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Top 10 Critical Financial Errors in Divorce

Compiled by Justin A. Reckers, CFP®, CDFA™, AIF

Certified Divorce Financial Analyst™ professionals highlight some critical financial mistakes made by divorce-industry pros.

The Institute for Divorce Financial Analysts™ (IDFA) recently asked members across the country to share the worst financial mistakes they've seen in their practices. After receiving more than 80 replies, here are the top ten:

1 Terminating Spousal Support when a Child Reaches the Age of Majority

With the assistance of their attorneys, a divorcing couple crafted a Property Settlement Agreement that included both an agreed-upon division of property and a ten-year, defined-duration spousal support award for the wife. Spousal support was set to terminate in the same month the couple's youngest child graduated from high school and turned 18, the local age of majority. IRC section 71 (C) (2) sets forth two child-related contingency situations in which spousal support will be re-characterized as child support:

a. If spousal support payments are reduced or terminated within 6 months before or after the date a child attains the age of majority, or
b. When payments are reduced within a year before or after two individual children of the payor attain a certain age between 18 and 24, if payments are reduced upon each child turning the same age.

In this case, had support payments ceased as scheduled, the payments would have been presumed to be associated with a child-related contingency and the IRS could have re-characterized spousal support payments as child support for the entire ten-year period. It would have cost the husband approximately $1,000,000 in additional taxes and very likely resulted in a malpractice suit for the attorney.

~ Gigi Robson CPA, CDFA™ practices in Richmond, VA.

2 Using Inaccurate, Misleading, or Incomplete Financial Information

For the preliminary hearings, many state courts appoint special masters to set the groundwork for the eventual settlement. If they are using inaccurate, misleading, or incomplete information derived from hastily prepared financial affidavits, they will most likely set a base line for settlement that will need to be substantially changed later. It is more difficult to completely restructure the settlement after their findings than to work within the scope of their plan. Although the financial affidavits will likely undergo several permutations, it is best to deal with the more obvious inaccuracies sooner rather than later. Such inaccuracies can include expenses that both parties claim or that may be exaggerated, income not reported, or deductions taken that should not be allowed. Time spent early in the process will usually mean great time-savings later on.

~ Alan Abrahamson, MBA, CFDA™ practices in CT, MA, NY, RI.

3 Forgetting about the Spousal Survivor Benefit

I have seen cases where both husband and wife were retired and receiving pensions pre-divorce and wanted to keep it that way post-divorce. No big deal, right? No QDROs needed. That might be true, but what about the spousal survivor benefit? Can the election be undone? Certainly the husband and wife may want to stop paying the premium on that election. And if either took a joint and survivor option at in retirement, can they now "pop-up" to a single life annuity option post-divorce? Both attorneys and clients sometimes overlook these considerations.

~ Donna Smalldon, MBA, CFP®, CDFA™, Mediator practices in OR, WA, and CA.

4 Failing to Follow Up

Typically, when a family law attorney receives a stamped Judgment of Dissolution, their job is done. Clients also think they're done – but there are many issues that could be avoided down the road if lawyers followed-up with clients to ensure they complete certain tasks to adequately wrap up their divorce. As a family law attorney, here are some of the most common issues I've seen:

a. Not closing and taking spouse's name off bank accounts, credit cards, and investment accounts, or changing the beneficiary for insurance policies/retirement accounts.
b. Not ensuring the QDRO is complet-

ed; the payee may die before it's completed.
c. Not amending their estate plan post-divorce.
d. Failure to address who is responsible for the Federal and State income taxes for the year the divorce is finalized, if filing jointly.
e. Failure to develop a post-divorce financial plan.

~ Puja A. Sachdev, Esq., MSBA, CDFA™ practices family law in San Diego, CA.

5 Ignoring Tax Status during Property Division

Most lawyers ignore the tax status of an account when working toward an equitable division of property. Many think only about getting the columns to add up for the husband and wife: they don't go a step further to determine how those assets will be affected by taxes if the spouse needs to sell the assets to survive. You need to understand the client's future cash needs and determine which assets are best for him or her before finalizing property division.

