Divorce Financial Planning/Investment Article

Taking Control

Understanding your income and expenses will help you to gain control of your finances -- and life -- during divorce.
By Diana Shepherd, CDFA™

Here's a question for you: do you have a written, detailed, up-to-date budget detailing all your daily, weekly, monthly, and yearly expenses and income? If you're like most people, your answer to this question will be "no." The lack of a budget may have caused financial problems during your marriage, but it could be ruinous post-divorce. If you don't know what your expenses are, how will you know how much you'll need to maintain your current lifestyle -- for yourself and your children? Or worse: you may already be living so far above your current income that you've taken the first steps down the road to bankruptcy without even being aware of it.

So the first step to gaining control of your finances -- and life -- during divorce is to prepare an accurate current budget and a post-divorce budget. You will need to gather documentation to ensure that your budget is objective and not the product of guess-work.

First, you need to identify your sources of income, which includes revenue from full- and part-time employment, investment return, and self-employment income. Add up all the income from different sources to come up with total income. If you're clueless about what your spouse earns, obtain or make copies of his/her tax returns for the last three to five years. Also, watch the mail for statements from banks or brokerage houses; if you have never opened any of these during your marriage, and you have good reason not to let your spouse know of your sudden interest in the family's finances, you can start by making a note of how many of these arrive in an ordinary month as well as the names and addresses on each envelope.

After you have an accurate picture of what's coming in, you need to create an equally accurate picture of what's going out. You should review your check register and credit-card statements -- or your online banking records if that's how you usually pay your bills. Remember that not all your expenses are paid monthly; some insurance premiums or tax bills might be payable quarterly or annually, so make sure to account for those as well.

Don't forget about cash withdrawals using ATM cards; you'll be surprised how quickly taking $50 here and $100 there can put you in the red if these withdrawals are not included in your budget. Also, you need to be able to account for where/how you spent the cash: was it taking taxis to work, going out to restaurants, on a new outfit, or paying the babysitter?

After you've completed a "first draft" of your budget, ask a reasonable and financially-savvy friend or family member to review it and question the expenses that seem unreasonable. (You may think a $500 shirt and weekly spa appointments are both reasonable and necessary, but someone who sees you living beyond your means may not agree!) If you're going to ask for help with your budget, you'll have to agree to keep an open mind and not to become angry or defensive if he/she questions one of your items. This person is trying to help you, and he/she will probably be a lot easier on you that a judge would be!

Start with the pre-divorce scenario using the budget table (Click here for a full set of Detailed Monthly Expenses Worksheets as a guide. Make two copies of the chart, replacing or deleting items to suit your needs, then fill in pre-divorce expenses on one and post-divorce expenses on the other. After you've created your pre-divorce budget, go to the post-divorce page and carry over each expense with an increase or decrease in its value based on your new circumstances. For example, an increase might be lawn care or snow removal if your ex used to handle that. Food expenses, on the other hand, should decrease now that you have one less mouth to feed.

If you're like most people, your number-one financial concern during divorce is maintaining positive cash flow -- in other words, being able to pay the bills on a monthly basis -- not only on the day after divorce, but five, ten, 15 years into the future. In order to meet cash-flow needs, there are three sources of money that may be available to you as a result of your divorce: child support, spousal support, and marital property. Let's take a quick look at all three.

Child Support

In the US and Canada, a parent is obligated to support his or her children, regardless of the parent's marital status. All states and provinces have child support guidelines; you should review the guidelines in your area to get a rough idea of what you might be entitled to receive or have to pay. Generally speaking, child support is based on factors such as the ages of and number of minor children, the amount of time they will reside with each parent, and the income of each parent. These factors are plugged into a formula, which then supplies a recommendation for the Court. In a divorce situation, the non-custodial parent is usually ordered to pay child support to the custodial parent, from which the custodial parent pays the child's expenses.

However, the child support formula does not take into consideration your child's actual expenses. For example, extra-curricular activities, private school tuition, and college funding are not factored into the formula. These are considered "extraordinary expenses," and they are often an area of great discussion and/or argument. It may be unrealistic to keep your child in Rep Hockey, horseback riding, and Kumon math; you and your soon-to-be-ex spouse will now have to start making decisions based on what is financially feasible.

Here's an example. My neighbor Cathy, who is in the process of getting a divorce right now, has an 11-year-old daughter who is a promising figure skater. Brittney's skating expenses are $500 per month in training, competition fees, and costumes. Cathy tells me that the costs will increase as her daughter gets older. Unfortunately, these expenses will not be taken into consideration when the court calculates child support for her, and Cathy cannot afford to cover them on her current salary.

One of the ways in which a Certified Divorce Financial Analyst™ (CDFA™) can help their clients is to determine which costs may not be addressed by the guidelines and then to help them find alternative solutions to cover these expenses.

