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Divorce—an Unsettling Financial Event?

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Though a sensitive subject, divorce has become a common thing in our society today. According to the National Financial Planning Association, more than a million divorces occur in the United States every year. Additionally, about 50% of first marriages and 60% of second marriages end in divorce.

So what does a marriage separation have to do with our finances? Well, actually a bunch considering some of these facts, not including the emotional impact for decades.

- At divorce assets are divided into two separate households (house, pension/retirement plans, personal property, income, etc.). Economies of scale no longer exist (rent, home, child-care, utilities, personal items, etc) and expenses increase.
- Legal fees can easily run $10,000 to $30,000 per spouse. After the settlement, legal costs can continue due to child custody, child support, changes in job situations, and not following through with what was agreed at the time of the divorce.
- A wife's standard of living drops as much as 35% after a divorce.
- 70% of the elderly poor in the United States are women. The majority of these are single, due to a divorce or death of a spouse.

Additionally, out of the three common life events (Death, Disability, and Divorce) that have a drastic effect on our financial picture, divorce is the only one that cannot be provided for in advance with some form of insurance.

With all that said, listed below is a short list of critical mistakes that can sometimes be avoided with the help of qualified professionals during divorce negotiations considering the client's long-term financial plan.

- **Having an Emotional Attachment to "The House"**. The marital residence is many times more than the divorced spouse can afford later. Usually the home is too large for the smaller income and there continues to be major cash expenses incurred (mortgage, taxes, repairs, higher utility bills, maintenance on the pool, etc.). Also, if the spouse who retained the home unloads it later he/she may incur capital gains taxes due to the lower tax exclusion for single taxpayers. Many times the home needs to be sold during the divorce, funds divided, and then each individual purchase what they can afford based on their own financial situation.
- **Failure to consider "Career Assets" during the Settlement**. According to Carol Ann Wilson, CFP and Certified Financial Divorce Practitioner, this includes potential earning power, education and training, health insurance, life insurance, vacation pay, sick pay, and seniority/networking power. Usually assets are split 50/50 but the settlement traditionally overlooks one major asset of a marriage….the major wage earners career (usually the husbands). Ms. Wilson emphasizes in planning with her clients that assets are usually divided once but career assets continue to produce income regularly for years. This plays out time and time again that the husband is able to rebuild his wealth through his future earning power, but the older female usually does not. If not dealt with properly during the settlement process for the older female client, particularly those who had limited work careers and lack their own financial resources to make up the difference, the female has high risks of depleting their assets and income some time in the future.

205 E. Main Street, Clinton, MS 39056 • (601) 925-8099
Email: financialplanning@mascagni.com

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- **Failure to involve a Certified Financial Planner™ during settlement**. Usually involved in client negotiations and divorce proceedings are each client's attorney, and some times a CPA. Many times their work focuses on thorough discovery, properly valuing an asset (business, real estate, a future income stream, etc.), child support, custody of children, and final mediation, etc. However, very seldom has a qualified financial planner been retained to illustrate the future impact of different divorce settlements. For instance, if the husband keeps the large cash balance along with his business and the wife gets the home, six years of alimony, and ½ his retirement plan how fair and balanced was the settlement 10 and 15 years down the road? Each scenario's future value should be considered before accepting an agreement for the client.
- **Forgetting to update Estate Documents and Beneficiary Designations**. Consider this possibility and see what you think. Finally the divorce is over and there were no requirements in the divorce decree to leave your $500,000 life insurance policy to your previous spouse. You had intended to handle all the loose ends and change the beneficiary to your children and your elder parent. You are killed 3 months later in an automobile accident and your ex-spouse was named as the beneficiary. Who gets the $500,000 proceeds? You guessed it …he and his girl friend.
- **Tax Considerations overlooked**. Often when a divorce occurs among middle-age to older adults the settlement usually involves assets that have appreciated significantly. These assets have a low cost-basis and may include oil royalties, land, rental property, timber, and stocks/mutual funds. In addition, usually the settlement will include a large retirement plan balance. Receiving these assets during settlement may appear you are "wealthy" but down the road the spouse will pay 10% to 40% of the balance in income taxes as he or she liquidates them to pay their bills. To say it in $ terms….the $1 Million is only worth $750,000 after you pay taxes not including maintenance and repairs to real property. In summary, consider the after-tax value of the settlement package prior to final settlement.

Last but not least, the best settlement package is one where there is reconciliation and healing in the marriage rather than divorce. Yes, consider the effect on your financial picture but don't forget the human side of things…..your family and children. Often this can be enough to work it out.

J. Randall Mascagni, MBA, CFP®

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