~ Sam L. Thornal, CFP®, CDFA™, ChFC®, CRPC® practices in Addison, TX.

6 Overlooking Pension Plan Assets

I had a client whose husband had always handled the couple's finances. I asked her to send me everything she could find regarding their assets; buried deep in the 80 faxed pages was her husband's pension statement. His pension had two parts: a monthly income stream and a supplemental benefit that had a present value of $30,000. The $30,000 was included in the husband's disclosure document, but he made no mention of the monthly pension income. I valued that income at around $390,000 and included it in the asset division report to my client and her attorney. However, when I reviewed the settlement agreement her attorney had drafted, the pension was omitted – a $390,000 mistake.

~ Irene Smith CFP®, CPA, CDFA™ practices in Woodland Hills, CA.

7 Assigning Dependency Exemptions without Considering the Tax Implications

I have seen the dependency exemption for the children assigned to a wage earner whose AGI is so high that they cannot use the Child Tax Credit, American Opportunity Credit, the Adjustment for Student Loan Interest, or even the $3,700 deduction amount due to AMT considerations. Meanwhile, the other spouse could have taken advantage of the deductions/credits – and even could have gotten some of the refundable parts without a tax liability. At $80,000 AGI for singles and heads of households the American Opportunity Tax Credit begins to diminish and at $90,000 it goes away completely. If an individual is consistently in AMT territory, the dependency exemption does not help them – these are disallowed under the AMTI calculation. The Child Tax Credit reduces at $70,000 and is completely gone at $95,000 for single and head of household. Bottom line: make sure exemptions are assigned to the ex-spouse who can benefit from them.

~ Beth Pickenpaugh, CFP®, ASA, CDFA™, MS practices in Columbus, OH.

8 Failing to Advise Clients to Refinance the Mortgage Before the Divorce is Final

Let's say that John and Jane have agreed that John will keep the family home post-divorce, giving Jane other assets to make up for her share of the current equity. You can do quitclaims to change the titling of the home, but unless John refinances the original joint mortgage, Jane is still financially responsible for the mortgage. If John stops making mortgage payments, it will affect Jane's credit report as though she had missed the payments herself. The only way to ensure this doesn't happen is for John to refinance that mortgage before the divorce is final.

~ Nancy Hofman Hetrick, AWMA®, CDFA™ practices in Phoenix, AZ.

9 The Perils of Jointly-Owned Business

I had a case in which a married couple, with no succession plan and no buy-sell agreement, jointly owned a business. Post-divorce, they agreed to continue to co-own the business. Unfortunately, after the divorce, the wife died and the husband became owner of everything. With the value of the business well in excess of $30 million, estate taxes were triggered with no way to pay them. With an accurate value on the business, it might have been possible to find a buyer before a triggering event occurred, or to have set up insurance to fund a buy-sell agreement.

~ Michael Kothakota, AFC, CDFA™ practices in Apex, NC.

10 Failing to Get the Insurance Before Signing the Settlement

The insured should go through the underwriting process prior to signing the settlement agreement. If coverage will not be available due to health issues, or if the premiums are prohibitively expensive, other provisions should be included in the settlement to protect against pre-mature death, such as the creation of trusts or other estate-planning tools.

~ Noah B. Rosenfarb, CPA/ABV/PFS, CDFA™ practices in Short Hills, NJ.

Some of the submissions in this article have been edited for length; to read the full submission – and dozens of others – go to www.familylawyermagazine.com/top-ten-financial-mistakes-in-divorce.

This Top Ten list was selected by Justin A. Reckers, CFP®, CDFA™, AIF. The Chair of IDFA's Communication Committee, Justin practices in San Diego, CA. To learn more about how a CDFA™ can help you and your client address the financial issues of divorce, go to www.InstituteDFA.com/Lawyer.