

Top Financial Blunders in Divorce Arise From Failure to Plan Ahead

When it comes to divorce, an old adage goes, the person with the highest-priced lawyer wins.

But a new breed of professional financial adviser -- a certified divorce planner -- is aiming to level the playing ground. As with everything else in divorce, however, it'll cost you.

Before you roll your eyes at yet another addition to the alphabet soup of financial-planning acronyms, consider that the Institute of Certified Divorce Planners provides continuing education services for the National Association of State Boards of Accountancy in Nashville. The role of a CDP is to determine how much money the client will need post-divorce, and create financial projections on how best to split up existing and future assets. CDPs take into consideration a couple's savings, real-estate holdings, tax-deferred retirement accounts, pensions and after-tax investments, as well as costs that will need to be considered after the divorce, such as alimony, child support and living expenses.

Typically, high-net-worth individuals will consult with a CDP at their attorney's suggestion. Like a divorce attorney, it's best for both spouses to hire their own CDPs to avoid conflict of interest. But you don't need to be rich to benefit from having an expert in matrimonial law create a long-term financial plan. In most cases, even if you've already signed a pre-nuptial or post-nuptial agreement, it's a good idea to have a CDP and your attorney revisit the contract in case life events, such as children or an inheritance, or changes in state divorce laws, have occurred over the course of your marriage. (For more on post-nuptial agreements, [see my July 25 column.](#))

In truth, there's no more crucial time to have a firm grasp on the state of your marital finances than before you head into divorce. Decisions on who gets what, made in an environment infused with emotion and rancor, can have financially devastating consequences.

Sadly, some of the biggest financial blunders are the most common, according to Fadi Baradihi, president and chief executive officer of the [Institute for Certified Divorce Planners](#) in Southfield, Mich. I sat with Fadi to discuss this interesting twist on traditional financial planning, and delve into what he considers the greatest mistakes spouses often make with their settlements.



Fadi Baradihi, CDP

Q: *I'd wager relatively few divorcing couples have even heard of a certified divorce planner, let alone consulted one. What's the designation mean, and how are your services different from your garden-variety certified financial planner?*

Mr. Baradihi: Most often, I'll make my first contact with a client through the divorce attorney, who calls me and says 'I have a client I'd like you to get together with.' Attorneys are skilled in family law, but most aren't financial experts and many often need assistance in determining what kind of settlement is fair.

The financial issues inherent to every divorce case are often times the ones that are the most overlooked. However, once a divorce settlement has been signed, it's too late to change it. For most of my clients, this is the first time they've ever been asked to map out their financial lives, and it can be an emotional experience. It's not uncommon for a therapist to join the consultation with myself and an attorney.

A CDP can answer questions such as: Who should keep the house? How much will it cost to live post divorce? How much alimony should be granted and for how long? How can the retirement accounts be split and accessed? How can a business be offset? And most important of all, will the clients be able to survive financially with the settlement post divorce?

Different than other "generalist" financial-planning designations, any one of the 800 CDP designees who have been through our training, use the same approach to helping and working with clients, and use our proprietary divorce-planning software to project the long-term ramifications of a divorce settlement on their client's future financial health. Depending on the region, CDPs charge anywhere from \$100 to \$200 an hour, and you can expect on average 10 to 15 hours will be spent per divorce case -- though that figure can be much higher for more complex marital settlements.

Q: *Ok, let's cut to the chase. The two biggest blunders you've seen divorcing couples make both involve residential real estate. What are they?*

Mr. Baradihi: Most often, the husband wants the retirement plan and the wife wants the house. The wife usually wants the house for the sake of continuity. For example, when there are children involved, a wife will often argue for custody of the children and the house, so that the children's lives will not be further disrupted by a move. But what many spouses fail to consider is whether they will be able to still afford to live in that house

after the marriage is dissolved. Say you have a wife, who perhaps interrupted her education or career to have children. After the divorce, this woman may have to return to school, or start at a lower rung on the corporate ladder than she would be at had she continued working. Because real-estate is very often the biggest portion of a couple's net worth, the spouse with the lesser-paying job will often argue the hardest to keep it -- but in reality it's an illiquid asset that carries a very hefty price tag to maintain. In many instances, it makes the most sense to sell the home and split the proceeds, though that adds in the coping with the emotions of giving up the house. Logic aside, however, the choice to keep the home and give up other assets usually is driven by emotion.

Q: *Besides the upkeep on maintenance and taxes, what other costs need to be taken into account when dealing with whether or not to keep the home?*

Mr. Baradihi: That brings me to the second biggest mistake, which is not considering cost basis in the property. A husband and wife married and bought a home 25 years ago for \$25,000, and now the home is worth \$425,000. Let's say their kids are two years away from finishing high school and as part of the divorce settlement the husband gets to keep the kids and gets full rights to the house. His game plan is, two years after the kids graduate and head off for college, to sell the house and buy a new home somewhere else. Now, assume that for the next two years there's zero appreciation on the house and, assuming the couple never made any major renovations or capital improvements, he's going to have to pay capital-gains taxes on that \$400,000 appreciation, minus the \$250,000 exclusion that he's allowed as an individual. But, had the couple sold the house before they divorced, their combined \$500,000 exclusion means they would have paid zero in taxes. The same also applies for stock portfolio and other taxable investments that they would have accumulated over the years together, so it's important to remember that cost basis -- not just the current market value of the asset -- needs to be taken into consideration.

