

## Achieving Long-Term Fiscal Fitness

Through the divorce settlement

By Jerry L. Love

A rather cynical (but competent) financial planner once remarked, “The aftermath of a divorce settlement can be worse than the breakup of the marriage.” Unfortunately, even in the most amicable divorce, a lack of long-range financial vision can indeed produce unintended and dire consequences for either partner or their children. What once seemed like a fair, well-structured settlement might fail when put to the test by all life has to throw at it.

Why do a surprising number of divorce settlements neglect to include financial arrangements structured to address long-term financial needs or diverse circumstances? Perhaps anxious to expedite the uncomfortable process or caught up in the turmoil of volatile issues, such as child custody, couples decline to dot all the “i’s” of their more distant financial futures. While the desire to “just get this over with” is understandable, such emotional myopia is a red flag to a good attorney and astute financial planner. In reality, agreeing on a financial settlement will actually expedite the divorce process.

Divorce is often a devastating emotional experience. The goal of financial planning during and after the divorce is to manage the devastation. Amid the oft-high drama of divorce, the most basic component of a settlement can seem rather tedious: an accurate, comprehensive financial statement that reflects all the spouses’ assets, liabilities, sources of income, and expenses. Armed with this information, a financial planner can evaluate the predivorce budget, flesh out the far-reaching aspects of the divorce settlement, and set up an appropriate postdivorce financial plan.

Depending on the complexity of the parties’ finances and whether they already have a personal financial planner, the divorce attorney may find it beneficial to bring in a Certified Public Accountant—Personal Financial Specialist (CPA/ PFS). The critical issue is to acquire sound financial advice from an optimally qualified source.

### All assets are not equal

Usually the initial issue in formulating a divorce settlement is the assessment of assets. This also is the first step each party takes toward divorcing a spouse and relinquishing the trappings of the marriage—the property, collectibles, and the like. However, all assets are not created equal, and the parties must be clearheaded about which ones will best serve their future financial needs. This also is the time to stop clinging to the economic lifestyle enjoyed during the marriage and begin developing a realistic attitude about the future. Problems in formulating effective settlements mostly arise when one partner feels entitled

to retain an unfair share of the marital assets. Dividing assets in an equitable manner will inevitably sting, and the parties need to prepare for the adjustment.

Cash is often the most valuable asset. Encourage your client to think long and hard before taking an investment gamble and passing up money in the bank.

The financial planner will help with asset assessment by:

- Determining marital assets versus separate property assets;
- Estimating what each asset is worth, both intrinsically and in the client's particular circumstances;
- Reviewing information received for completeness;
- Identifying which assets have liabilities attached;
- After evaluating the client's priorities, recommending a division between liquid and nonliquid assets; and
- Gathering information concerning disposable income and personal living expenses.

Going with the cash flow

During and after a divorce, cash flow may tighten, and families may need to tighten their belts and be more careful about expenditures. A number of tools can be helpful in this regard. Your financial planner will need precise information on the spouses' sources of income and scenarios for potential future income. Money issues to be evaluated include:

Alimony. Will one spouse get it and, if so, how much and for how long? Does the receiving spouse have a plan for self-support when alimony ends?

Child support. What are the state guidelines, and will the probable amount mandated cover the children's current standard of living? Is the noncustodial spouse willing to pay more? Will the level of support be adjusted in the future as children's needs change?

Child care. Will your client need it, and what will it cost? What level of care is needed? (Consider the myriad of additional expenses required for special-needs children.)

Housing. What are current mortgage obligations and property taxes? Will the primary residence be sold and the proceeds divided, or is one spouse planning to buy out the other? If so, what will the new housing arrangement be and what will it cost? Or, will the house remain in trust with the custodial parent in residence until all minor children reach 18? If so, who will be responsible for maintaining the property and what does that entail? Who is responsible for paying the insurance, property taxes, and maintenance? Who pays any homeowners' association dues? What happens to the property after the children are of age? Do the parties own more than one residence (e.g., a vacation home)? Is the

balance on the mortgage(s) greater than the value of the house? If so, how will this be dealt with in the overall property settlement? The financial advisor should help the client avoid a situation in which the client has no property ownership rights yet still is at risk of having to pay the mortgage if it later becomes delinquent. Refinancing should be on the table as an option.

Education. Are the children in private school, and can the split-family afford the tuition postdivorce? Will either spouse need to return to college or enroll in vocational training as a result of the divorce? Will provisions be made to assist children with college or vocational costs?

Transportation. Will one spouse pay for insurance, maintenance, and periodic replacement of automobiles for the split-family? How much and over what period of time? Will visitation necessitate out-of-city or out-of-state travel for the noncustodial parent or child? Will a car be provided to any children when they reach driving age?

Other monthly expenses. This can be a short or long list, depending on the couple or family. The basics include groceries, utilities, auto expenses, and clothing. More affluent families may include club memberships and vacations. The CPA financial planner can assist in an analysis of the family's predivorce cash flow and in developing a reasonable plan for both the transitional and postdivorce budgets.

Medical care. Who will be responsible for the family's out-of-pocket medical expenses? (Health insurance will be discussed separately.) Some families may also budget for counseling to help cope with the divorce. If there is a special-needs dependent, how will the spouses determine who will contribute to costs such as therapy, special treatments, special dietary requirements, modification to transportation or housing for needed accommodation, just to mention a few possibilities?

Debt service. What other loans, credit cards balances, etc., are on the family books? Who will be responsible for paying what? Remember, despite a settlement agreement directive for one spouse to pay a debt that is in both parties' names, if the party deemed responsible defaults, the other party can still be liable. It usually is best to negotiate the payoff of mutual debt obligations as part of the divorce. In some cases, deciding how to retire debt is a bigger issue than dividing assets. Are either of the parties expecting to file for bankruptcy prior to the divorce or immediately after? How will this impact the overall settlement and the credit history of both parties?

