Top Ten Financial Mistakes Made in Divorce

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Divorce in our society is an every day event. At least one-half of everyone who gets married gets divorced. The statistics increase even more for second and third marriages. Yet, although a common occurrence, a divorce can be as traumatic as the death of a loved one. Divorce is full of emotion, pain and sorrow. It is for that very reason that it is essential that a person facing a divorce must be represented by an attorney who understands the emotions and pain of a divorce. Many decisions in a divorce are based upon emotion. Those emotional decisions can lead to financial mistakes that may significantly impact a person in the future. This article will outline what we believe to be the top 10 financial mistakes people make in a divorce and, hopefully, help people in avoiding these mistakes.

1

The first mistake is, "I'll take the house, you keep your pension." This is the most common mistake. Many people are emotionally attached to their home and cannot think of living in another house. Generally, the house comes with a cost… high mortgage, insurance, taxes, maintenance and repair bills. These additional expenses can devastate a person's finances. Although the value of the house might be equal to the value of the pension, they are apples and oranges. The house requires income to pay for repairs, maintenance, improvements, taxes and assessments. On the other hand, a pension produces income and does not cost anything. A 50/50 division of assets appears to be equal but it may never be equitable. You cannot sell a door or a window to put food on your table. Remember, it is not how much we have that counts, it is what we can do with what we have that matters most.

2

The second financial mistake involves Qualified Domestic Relations Orders (QDRO). The QDRO is one of the most treacherous areas of divorce law. Many attorneys that practice family law do not fully understand how to divide a pension, and the various ways to do so, through a QDRO. The house and the retirement plans are likely to be the largest assets in your marriage. Did you know that you could elect to commence your former spouse's pension even if they have not yet retired? The ages of each spouse are an important factor in this regard. You need to know the earliest possible retirement age and why you should mark that date on your calendar as the date you must absolutely commence your pension. You also need to find out how often the plan is valued by the administration firm and when the company's contributions are made to make sure you get your full share.

Another missed opportunity is forfeitures. When an employee leaves a company and is not fully vested in their plan, the non-vested portion is shared equally with the remaining participants in the plan. When the forfeitures are added to the plan is an important factor. Lastly, even though your QDRO may clearly spell-out that you are to receive 50% of the accrued benefit as of the date of the divorce, unless you are an actuary, 50% may be different than what you believe it to be.

3

The third mistake is failure to understand taxable options on division of your retirement plan. One of the pluses afforded to divorcing couples is that the tax laws are actually favorable. Under §10441 of the Code, virtually all transfers of assets between spouses are tax free if properly structured. In addition, a premature distribution from a qualified plan prior to age 59 ½ can be facilitated without the traditional 10% federal penalty, and the 3.3% state penalty. This is a very powerful tool when used to reduce expenses or to pay off debts, i.e. attorney's fees, credit cards and other consumer debt.

4

The fourth financial mistake made in a divorce involves health insurance coverage under the Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA). COBRA covers you as a former spouse for 36 months after the date of divorce, but who is going to be paying the premiums? If your former spouse pays the premiums, you may be required to report those as income on your tax return. In today's health care market place, health insurance costs can easily exceed that of a monthly mortgage payment. Also, you must consider what would happen if you became uninsurable during the 36-month period. One of the number one causes of bankruptcy is excessive health expenses generally incurred because of the lack of insurance coverage. There are options, such as the Health Insurance Risk Sharing Plan (HIRSP) offered through the state, but you can never have a break in coverage. The solution is that you should seek individual coverage as soon as possible. In fact, you should be looking for coverage during the divorce process so that you can take the cost into account, especially if your case involves maintenance.

5

The fifth mistake is the failure to understand tax consequences of the various assets. Your house, stocks and bonds, annuities, mutual funds and retirement plans all have different tax consequences. If you do not understand the tax basis and how that affects your settlement with each of these assets, you will be in for a big surprise when you sell them. Furthermore, with today's financial marketplace, some investors have racked up huge losses in their investment portfolios as well as possible carry-forward losses from previous year's tax returns. A stock that originally cost $50,000, but is worthless today has approximately $12,500 in future tax savings potential.