Q: *You spoke about the husband always wanting the retirement savings. What pitfalls are involved there?*

Mr. Baradihi: Pensions and retirement plans like 401(k) plans and Individual Retirement Accounts are usually considered marital assets and, depending on the state you live in, a portion of your savings earned before your marriage may be considered part of the marital asset as well. There may be a situation where it might be desirable for a spouse to receive an equitable sum of cash upfront. For example, if a husband is making \$175,000 and the wife is a stay-at-home mom who will need to go back to school or go back to work at a lower-paying job, gaining access to the pension is not going to help her now. But being able to determine the value of the pension now, we might suggest an arrangement where the husband is able to keep the pension in return for cash or other assets or investments.

Another thing you need to consider when deciding whether to include a retirement savings account in your demands is what's known as the tax-effecting of assets. Basically, all that means is \$100,000 in cash sitting in an IRA isn't the same as a \$100,000 cash in a

savings account. If each account holds \$100,000, depending on the couples tax bracket, they might be paying 15% to 27% tax on that money once it's distributed at age 59 1/2. And remember, the funds in the IRA cannot be accessed before 59 1/2 without paying a 10% penalty for early withdrawal.

If there's a need to split retirement assets, you'll need a qualified domestic relations order (QDRO) -- a written agreement that spells out to the asset-management company who gets what money held in a pension or 401(k) plan. Without a QDRO, withdrawals from 401(k) and pension plans -- even to split the assets evenly between the divorcing husband and wife -- are subject to federal taxes and early-withdrawal penalties. (For more details on how QDROs work, [see this article](#).)

Q: *So we've covered the house and the nest egg, what about alimony and child support?*

When it comes to child support and spousal support, or alimony, no two cases are the same. That's when all the paperwork you've compiled helps a CDP build a picture of what your financial need was during the marriage, and what it will be after you're divorced. The number of people I see walk into my office with literally no idea of what it costs to run their households is astonishing. For example, can the spouse support herself with alimony plus investment income, or will it also be necessary to get a job? Would the spouse be capable of paying sizable support and also afford to pay his own living expenses? How long was the couple married; when couples are married for longer than 10 years, it generally makes a stronger case for more support for a lower-earning spouse.

If our side is looking for more alimony than a spouse is willing to give, we will use our software to show that without that money our client is going to run out of money within a specified period of time. Most times, a judge appreciates having that data available when making a decision on the final settlement should court action be necessary.

One final note I might add about alimony is one most often overlooked: not protecting the spouse that is making the payments through life insurance or disability insurance. Say you get divorced and your spouse is paying \$3,000 to \$5,000 a month. If your spouse suddenly dies or become disabled -- and I'm telling you it happens a lot more frequently than most people think -- then you're both up a creek. Depending on the couple's financial situation, it often makes more sense for the spouse who's receiving the alimony or child support to hold the insurance policy in his or her name, to ensure that premiums are being paid and that the policy is enforced in the terms originally agreed upon.

Q: *The highly publicized 1996 divorce of former GE Capital CEO Gary Wendt and his wife, Lorna, raised awareness of the value of stock options in a divorce decree. What are the pitfalls there?*

Again, it all depends on where you live. There's really no established way to split stock options. Whether and where stock options fall into a divorce settlement really boils down to, 'Are they in the money?' or worth more than the strike price of the option. If they are, then I find the best way to handle them usually is to include that value in the settlement,

or use it as a bargaining chip to trade off if there are other investment or retirement assets that hold less risk. (For more details on dealing with stock options in divorce, [see this article](#).)

Q: *You haven't touched on college-savings plans here. What role do they usually play in divorce settlements?*

College-savings plans such as Uniform Gifts to Minors and Uniform Transfers to Minors usually aren't considered marital assets, but instead are completed gifts to the minor. So those funds technically belong to the children and are not split up in a divorce settlement. And depending on the state, providing additional funds to pay for educating your children doesn't have to become part of the divorce decree -- meaning in many states it's not necessarily either parents responsibility to pay for a child's education.

Q: *How likely is it that a financial plan agreed upon by both parties won't get thrown out in court?*

Its been my experience that financial settlements that have been signed and agreed upon by both parties are rarely contested by the judge. In fact, Judge Kathleen M. McCarthy, who serves in the Family Division of the Wayne County Circuit Court in Michigan, does some of training here at the institute. She often talks about certified divorce planners to couples before her in her courtroom, explaining the value of bringing in experts who can flesh out the complete financial picture. She counsels each spouse to get their own planner, to ensure that both parties' needs are being adequately addressed. CDPs develop their own plans, then give it to the client's attorney, who in turn will present the proposal to the spouse's attorney. Obviously, there's a lot of back and forth between the two attorneys and, when all parties are satisfied, the settlement is signed and presented to the court. By providing hard numbers, equitably divided to meet each of the spouses' personal needs, you're able to take some of the emotion out of the equation by documenting how the process can be fair.

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