Since child support is such a complex area of the law -- and because it can be a very contentious issue between divorcing parents -- you should ask your lawyer for guidance regarding the child support amount.

Spousal Support

Another source of income (or an expense) for many divorced people will be spousal support. Spousal support is based on different factors, and it's a very gray and subjective area. However, the two most heavily weighted factors are need and ability to pay; the length of the marriage is another factor that is considered when awarding spousal support.

Unless you have prepared an accurate budget, you will not know how much spousal support you need -- or, if you're on the other end of the equation, how much you can afford to pay.

Aside from determining need and ability to pay, you need to understand some other important issues with regard to spousal support. With respect to the amount and duration, this can either be a negotiated amount between spouses or it can be court ordered. (In the US, spousal support can be set up as modifiable or non-modifiable; if it's non-modifiable, this means that neither party can ask for it to be changed for any reason at any time in the future.) In most cases, each party may revisit the amount and duration each year after filing a tax return. As well, there may be the ability to revisit the amount of support if there is a substantial change in circumstances for one or both of the parties. Here's an example: John is paying Mary, who currently has a minimum-wage job, $20,000 per year in modifiable spousal support. In the second year after the divorce, Mary finds a job that pays $55,000 per year. Due to this change in circumstances, John may be able to have the spousal support reduced.

No two divorcing couples have identical circumstances. The standard is to give support to the spouse who needs it in order to keep the family on a equal setting -- however, there is an underlying duty for each spouse to work towards being independent of each other.

Property

The third potential source of money in a divorce is property. Many states and provinces call for an equitable division of property. "Equitable" does not always mean "equal" -- it is, however, supposed to mean "fair." If the spouses can't agree, the judge is the final arbiter of what constitutes fair. Although most divorces settle 50/50, it can make a huge difference which 50% you get; in other words, all assets are not created equal.

The first thing to know is that there are two kinds of property: Marital and Separate. Anything that is marital will go into the marital pie that's going to be equitably divided; anything that's separate property will not. The distinction between the two is a gray area and should be discussed with your lawyer, but here's a short explanation of how the courts typically define property.

Separate Property

Separate property is anything that was gifted during the marriage, inherited during the marriage, or brought into the marriage and kept in either spouse's separate name. Let's take a look at some examples. My friend Karen got married 10 years ago. She was in love, so she told her husband, "What's mine is yours and what's yours is mine". So she changed the title on her cottage from her name alone to both of their names. This is called making a presumptive gift to the marriage and now the cottage will likely be part the marital pie and up for division now that she's getting divorced.

How about the inheritance that Karen received five years ago from her Aunt Millie? She left it in a trust account in her name, which means that it's her separate property. What if Karen had taken her $15,000 inheritance and used it to renovate the kitchen in the marital home? She could ask her lawyer to try to subtract $15,000 from the marital portion, but the courts are likely to rule that the inheritance became marital property when she invested it in the home.

Here's another tricky part: any increase in value on the inheritance (or any other separate property) is considered marital, so if that $15,000 grew to $20,000 at the time of Karen's divorce, the $5,000 in growth could be considered marital property.

Marital Property

Everything that's not considered separate property is considered marital. As long as it accumulated during the marriage, it's going into the pie to be divided -- no matter whose name it's in. So, starting at your date of marriage, the contribution to your retirement plan that comes out of your paycheck and goes directly into the XYZ fund account in your name is marital property; ditto for your spouse's pension.

In many divorces, the biggest question is who gets the marital home. Should the wife get it, should the husband, or should they sell it and split the proceeds? What if the house is "underwater" -- meaning that the householders owe more on their mortgages than their houses are worth? The answer is not always easy or clear. In a normal economy, couples typically build equity in their homes; if they decide to divorce, they would usually divide the equity they had built by selling the house or by one partner buying out the other's share. But after the recent boom-and-bust cycle, many couples own houses that neither spouse can afford to maintain on his/her own, and that they cannot sell for what they owe.

According to a recent survey of CDFAs in the US and Canada, 73% of respondents stated that the current housing market has forced them to come up with creative solutions to property-division problems when the matrimonial home fails to sell -- or would sell for less than what clients still owe on the mortgage. The most common solution is for ex-spouses to retain joint ownership and continue to live in the house (often, he moves into the basement and she lives upstairs) until the market improves, agreeing to postpone final division of assets until after the house is sold.

The Last Word

You need to create an accurate budget today, and you need to understand how child support, spousal support, and property division will impact your ability to cover your cash-flow needs. This is where a CDFA™ comes in: we analyze and illustrate the short- and long-term implications of different settlement proposals by factoring in expenses, investment earnings, taxes, and inflation. Our clients are then able to make educated decisions about their financial futures. Remember, you only get one chance to negotiate your property settlement. Can you really afford to make a mistake?

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