Divorce Mediation 101:
A Financial Mind & The Legal World

Money is one of the biggest concerns people face in divorce. It drives how couples react in the situation concerning children, employment, where they live and so much more. With all this at stake, too many go about it the wrong way.

First, looking back on the history of family law, it was not that long ago that women did not have property rights. They were forced to live based on the generosity and protection of a husband. Any property she brought to the relationship was placed in his care to manage for her, under the assumption that she was incapable of handling financial matters[i].

Over time, this antiquated way of thinking evolved, and women gained rights to property. But marriage was a way of keeping people bound to each other based on the concept of fault. A divorce could only be requested when someone was at fault for abuse, infidelity, the inability to bear children or some other breach of the relationship that was deemed as serious. Churches also chimed in with the doctrine that divorce was a mortal sin or a gross violation of God's laws.

January 1, 1970 changed everything with the enactment of no-fault divorce that was signed into law by Ronald Reagan when he was California's Governor. That opened a movement across the country, with anyone being able to file for divorce. Yet property and income were still a problem, and that is what most of the divorce laws and court actions today are about.

Impact of Laws on Divorce

The simplest way to state how this all came into being is the struggle over money and resources. Like in any war, there is an objective that one side, at least, sees as worthy of the battle.

Families are no exception to that reality.

But in looking at divorce and resources, we note that the rate of divorce in the United States is on a decline, and has been for some time. Part of this has to do with a decrease in the number of marriages happening in the first place. People are waiting until later in life to marry, and thus having children later. Further, people are bringing more property to the marriage, which creates more stability and security, leading to a better climate for the relationship.

Wealth (resources) is a significant factor in divorce. Those who suffer from financial problems often seek divorce as a way to get away from the economic suffering. It is odd, given that divorce can accelerate the path into poverty for women and children of divorce, that financial trouble is a factor cited by so many for breaking up. The fight that can follow, as well as the efforts to enforce court orders, only increases the cost, aggravation, and pain of separation.

Looking across the Atlantic to Scandinavian countries, we see a different picture. The divorce rate within these societies is very high. Sweden, for example, saw over 25,100 divorces in 2013 alone. That was their highest figure since 1975. Similar to the changes in laws in America to the no-fault divorce concept, in 1974 the law in Sweden changed to allow divorces to be sped up. Since that change was enacted, the divorce rate rose each year for over 40 years. The divorce process had become so easy that, as one author notes, "more than 100 couples who tied the knot in 2013 were divorced by the end of the same year[ii]."

A review of factors the led to the higher rates found that morality, or any form of a degraded society, was not the reason behind the changes. The factor that weighed in as the most important—that led to about 47% of all marriages in Sweden ending in divorce—was economic security. Based on information by researcher Glenn Sandström, "The expansion of opportunities to make do without a spouse, the fairer distribution of wealth among social classes, and the development of a welfare state have all contributed to higher divorce rates." Sandström further notes that, "Individualistic and secular values have flourished and gained legitimacy… periods, where divorce rates rose have coincided almost entirely with times of major progress in the welfare state."

The result is that an economy that supports the people in a welfare state leads to a lack of need for people to stay in relationships. Therefore, other than the emotional aspect, divorce becomes easy and a non-stressful event.

That does not exist in the United States, and therefore, couples find that they need to “pay” for the divorce between themselves. In so many cases, the path of that fight leads to court. The judge is confronted with the facts and existing laws. The judge then needs to craft a solution based on that law and/or existing cases with similar facts in question. One recent case focusing on the date of separation illustrates this process in California.

In 2015, the case of the Marriage of Davis (2015)[iii], the California Supreme Court ruled that for a couple to be declared as separate and living apart, they must have physically separated and must be in two different locations. This ruling defied the standard practice of family law professionals for couples to simply agree on a date of separation. The ruling from the Supreme Court of California removed any judicial discretion in cases where couples may be negotiating on setting a date of separation that meets their requirements for their unique situation.

