# Two costly divorce settlement mistakes to avoid

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A general goal in any divorce is to come to an equitable settlement between parties under the law. However, this is often more difficult to accomplish than one would think. Here are two real-life examples of how a small oversight can result in serious financial consequences in a divorce settlement.

**Calculate the value of a pension using a cost-of-living adjustment**

Pensions earned during a marriage are considered *community property* subject to division by the Court in a divorce. Most pensions are paid out like annuities. When an individual retires and begins taking his or her pension, it comes in monthly increments and continues for a designated number of years, or until the recipient's death. Sometimes, the monthly payouts are adjusted annually to reflect cost-of-living adjustments (COLAs). For instance, the Federal Employees Retirement plan provides a COLA.

This makes calculating the value of a pension over the lifetime of both individuals a bit more complicated. For example, if a couple agrees that the receiving spouse should get 50 percent of a $6,000 monthly pension payment upon retirement, he or she will get $3,000 per month for the first year of retirement. However, going forward and using a reasonable 3 percent annual cost-of-living adjustment, the outcome is quite different. By the 25th year, the spouse without the COLA increase will still be receiving $3,000 per month, while the pension beneficiary will be getting more than $4,800 per month, thanks to the effect of compound interest. Over the span of 25 years, the total calculated present value of the COLA adjusted pension is $931,000, while the pension without the COLA is worth $427,000.

So, make sure the receiving spouse's financial analyst factors in an annual cost-of-living adjustment (COLA) when crunching this number, and that the attorney includes clearly stated wording about the COLA in the divorce decree.

**Calculate the value of an IRA or a 401(k) using passive appreciation**

Many couples today have 401(k)s or IRAs in lieu of pensions. The funds that accumulate as a result of contributions to these accounts during a marriage are considered *community property*. The portion accumulated before marriage is considered the *separate property* of the contributing spouse, and not subject to division during a divorce.

In many divorces, the value of these accounts is calculated by using the value of the accounts at the date of marriage, subtracted from the total value of the accounts at the date of filing for divorce, and then divided between the couple. However, financial experts can “trace” the accounts and determine the amount of appreciation on the non-marital portion. Such appreciation is *separate property* according to Texas statutes. This could make the separate property portion much larger, leaving much less to divide in a settlement.

For example, a man marries in February of 2004 and brings to the union a 401(k) with a value of about \$50,000. When his wife files for divorce in late 2012, the account has grown to \$230,000. The husband's financial expert finds that the husband's non-marital (*separate*) portion of the 401(k) had grown from \$50,000 to \$106,000. Consequently, the *separate property* portion of the 401(k) was figured to be \$56,000 more than first anticipated. So, he retained \$106,000 of the 401(k) as separate property before dividing the total in the divorce settlement.

When calculating a divorce settlement, be sure you have a knowledgeable financial expert on your team to ensure that the agreement is as truly equitable as you and your spouse believe it to be.

*For more information on divorce law in Texas, visit www.GuideToGoodDivorce.com or call 713-932-7177.*

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