Costly Divorce Settlement Financial Mistakes

Many divorcing spouses are financially unaware & will be financially ruined because of it. Sometimes it is due to accepting an unfair settlement only to find out a few years later they're experiencing serious financial difficulties. Other times it is because they never handled the family finances so it is completely new for them. Below, are most common financial mistakes made during a divorce.

Mistake #1: Not Understanding the Retirement Accounts

Retirement accounts deal with tax-related issues, but some of them can be very complex. During a divorce, you are able to take a distribution from certain retirements during a transfer and avoid a 10% penalty if done correctly. Depending on the type of retirement plan, you may need a Qualified Domestic Relations Order (QDRO) to complete this transfer. You will have a mandatory 20% tax withholding from the asset. Most divorcees take a distribution AFTER they have transferred the account costing 10% of the asset. If you need money to live on, or pay bills, make sure you take them out prior to transferring them to avoid the 10% penalty.

Mistake #2: Not Knowing the Liquidity of Assets

Liquidity refers to your ability to turn an asset into cash. In most divorce settlements, one spouse will receive mostly illiquid assets, such as the home, while the other party receives liquid assets such as retirement plans or bank accounts. The potential problem with this type of settlement has to do with cash flow. How will you pay the bills if your largest asset is the house?

If you will end up with very little liquid assets as a result of a proposed financial settlement, you may end up selling the home and using the proceeds to pay living expenses.

Mistake #3: Failing to Consider the Impact of Taxes

The effect of your settlement on various taxes can be very costly if not addressed thoroughly. Words like “capital gains, income tax, and alimony” may have a big impact on your tax payment. **Capital gains** are of particular importance and refer to the fair market value of an asset minus its cost. For example, if you paid $5 for a share of stock and it is now worth $25, you have a capital gain of $20. This applies to other assets such as real estate (including your home), mutual fund accounts and just about any investment that has appreciated in value. Be very careful that the property you're receiving in a settlement does not have large capital gains as compared with your spouse's property. Don't be fooled if your spouse offers you property of equal value but conveniently forgets to inform you of the tax liability. Be sure to consult a tax specialist before agreeing to any settlement proposal.

Mistake #4: Failing to Budget

One of the most common mistakes is the failure to budget based on your new income. This happens most often when one spouse keeps the home for the sake of the children & does not have liquid assets. Because of the value of the home, there are few other assets awarded in the settlement. The expense of maintaining the home often results in a depletion of cash they received and eventually leaving no choice but to sell the home.

This scenario may be avoided if you take a close look at your expenses. This needs to be done prior to agreeing to the divorce settlement. A Certified Divorce Financial Analyst (CFDA) can help you if you have enough income to support your current lifestyle now and in the future. This type of analysis should be completed prior to a settlement. If it is determined that you will be unable to maintain your lifestyle with the proposed offer, you have a reason to request more spousal support, child support or a greater share of the marital assets.

Mistake #5: Overlooking Credit Rating & Debt Issues

There are several steps during the divorce process you can do to minimize the chances of your credit being ruined.

- When the divorce begins, obtain a copy of your current credit report. This will identify all your joint accounts, any accounts you may not have been aware of, and any potential credit issues.
- Be sure to pay off and close all joint accounts (if able) prior to the final divorce settlement. You will want to open new accounts solely in your name. Unfortunately, creditors don't care how an agreement divides responsibility for joint debt. They only care about who is liable for the full amount of debt until the balance is paid If you will be applying for a mortgage shortly after the divorce begins, be sure to talk to your CDFA about potential pitfalls of the closed credit.

Mistake #6: Not Owning The Life Insurance Policies

Many divorce judgments require the party paying support to obtain a life insurance policy to insure the value of spousal support payments, child support, or property settlement obligation. If you are the spouse who is receiving the support or payments for the obligation, it is extremely important for you to be the owner if not, your ex-spouse could easily stop making payments on the policy, and you would never know until they passed away. As the owner, you would be notified of any as non-payment of the premium or cancellations and could take action to prevent the policy from lapsing or being cancelled.

.Mistake #7: Failing to Identify Hidden Assets

Once a divorce is begins, many spouses will do whatever they can to preserve what they feel is theirs. Some spouses maintain secret accounts, create fake debt or engage in other unethical financial activities. If these assets are not uncovered, the other spouse is certain to obtain an unfair settlement. There are many places to locate hidden assets:

- **Tax returns (Especially corporate returns)**
- **Checking account statements and cancelled checks**

- **Savings accounts**.
- **Brokerage statements.**
- **Expense accounts. Children's bank accounts**.

  This is not a complete list. If you suspect that your spouse has hidden assets, you owe it to yourself to seek help from a financial professional to dig into your financial documents. You should also contact an experienced family law attorney that can ensure that your legal rights are fully protected.

Mistake #8: Failing to Follow Up

Most clients think they are done as soon as they receive the stamped judgment but they're not. Many issues that could be avoided down the road if attorneys followed-up with their clients to ensure they completed what they needed to wrap up their divorce.

Some examples are:

1. Not closing and taking spouse's name off joint bank accounts, credit cards, and investment accounts

2. Not Changing the beneficiary for life insurance policies, retirement accounts or pensions.

3. Not ensuring the QDRO is completed; the payee may die before it's completed.

4. Not amending their financial or estate plan post-divorce.
5. Failure to address who is responsible for the Federal and State income taxes if filing jointly for the year the divorce is finalized