

Common Financial Mistakes to Avoid when Going Through a Divorce

1. **Not communicating with your spouse.** One of the biggest and most expensive problems that CDFAs have to deal with is finding all the information. Many times, spouses will hide documents, transfer assets, not disclose information, etc. Then, time and money is spent on attorneys having to subpoena documents and perhaps even schedule depositions. This can result in you spending more money on discovery than the asset was worth in the first place. It can also contribute to an atmosphere that is not healthy for the children and can divide the family even more. Transparency and full disclosure can make the process go much more quickly, inexpensively and with dignity.
2. **Not understanding the 72(t)(2)C section of the tax code.** IRS rules say that monies coming out of a qualified retirement plan pursuant to a divorce settlement can avoid the 10% penalty. Income tax still needs to be paid.
3. **Qualified Domestic Relations Orders.** QDROs are orders from the court that, among other things, tells the plan administrator how the division of the pension should be done. Some of the critical issues that may arise include:
 - a. If the participant dies before the QDRO has been written and accepted by the pension administrator, the alternate payee may have lost his/her pension rights.
 - b. Will it be separate interest or shared payment? In other words, will the duration of benefit payments be based on the alternative payee's life expectancy or the participant's life expectancy? If separate interest, and the alternate payee has a longer life expectancy, then his/her payments will likely be less per month than the participant's payments. Also, with separate interest, the alternative payee may elect to begin payments at the participant's earliest retirement date, even if the participant has decided not to retire. In a shared payment approach, the alternate payee simply shares in the participant's benefits when they go into pay status.
 - c. What happens if the participant dies before retirement or during retirement? It is almost always necessary to have both a pre-retirement survivor annuity, and on a shared payment approach, to always have a joint survivor annuity. Otherwise, the alternative payee may be without a pension.
 - d. How do you determine the marital portion of the pension? In most cases, true coverture is the only way to ensure that the two halves of the marital portion are the same when eventually paid. However, be aware that coverture does not work on some union plans (partial year credits), military plans (point system) and career average plans.

4. **Recapture of Alimony.** To prevent a property settlement from being disguised as alimony and thus being deducted as alimony, the Internal Revenue has rules that prevent excess front loading of alimony payments. If alimony payments decrease in excess of \$15,000 during any year during the first three calendar years, the excess is subject to tax and is not deductible by the payor. There are exceptions such as death of the spouse and payments fluctuating for reasons not in the control of the payor.
5. **Not understanding the link between child support and maintenance - the Six Month Rule.** Care must be taken to ensure that alimony payments are not designed to be reduced with occurrences related to the children, or they may be considered child support for tax purposes, thus losing the deduction. If alimony payments are to be reduced less than six months before or after a child reaches 18, 21, or the age of majority in the state, these can be considered child support.
6. **Not insuring maintenance.** Since maintenance usually stops upon the death of the payor, the stream of payments can be covered by life insurance on the life of the payor if there is not other adequate source of security for the future income stream. The payee should own the life insurance policy and make the premium payments which prevents any changes in the policy without the payee's knowledge.
7. **Not considering the basis in property.** Those who have owned a house for a long time may face capital gains tax if the house has increased in value more than \$250,000. Long term marriages, where one spouse keeps the house may be in for a huge tax shock when they try to sell the house and did not know they would be subject to capital gains.
8. **Property Settlements.** If a property settlement is to be paid out over time, avoid mentioning an interest rate, as this could result in a tax charge on the interest income.
9. **Carry Forwards on Tax Returns.** With all the losses that were experienced in the stock market at the beginning of the decade, many couples will be carrying forward capital losses. These are divisible assets. However, Net Operating Losses are not normally divisible and must stay with the company that incurred the losses.
10. **Double Dipping.** If one spouse has a closely held business or practice, the temptation is to swap the house for the business. However, if maintenance payments are based on the income that is generated from the business, then dividing the asset that generates the income is considered by many to be unfair.
11. **Government Pensions.** Valuing government pensions can be tricky because some government employees will receive no or a reduced social security pension because they have not paid the full amount into FICA. Since social security is not a divisible asset, government pension valuations need to take into account the value of what would be the social security benefits that the employee will not be receiving.