches age 18, the age of emancipation in Colorado. If this happens, the entire amount of alimony from the beginning is considered to be child support and may not be deducted from taxable income. This may trigger tax recapture. Understanding the rules is critical to designing an equitable settlement!

5. **Not insuring alimony and/or child support.** Your ability to collect alimony and

child support is only as good as your ex-spouse's ability to pay. If the unexpected happens, there are several methods of insuring alimony and/or child support. We can help you choose an appropriate option that makes sense for your situation while at the same time making sure an investment or insurance salesperson does not take advantage of you.

6. Not understanding the consequences of unsecured debt before and after the divorce. Unsecured debt is normally credit card debt. Debt created during the marriage is normally joint debt, meaning both spouses are responsible for it, no matter who incurred the debt. The credit card companies don't care that your settlement states one spouse is responsible for certain debt. If one of you assumes the debt in a divorce, the credit card company will go after both of you if they don't get paid.

7. Not evaluating the defined benefit pension plan correctly. A defined benefit plan is a pension plan, not a defined contribution plan such as a 401(k). The defined benefit plan normally pays a monthly income at retirement, and is under the control of the employer. On the other hand, the 401(k) is under your control today and eventually you will roll it over to an IRA and take income at some point in the future. Even though a defined benefit plan won't start paying monthly income until the employee retires, that plan does have value today. You need to know this value so you can work toward an equitable settlement.

8. Not understanding the purpose of a Qualified Domestic Relations Order (QDRO) and when it should be completed.

The Qualified Domestic Relations Order (QDRO) is a legal document which, among other things, tells the plan administrator the amount (either percentage or dollar amount) to be given to the non-employee spouse pursuant to the divorce. Some retirement plans do not allow the use of a QDRO or they might have very strict requirements. The legal structure of the retirement plan takes precedence over a court ruling for a divorce settlement. Knowing the proper process to getting a QDRO approved before it is too late is vital. Doing this yourself or using a paralegal can result in unfavorable permanent financial consequences.

9. Believing that spending retirement assets before age 59 1/2 will always result in a 10% IRS penalty. There are specific IRS rules that allow withdraw of certain monies coming from a qualified retirement plan to the non-employee spouse, without incurring the 10% penalty, even if this person is less than 59 1/2 years old. However, you need to understand the rules and follow them exactly. Income taxes are paid, since the withdrawal is income. Get advice from someone knowledgeable about these retirement plan rules. We can help.

10. Not having a financial plan in place for your future after you are divorced. If you are like most people, you didn't have a written comprehensive financial plan to start. In many cases, we have found that misunderstandings about money can put a lot of pressure on a marriage. After the divorce, things can get a lot more complicated, and you are the only one responsible for your financial health. You need a comprehensive financial plan that addresses cash flow, debt, education funding, insurance needs, employee benefits,

retirement planning, investments, and estate planning. A plan will empower you with the knowledge that you are in control. We can help. Financial planning AFTER the Divorce can help you understand how to address key financial issues important to you to help achieve success in your financial life.

11. Deciding financial issues one at a time instead of understanding how they affect each other. By looking at each asset or source of income separately, you miss the interaction of taxes, capital gains, investment losses, timing issues, inflation, and more. A fair settlement begins by looking at a comprehensive picture of your finances and then determining suitable courses of action.

12. Believing that your settlement must conform to what a judge would order if your case did go to court. A judge makes decisions based on their own knowledge of the law, finances, taxes, investments, pension plans, and more. I will tell you that professionals in each one of those areas (law, finances, taxes, investments, pension plans, etc) can spend a lifetime working in just one area. How can a judge, or one attorney for that matter, keep up with all the changes, latest strategies, and details of 5 or 6 bodies of knowledge? The quick answer is they can't. Many times tax issues are overlooked, the details of specific company pension plans go unnoticed, and one or both spouses end up with a settlement that is less than optimal. Getting the appropriate professionals on your team gives you the advantage of knowing that all the issues are addressed and presented properly. Judges and lawyers need education too. A better educated judge can render wiser decisions (this is true of anyone). A financial expert trained in divorce financial analysis can provide such an understanding to facilitate an equitable settlement, whether it takes place in the courtroom or not. Closely related to this Mistake is one in which an individual seeks financial advice from someone whose expertise is the law. We always say, "If you want a heart doctor, go to a heart doctor, not a brain surgeon." They are both intelligent professionals, but each has an expert understanding of their area only. You don't want to make irreparable mistakes by relying on the advice of the wrong expert.

13. Failing to include transaction costs in the settlement when those costs may be years in the future. Surrendering an annuity may cost you 10% or more of its value. Selling illiquid assets such as limited partnerships, businesses, and certain mutual funds, may result in fees of 4 to 10% or more. This is on top of the income taxes and capital gains due on such transactions. Know what the financial impact is of each type of transaction, even if the transaction is expected to occur in the future. On the other hand, if your future ex-spouse tries to convince you they are going to take a large loss when they sell a certain asset, make sure you know the real story so you can compare apples-to-apples.

14. Using unrealistic assumptions about inflation and investment returns. If your future ex-spouse is trying to convince you to settle for a certain investment because "it's going to grow at 30% per year," you might want to get a professional opinion. That great investment may not be so great. Likewise, be realistic about your future living expenses. Not taking inflation into account will grossly underestimate your future needs. You could find yourself in a situation where your quality of life is dropping year-

after-year.

15. Failing to consider creative financial solutions. This ability comes with experience and keeping up with certain industries. A cookie cutter approach, suggested by the other spouse's team may be appropriate, but may their suggestion may also overlook some of the latest strategies and ideas in the industry. For example, using a large 'full-service' brokerage firm may be recommended to when splitting and transferring accounts to you. However, knowing that their fees are normally higher than using a discount brokerage firm may cost you a significant amount of wealth during your lifetime. This is known as terminal value. What is the long-term financial impact by having higher fees each and every year? It's more than you realize.

16. Failing to ask, "How do I know that I will be financially secure after my divorce?" before signing the divorce papers. If you look only at the immediate task of splitting assets and obtaining alimony and/or child support, without understanding how it looks 5, 10, or 20 years down the road, you are doing yourself a great disservice. Planning for the future is the key. By addressing all the Financial Mistakes discussed on this page, and analyzing the long-term financial impact of various settlements, you will get an excellent understanding of the shortfalls of certain proposed settlements and the fairness of others. You need to focus not only on your immediate and short-term needs, but your long-term financial security. Remember, once the papers are signed, the settlement is done!