The Dollars and Sense of Divorce: The Role of Certified Divorce Financial Analysts in Divorce

by Lorraine P. Brown and Billy Peterson

"'Only people who have what you want can take you where you say you want to go.'"

– Pauline Tesler[1]

Today's divorcing couples face different and far more complex challenges than divorcing couples forty years ago. Multiple incomes, combined families, alternative lifestyles, new retirement and investment options, and an unpredictable economic landscape present new issues which challenge the traditional, and almost exclusively, legal, response to divorce. After all, divorce is more than the dissolution of a marital contract; it is an emotional gauntlet, a parenting journey, and, most significantly, a financial restructuring. In light of these realities, it is time we rethink the legal paradigm for divorce and acknowledge that the fracture of American families is more than a legal phenomenon and demands a multi-professional response.

Attorneys are generally first-tier responders to divorcing parties, together with counselors, accountants, and forensic experts. What is missing in this first-tier response, however, is the financial analyst. The Certified Divorce Financial Analyst® (CDFA™) offers a second, equally indispensable professional tier, specifically trained to assist divorcing couples resolve the financial issues of their divorce. Unlike financial planners and accountants – whose expertise generally extends only to questions of accounting and profitability – CDFAs are specifically trained to evaluate and plan for the short and long-term consequences of divorce. Their role is to assure that clients and their attorneys fully understand the parameters and consequences of all financial decisions incident to divorce. This information is critical to decision-making, but frequently beyond the expertise of the family law practitioner. Without this information, both the divorcing client and attorney may unwittingly act on assumptions that, though successful in achieving a settlement, work against the client's long-term interests and financial goals. Just what are these mistaken assumptions? Consider the following:

This couple's financial health will improve once they divorce. Although the reasons for divorce are generally unrelated to financial health, many divorcing clients perceive that their financial well-being will improve once they independently control their assets. This is not usually true. Dividing one household in two leads to many new and often overlooked expenses. One utility bill, one phone bill, one garbage bill suddenly doubles, not to mention the cost savings of purchasing household goods and services such as cleaners, kitchen items and lawn care for a single family unit rather than separate units. The sad reality is that financial hardship

LORRAINE P. BROWN is an attorney at Smith Knowles where her practice focuses on labor, employment, and family law. The opinions and services of Lorraine Brown and Smith Knowles are independent of Raymond James.

BILLY PETERSON is a registered representative who holds certifications as Certified Financial Planner®, and a Certified Divorce Financial Analyst™. He established Peterson Wealth Service in 2009, where he offers securities through Raymond James Financial Service, Inc.

accompanies almost all divorces, and those who do regain their pre-divorce financial status do so only over the long term.[2]

My client should keep the marital home.

Although maintaining the status quo may enhance your client's sense of security and ease the discomfort of divorce in the short term, keeping the marital home may be a financial liability, realized fully only in the months and years following divorce. Capital gains exposure, mortgage terms, property taxes and other fixed expenses may no longer be affordable after factoring in the lifestyle changes that frequently accompany divorce. In some situations it is better to sell the home and find another one that is smaller and less expensive to pay for and maintain. It may actually be a better idea to start fresh in another home. Aside from the financial considerations, there may be too many memories attached to the marital home to allow the client to move forward emotionally. Some of the ways to handle the marital home are:

- One spouse can buy the other out by refinancing the home or by trading the home for other property. Special care should be taken to match cost basis and tax liabilities on assets that are traded.

- Both parties can hold it jointly for a number of years – for instance, until the parent who has custody of the children remarries, or the children reach a certain age, after which the home is sold and proceeds divided in some fashion. In many cases, the party who remains in the home pays the mortgage and taxes and gets credit for any reduction in principal on the mortgage from the date of the divorce until the date that the home is sold or one party buys the other out. Major repairs are often divided between the parties, with the person who advances the money for repairs being repaid at the time of the closing on sale or buyout of the home. Note – this option doesn't work well if the parties are at odds with one another and unlikely to cooperate.

A dollar of child support equals a dollar of spousal support.

Alimony, or spousal support is deductible to the payor spouse, child support is not. However, child support is relatively easy to modify post divorce, while alimony is not. The tradeoff between deductibility and modifiability frequently tempts parties to mix the obligation to create the most predictability, at the lowest cost, for the payor spouse. This is not always wise. The ideal split between child support and alimony can only be derived by measuring the present value of alimony and child support proposals against income projections for your client. Best estimates, guess work and personal preferences are simply inadequate substitutes for informed decision-making in this arena.

All investment assets are created equal.

There are typically two types of assets: Marital and Separate Property. Marital investment assets may include CDs, IRAs, stock options, securities, 401(k)s, 403(b)s, pension plans, real property, annuities, life insurance and basically anything that was acquired during or as a result of the marriage. Inheritances received by one spouse should be maintained as separate property in many cases. Once commingled, those assets become marital property. The first step in dividing marital assets is determining where and what they are. The discovery process can be informal or formal. The informal way is to exchange lists of your assets and debts in an affidavit form. This method should only be used if the client is sure that he or she knows everything that exists in the estate; if the client is not sure, then a more formal means of discovery should be utilized. This could entail interrogatories, depositions and extensive review of tax returns.

