10 CRITICAL FINANCIAL MISTAKES IN DIVORCE

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Divorce is one of the most difficult transitions you will experience. In addition to emotional pain, you may also be carrying a heavy burden of financial concerns. Avoiding the following can help you take control of your future and pave a path to financial independence.

1. NOT CREATING AN ACCURATE BUDGET

Many people going through divorce underestimate or forget to include expenses when they create their initial budget. Later, during the divorce process or post-settlement, they realize they may be unable to pay their bills.

SOLUTION: Ask a financial analyst specially trained in divorce to create an accurate and complete budget that will support your case throughout the entire divorce process.

2. DISREGARDING THE IMPACT OF TAXES ON ASSETS IN A DIVORCE SETTLEMENT

To accurately calculate the bottom-line amount of your settlement, you must take into account the share that the government (IRS) will take from the settlement for taxes. A 50/50 equitable distribution that seems fair initially may produce unexpected tax consequences that will diminish the after-tax value to you.

SOLUTION: Enlist the aid of a financial professional to determine the after-tax value of assets ou will receive, comparedre to your spouse, before accepting a settlement.

3. NOT DETERMINING THE CONSEQUENCES OF YOUR NEXT TAX FILING

Following are some of the changes you may experience on your tax return as a result of your divorce:

- Your filing status will change from "Married Joint" to "Head of Household" (if you have at least one child living with you) or to "Single."
- The number of personal deductions you can claim will be reduced by at least one: your ex-spouse. However, it could be more if you agree to split deductions for dependents.
- Your income may put you in a lower bracket, with a different tax rate.
- Your itemized deductions—such as state income taxes, real estate taxes, mortgage interest, charitable contributions, and non-reimbursed employee business expenses—may differ from previous years, affecting your return's bottom line.
- If you receive alimony, it is treated as taxable income, and you will be required to pay quarterly estimated taxes on it.
- You may still owe Alternate Minimum Tax despite your change in income and deductions.

SOLUTION: Consult a financial professional or tax advisor specially trained in divorce issues to determine the impact of these changes before accepting a settlement.

4. BRINGING EMOTIONAL ATTACHMENTS TO ASSETS INTO DIVORCE NEGOTIATIONS

Your marital residence, retirement plan, and other assets purchased during your marriage can often bring emotionally-charged discussion into the divorce negotiations. Many people can't afford their marital home post-divorce. Your house is an asset that provides a low return on investment, yet it often requires major cash outlays for mortgage payments, taxes, home repairs, and other expenses. In examining assets, people often place too low of a priority on retirement planning.

SOLUTION: Focus on taking a practical, rather than emotional, view of your marital assets. Fully account for post-divorce expenses and long-term goals to determine the assets you want to keep and those you can part with before agreeing to separation of assets.

5. DISREGARDING THE LONG-TERM IMPACT OF INFLATION

The effects of inflation on your finances can be dramatic. Many people don't anticipate how much inflation will affect the cost of a child's college education and the amount of income needed for retirement.

SOLUTION: Use the Rule of 72 as a simple way to judge the impact of inflation. If the inflation rate is 3%, the Rule of 72 states that prices will double in 24 years (72/3=24). College costs at 5% inflation will double in 14.5 years (72/5=14.5). Make sure a settlement that looks good today will support your needs in the future.

6. FORGETTING TO UPDATE ESTATE DOCUMENTS

After divorce, many people forget to change the beneficiaries on their IRAs, wills, life insurance policies, and qualified pension plans. If you die before these changes are made, your ex-spouse will end up inheriting your estate, which you may have wanted to leave to your children, a new partner/spouse, or charity.

SOLUTION: Review your documents with a financial professional and an attorney so you can initiate needed changes immediately after the divorce.

7. FAILING TO ADEQUATELY INSURE THE DIVORCE SETTLEMENT

The premature death or disability of your ex-spouse can result in loss of money for maintenance, child support, college tuition, or property settlement.

SOLUTION: Purchase life and disability insurance on your ex-spouse to guarantee your payments and your family's security.

8. NOT DEVELOPING A POST-DIVORCE FINANCIAL PLAN

One often-overlooked divorce fact is that is often overlooked is that two households cost more to operate than one, yet the income post-divorce remains the same. Many people forget that their divorce settlement must last a significant amount of time, perhaps even for the rest of their lives.

SOLUTION: Seeek assistance in transitioning from the married lifestyle to the single lifestyle. A financial planner will help you prioritize financial goals and set realistic expectations, in addition to producing a written plan for allocation of financial resources.

9. NOT USING IRS CODE SECTION 72T(2)C TO GET DISTRIBUTIONS FROM QUALIFIED PLANS

During divorce, couples may face serious cash flow issues because they have a second household to support. Often, a cash infusion is needed to purchase, set up, or carry the second residence.

SOLUTION: Consider tapping into your retirement savings. Section 72t(2)c allows the alternate payee (the spouse who is not the employee) to take distributions from a qualified plan (not an IRA) without paying the 10% early distribution penalty even if he or she is younger than 59½. The distribution is still subject to income tax.

10. NOT WRITING OFF THE COST OF YOUR DIVORCE

The portion of your divorce cost that relates to tax and financial advice may be deductible on Schedule A of Form 1040. This can result in a much-needed tax deduction.

SOLUTION: Obtain a statement from your attorney or mediator delineating the total cost of legal services and the amount attributable to tax and financial advice. Normally, the deductible portion of your divorce ranges from 1/3 to 1/2 of the total cost. To claim these expenses, you must file a Schedule A (Itemized Deductions), with your deductible divorce fees categorized as miscellaneous expenses. You can deduct miscellaneous expenses that are greater than 2% of your income.

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