Following this ruling, the California Legislature was called into action and Senate Bill SB 1255 was enacted and signed into law by Governor Jerry Brown. This law overrode the Supreme Court and offered clarification to the law in that it allows the couple to consider many reasons for living under the same roof while going through a divorce. These include economic and family reasons, among others.

Why is the date of separation so important? It sets the date at which earnings and asset acquisition are assigned to the individual as separate from the marital assets. The impact is that financial assets acquired or earned from that point forward are no longer part of the marital property.

The fight over money led to a court action which, in turn, led to a legislature enacting a law. That is the basic method under which the family code evolved. Since we do not live in a welfare society, a large part of the law is about money. When couples are not financially minded and only think of the “legal rights,” they often make mistakes—not realizing the consequences of those choices on a financial level.

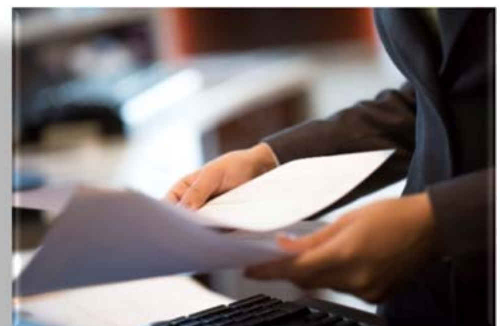
How Separation Can Hurt One Side Over the Other

Looking at the ruling in the Davis case, if one spouse gets a bonus in October of each year, that bonus is community property up to the date of separation. Even if the couple was working cooperatively and wanted to share that bonus entirely, and they had already moved to separate residential locations before the payment of the bonus, the law states that any bonus earned would technically be the property of the person who earned it. The bonus would be treated as separate property under this ruling. Any further division would need to be under a property settlement.

Under the changed laws, the couple could negotiate that the date of separation was coincidental to the payment of the bonus, and the result would make the bonus community property and community income that is equally divided.

Focus of the Court is the Legal Side of Money, Not the Financial

The system today looks at the division of assets and is void of moral judgment. They can also miss technical issues regarding finances. The court sees their position as the forum of last resort to settle property disagreements and to see that the welfare of children is upheld.



There are some factors that can impact a judge's discretion, including spouse abuse, non-disclosure of financial assets, or the attempt to avoid responsibility for child support. Outside of this, judges who don't know the couple or the details of their life do not grant time for couples to plead their grievance based on any emotional pain[iv].

Couples Should Not Expect Lawyers or Courts to Take Care of Them

Obviously, emotional pain is not a part of any legal or financial reality of divorce. The assets, income, support, debts and, more important, the children are ultimately all the couple's joint responsibility

Looking at the issues surrounding children, we see three overarching themes that are most important:

- Protection from the process of divorce
- Devotion to each child's emotional well-being (they are not the parent or comforter—the adult parents are).
- Offering sufficient financial support to a child over time that is in line with his or her needs in life

Protection for Children from The Process of Divorce

Looking at the financial side of divorce, children can become the inadvertent or intentional focus of financial negotiations. They may also become the victims of negative arguments between adults in divorce. A child seeing a parent degrading the other parent can be devastating to that child. In the video “*Split*,” we see some children that withdraw from conflict and make up their own worlds to live in. Some become confused and do not have a solid emotional base from which to operate. Others build their defenses and appear to “handle” the change only to act out later in life as they deal with depression and other emotional issues that were buried along the way.

Child support is a fact of the law under all jurisdictions in the United States. It is based on the concept that children are the responsibility of the parents and should not become welfare recipients. Due to this mandate of law, the elements of support are often a point of contention, and include income allocable to support and the time a child spends with each parent. The more time a child spends with a parent, the more money is assumed to be spent by that parent for that child. Likewise, the more income one person has, the more capable they are of providing support for that child.

