Two Common, Potentially Devastating Mistakes Divorcing Persons Often Make

By Kevin Bourke

Children disinherited, bankruptcy, unforeseen tax liability and other financial upheaval. What could cause so much distress?

Divorce. Besides being one of the most stressful times in life emotionally, divorce is also a transition that is fraught with financial pitfalls which can easily catch the unwary. Many times, assets and income are divided in a way that seems equitable today, but can lead to extreme hardship in just a few short years.

Let's look at just a couple of common mistakes made when divorcing and see what could be done to prevent them. I'm going to refer to 'husband' and 'wife' in the roles I see the most, but certainly these roles are often reversed.

Most divorces involve two or three large assets; the family home, the retirement plans, and perhaps the family business. But dividing these assets is anything but straightforward. It's common for the wife to retain the house and its equity, while the husband retains the equivalent value in the retirement plan or business. This sometimes leads to financial ruin for the wife and the reason are very simple. While she may have an attachment to the house, the feeling of security it provides, and the equity the house represents, it doesn't provide cash flow, and therein lies the problem.

If the wife is awarded the house what happens when the alimony or child support ends? Where does the cash come from to finance her lifestyle? Unfortunately, the one valuable asset left is the house, and she is often forced to either sell or refinance. Then what? She is left with a declining net worth, perhaps no appreciating assets, and the potential for huge tax liability on the sale. Once the equity from the house is spent, what does she have? Just like many men, many women have tremendous earning capacity, nevertheless this is a common real world experience. If the spouse that keeps the house were to have projected out several years, they might see that keeping the house might provide some short term comfort, but ultimately lead to financial ruin.

Retirement plans also present a tremendous opportunity for error. In one case, the husband received a statement from his employer stating that his retirement plan was valued at $92,000. The wife had a retirement plan from her employer reflecting a value of $93,500. Simple enough, she keeps hers, he keeps his, and everyone's happy, right?

Unfortunately, he did not understand that the $92,000 represented what he would receive were he to quit or retire now. If he stayed at his job until retirement age, his actual benefit would be an income stream based on a percentage of his final average pay. He wasn't trying to be underhanded, he just didn't understand. The current value of his future stream of income? A Certified Divorce Financial Analyst working with the family law attorney testified that the plan's present value was over $340,000. Based on this testimony, the judge required him to pay her $1500 per month for 15 years. Do you think she would have been unhappy? had this subtle nuance been overlooked?

These are just two of the many and varied common financial mistakes made when divorcing. Judging by the volume of questions my office receives on this topic, financial planning in divorce is a very hot topic, and potentially devastating financially. Give it careful consideration.

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Since 1987, Kevin Bourke, the owner of Bourke Wealth Management, a frequent guest on KEYT ABC News, and the online financial columnist for the Santa Barbara Independent, has helped hundreds of individuals navigate life's transitions, with a minimum of stress and distraction. Kevin holds the Certified Divorce Financial Analyst (CDFA) and Certified Financial Planner (CFP) designations, is a Chartered Financial Consultant, and holds various FINRA qualifications and insurance licenses. He serves on the Board of Trustees for Child Abuse Listening & Mediation, CALM http://www.calm4kids.org a Santa Barbara based non-profit whose sole mission is to prevent, assess, and treat child abuse by providing comprehensive, culturally appropriate services for children, adults, and families.

As a featured speaker, Kevin has given hundreds of lectures on a variety of topics including how to make philanthropy a charitable act of giving. He is considered an expert on the financial implications of divorce.

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