6

The sixth financial mistake is not planning for the tax consequences of maintenance. Many people fail to consider their tax liabilities from receiving maintenance. Usually, it is not until the end of the first year of the divorce, when the maintenance recipient prepares his or her tax returns, do recipients of maintenance realize that they owe thousands of dollars in income taxes and underpayment penalties for which they fail to allow for in their budget. You, as the person receiving maintenance, are obligated to make these payments. The sooner the tax consequences of maintenance are considered and dealt with, the less chance of surprise. Also, maintenance received is treated like a wage for purposes of IRA contributions. Former spouses receiving maintenance are eligible to contribute $3,000 ($3,500 if over 50 years old) to a tax deductible IRA account or Roth IRA even if they are not employed.

7

The seventh financial mistake often seen in divorces is not planning for the premature death of a former spouse. It frequently happens that a person, receiving maintenance for a certain number of years under a Marital Settlement Agreement, is faced with the premature death of the payee before the expiration of the maintenance obligation. Of course, if there are children at home, social security benefits may apply. However, maintenance under the tax laws must cease. If you are going to be dependent on your former spouse paying maintenance for any extended period of time, it would be in your best interest to ensure that income stream. By planning in advance, you could negotiate during your divorce for your spouse to pay for the coverage or a portion of it. Please remember that, if the former spouse pays for a portion or all of the premiums, you may be required to report those as income on your tax return, as well.

8

The eighth mistake is failure to organize personal financial affairs immediately after the divorce. It is imperative to review all of your financial matters such as the named beneficiaries on your life insurance policies, 401(k) plans, annuities, etc. If children are involved, it is possible that your premature death could result in your former spouse gaining control of your assets in trust that are left for the benefit of your minor children. Most divorced couples would find that inconceivable. A thorough review of your estate plan and a simple testamentary trust can be established so that you may name a person of your choice to handle the finances left behind for the benefit of your children. In that manner, the custodian spouse must then go to your named trustee for funds, and you are assured that your children's inheritance is handled by a person you trust. This planning can occur even during the divorce to avoid the same scenario occurring if the unforeseen happens before your divorce ends. An experienced and well qualified divorce attorney should discuss estate planning options at your very first meeting.

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The ninth financial mistake is failing to recognize marital assets from non-marital assets. Assets brought to a marriage, as well as assets acquired during the marriage are considered marital property in Wisconsin. That does not automatically mean that all assets are divided equally between the partners. Assets that are gifts or inherited are not considered marital property. However, the characterization of those assets may very well turn unintended non-marital assets into divisible marital assets. In addition, if you have brought a substantial amount of assets to the marriage, depending upon the circumstances, including the value, whether or not they are still in existence at the time of the divorce, the length of your marriage, etc., could be considered by the court to allow you to receive an unequal share of property. You need to know the difference between marital and non-marital assets and how they are counted for in a divorce.

10

Finally, one of the biggest mistakes is failing to hire a knowledgeable divorce attorney and consulting with other professionals during your divorce. An experienced divorce attorney may not understand all of the tax issues but understands them enough to know when to bring in other professionals such an accountant, financial advisor, etc. These professionals can show a client the short and long-term results of the various options and proposals made throughout the divorce case. This will educate you, the client, and allow you to make much better-informed financial decisions now and into the future. Often times, people going through a divorce can only think a day or two ahead of them which is why it is even more important to have professionals on your behalf looking out for your financial future.

If you, a family member or a friend have questions about divorce or would like to make an appointment with a qualified and experienced divorce attorney, please contact our firm toll free at (866) 455-2993.

About the author
Attorney Mark L. Krueger

Wisconsin based Attorney Mark Krueger has over 23 years experience as a trial attorney.

Attorney Krueger is an active member of the American Association for Justice, Wisconsin Association for Justice, State Bar of Wisconsin, State Bar of New York and the Sauk, Juneau and Dane County Bar Associations.

Mark is licensed to practice law in Wisconsin and New York, as well as the Eastern and Western District Federal Courts of Wisconsin, the Seventh Circuit Court of Appeals, and the highest court in the country, the United States Supreme Court.

Mark is also licensed to appear in the United States Court of Claims where he represents individuals and families injured as a result of receiving vaccinations, both as children and adults.

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