Credit issues. Do both spouses have their own credit scores? Has your client's credit been damaged during the marriage? If so, what is the plan for restoring that credit? If the client is planning to pay off and close credit card accounts, does he or she know what is required to accomplish this?

Savings. Do the parties have savings—where is it—and what are future savings plans? If assets are sufficient, how will they be invested and managed? What is the “rainy day” plan?

Taxes. The CPA financial planner will be able to define filing status, properly file the client's taxes if the divorce is not final before the tax-filing deadline, and explain how divorced parents claim dependents. Remind your client that alimony is usually taxable income to the recipient and deductible to the payor. However, child support cannot be deducted by the paying party, and is not taxable to the receiving party. Tax laws change constantly, but the CPA financial planner will determine the most advantageous timing and structure of the final settlement. It is also essential for the CPA financial planner to resolve now any tax issues pertaining to prior years. Note that new tax laws protect innocent spouses who have signed fraudulent federal income tax returns.

Divorce costs. Last but not least, remind your client that attorney's fee and other costs incurred in the divorce, such as for financial planning, court costs, filing fees, expert witnesses, and business valuation professionals, etc., will necessarily consume some financial resources in successfully negotiating the financial settlement. Rather than a passing expense, these are an investment in the client's future financial stability.

Some complex long-range considerations include insurance, pensions/retirement, and estate planning. Competent financial advice to navigate these treacherous channels is essential. Let's look at the basics.

#### Insurance or the "hit by the bus" plan

For divorced spouses—especially for divorced parents—having the right amount of and kind of insurance is key to preserving the integrity and functionality of the divorce settlement for the years ahead. In addition to auto insurance, homeowner's (or renter's) insurance, and health insurance for every member of the family, disability insurance, life insurance, and long-term care insurance are necessary to insulate the family from future shock.

Consider what could happen to a carefully negotiated financial settlement based primarily on one spouse's ample earning power if that spouse were to die or become gravely ill or disabled. Does the spouse have disability insurance and is the policy structured to work in sync with the divorce settlement? Is your client the irrevocable beneficiary of a life insurance policy with a payout equivalent to the financial support the deceased was scheduled to provide? Even if all the right policies are in place at the time of divorce, what safeguards exist to guarantee that those policies are maintained and premiums are paid for the life of the divorce settlement?

Health insurance is an entirely separate minefield. Is your client aware of the possible difficulty and expense of securing his or her own health insurance? This is especially true if the client is middle aged or a senior at the time of divorce. What, for example, are the health insurance options of a cancer survivor or a spouse with a family history of heart problems? Has the client considered looking for a health insurance policy that covers counseling? Address health insurance coverage and costs with your client before finalizing the divorce settlement so that the cost of insurance can be factored into the settlement.

Has the couple planned for long-term care, and, if so, can the policy be divided? One financial planner reported that breaking apart a client's long-term care policy would force up premiums. After researching the issue, the couple opted to retain the joint policy after the divorce; one spouse agreed to pay the premiums and bill the other spouse for a portion.

### Being of sound mind

One of the simpler but most defining acts of divorce is writing an ex out of the will. (Surprisingly, not everybody does it.) In truth, the parties' entire estate plan will likely need revision including the following:

- Are the parties still in agreement as to a guardian(s) for the minor children? Is your client more comfortable setting up a trust for the children in the event of his or her death? After a divorce, many spouses no longer trust an ex or an ex's family to administer minor children's assets.
- Has your client reviewed his or her will for specific bequests of property that he or she no longer has due to the property settlement?
- If a durable power of attorney (DPOA) has been designated, is the client comfortable with its continuation or is a change warranted?
- Do the parties have retirement plans? If so, how will those be divided or reconciled? In a long marriage, the pension may be one of a couple's most valuable assets. Your client may need a qualified domestic relations order (QDRO) to provide additional legal protections.
- Does either spouse have an IRA? If so, how will it be addressed in the settlement?
- Does the client understand Social Security rights? Have you explained that if the parties were married for 10 years or longer, your client may be entitled to a payment that is equal to 50 percent of the former spouse's Social Security benefits? This entitlement does not reduce the former spouse's benefits.

### Solid foundation

Obviously this is a broad overview of what, in general, a financial planner handles for divorcing clients. The basic goal is to balance current financial needs with future financial expectations. Planning during a divorce should consider lifestyle expectations, assets and liabilities, taxes, income, and expenses of both partners at the time of divorce and for a reasonable period into the future. Financial planning during a divorce should address all areas that can have a future financial impact big or small on the individual and the postdivorce family.

When other variables come to the table—such as spouses who own a business together or a large multigenerational family trust—the issues multiply exponentially. However complex the untangling and separation of a couple's lives, it is critical to address each

and every area that can have a future financial impact. A mutually agreed upon, functional settlement also goes a long way toward alleviating postdivorce blues and helping family members get on with their lives. Sophisticated, informed clients will want to look far beyond “who keeps the house” and “who pays for college.” Once the settlement is final, it is too late to build a better divorce.

Jerry L. Love, CPA/PFS, CFP, is president/CEO and managing partner of Davis, Kinard & Co., P.C., the largest CPA firm in Abilene, Texas. In 2006–07, Mr. Love served as chairman of the Texas Society of CPAs (TSCPA). In 1999–00, he was the recipient of the TSCPA “Distinguished Public Service Award.” In 2006, CPA Magazine listed him as one of the “100 Most Influential Practitioners in America.”