Marital debt should be divided equally.

Generally, parties attempt to equalize the dollar value of marital debt, with each party assuming the debt on the asset they receive. Although fair, such a plan for distributing debt may not be optimal. In addition to the dollar amount of existing debt, practitioners should consider the interest rate on debt, whether debt payments are tax deductible, and whether the asset will appreciate in value over time. Sometimes a party can be held liable for debts they did not incur. Be very diligent about your client's exposure to spousal debt. Before the divorce is final, advise your client to get a copy of his or her credit report and close out all joint accounts and joint credit lines. Credit cards issued in joint names should be monitored closely or potentially cancelled and reissued in separate names if possible without harming credit.

An equal division of assets is a fair division.
Asset divisions based solely on the equalization of current values are often inequitable. Intangibles, such as job skills, education and ability to earn, must be identified and factored into any asset division. Also, marital assets may have varying degrees of growth potential. One bundle of assets may grow significantly more than another over five, ten, or twenty years. Trading their share of a spouse's pension for the marital home is one of the most common mistakes divorcing people make. Even though the values can be equal at the time of divorce, they are apples and oranges. A house requires income to pay for repairs, maintenance, improvements, and property taxes; a pension, however, produces income without costing income. A fifty-fifty division of assets may sound equal, and it may in fact be equal in value at divorce, but it rarely ends up providing equal long-term outcomes. Division of some marital assets may also impose penalties or tax liability on the receiving spouse. These factors significantly impact the valuation of marital assets and must be part of any distribution decision.

"A fifty-fifty division of assets may sound equal, and it may in fact be equal in value at divorce, but it rarely ends up providing equal long-term outcomes."

Tax law has no bearing on the division of marital assets.
Tax law has enormous implications for divorcing clients but is rarely addressed. For instance, one spouse may decide to take $100,000 of bank savings, CDs or bonds, and in return permit the other to keep the $100,000 401(k). This is most definitely not an equal split net of taxes since the 401(k) is 100% pretax. Another common mistake is to not consider the tax status of the martial home pre-divorce. It might pay to sell the home pre-divorce in order to receive the full benefit of the $250,000 capital gain exclusion per person. If the home is awarded to one spouse and later sold for a $400,000 capital gain, the spouse may pay a significant amount of tax that could have been avoided.

The age of the parties is irrelevant to the divorce settlement.
Age impacts every divorce settlement. Age determines the length of each party's income stream. Age determines the viability of any attempt to obtain training and reenter the workforce. Age determines access to retirement benefits, social security benefits, and also health insurance coverage in the form of Medicare. Age impacts every alimony award and may also bear on requests for rehabilitative alimony and the division of assets and liabilities.

Involving a CDFA will increase the cost of divorce.
Although retaining a CDFA will increase costs for divorcing clients, keep in mind that the real cost of divorce includes the frustration and expense of correcting mistakes, which could potentially be avoided by utilizing a CDFA. Teaming with a CDFA saves attorneys time and uncertainty and moves cases forward in a cost-efficient and effective way. Furthermore, fees for tax planning, deriving taxable income, and securing an interest in a qualified retirement plan, whether paid to an attorney or a CDFA, are typically tax deductible. *See* I.R.C. §§ 162, 212, 263 (2000). Good teamwork between an attorney and a CDFA has the potential to pay dividends for clients.[3]

The CDFA can be a valuable resource for the family law practitioner and his or her divorcing clients, particularly those clients with high incomes, clients who own businesses, investment or retirement assets, are subject to capital gains tax, or are self-employed or facing retirement. A CDFA can play a vital role in managing the financial future of your clients and their families and setting them on the road to a bright financial future.

1. Susan Pease Gadoua, *Contemplating Divorce: Will the Future of Family Law Look Like Integrated Medicine?*, Psychology Today, June 5, 2011, http://www.psychologytoday.com/blog/contemplating-divorce/201106/will-the-future-family-law-look-integrated-medicine (quoting Pauline Tesler).

2. Patricia A. McManus & Thomas A. DiPrete, *Losers and Winners: The Financial Consequences of Separation and Divorce for Men*, 66 American Sociological Review 2, 246-68 (2001); Pamela J. Smock, *The Economic Costs of Marital Disruption for Young Women over the Past Two Decades*, 30 Demography 3, 353-371 (1993).

3. Terry M. Hargrave & Peter M. Walzer, *The Tax Deductibility of Attorneys' Fees in a Marital Dissolution*, (2006), http://tax wizard.com/attorney.html (Review of case law and regulations interpreting I.R.C. §§ 162, 212, 263, and services that qualify as "tax planning" under I.R.C. § 212).