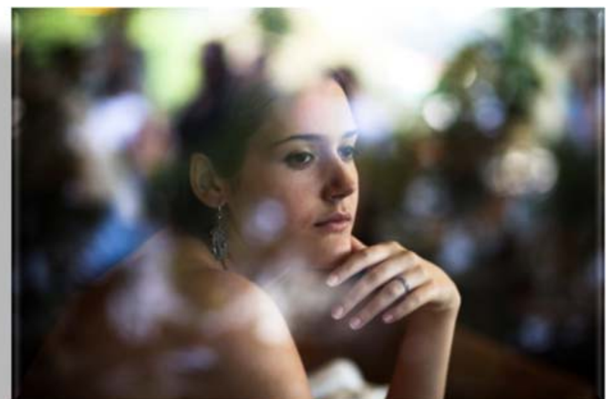
This scale of income versus time is used by some to manipulate the calculation to reduce their support obligations. Others use the time and income sides of the calculation to push for higher levels of support as a way of increasing their income, while never intending to use the funds for the child. These are the realities that ultimately come down to the injured person—the child—being the focus of a perverse argument over money.

In 2016, one case we worked on included the couple insisting that the income and time be balanced so that there was no child support obligations. Their incomes were almost identical; they purchased homes near each other so that their child could attend the same school and be around friends that are familiar and consistent. Also, the child had grandparents in the same neighborhood. While this is idealistic, it is an illustration of a couple that was looking out for the child in all aspects, and used their resources to foster that child's wellbeing. They even set up a 529 plan that they equally fund for future education costs.

This ideal is not realistic for many based on economic needs. But the heart of the intention behind their choices is exemplary for couples to adopt. Keep the children's interest first. They did not choose the divorce, and they should not suffer the consequences of adults fighting over financial considerations.

How Do Women Cope with Finances in Divorce?

In 2012, the U.S. Government Accounting Office issued the results of a study[v] that looked at how women fared as they approached retirement. The study showed that women were more likely to be financially disadvantaged than their male counterparts.



"For women approaching or in retirement, becoming divorced, widowed or unemployed had detrimental effects on their income security. Moreover, divorce and widowhood had more pronounced effects for women than for men. For example, women's household income, on average, fell by 41 percent with divorce, almost twice the size of the decline that men experienced. For widowhood, women's household income fell by 37 percent—while men's declined by only 22 percent. Unemployment also had a detrimental effect on income security, though the effects were similar for women and men; household assets and income fell by 7 to 9 percent."

Factors that add to the reasons women do not do as well as men include:

- Time out of the workforce reducing the level of marketable skills
- Incomplete education
- Cost in terms of time to attend to the needs of children
- Costs of running a household without a spouse, including day care
- Periods of unemployment
- Helping elderly parents in need of assistance

This is not intended to be a complete listing, but it is a general representation of why women tend to do worse than men after divorce.

To be better prepared, understanding the difference between the "legal" and the "financial" may lead a woman (or man) down different paths. For example, while a mother may receive large support payments, if she does not have the resources and support structure to help her overcome at least the first four impacting issues noted above, then she will never escape the trap of lower income. The closer she gets to those retirement years, the fewer options she will be able to avail herself of. This proximity to retirement was the core finding of the GAO study noted above.

Alimony and Family Support

Understanding the needs of the two people in divorce is critical to moving the process forward. First and foremost, the process is jarring, emotionally and economically. Someone moves out, a family residence is sold, and two rented units may be required (in most cases) to bridge the gulf from divorce to a new life. Looking back to the comments about poverty, what is the best path forward?

One case had the mother asking for less in support over time but much more in the short term. Her goal was to attend a college for medical training. While she could have negotiated for a larger amount of money in support payments over time, the savings to her ex-spouse was large enough for him to agree to the terms. The result was that she got a degree without going into debt, the children were able to have a reasonable existence in this life transition, and she ended up with her career and ability to support herself and family moving forward. As a side note, she later remarried but was careful about retaining her independence regarding economic capability.

This is not a solution for all situations, but it highlights the need for everyone to weigh economic benefits and costs. Long-term payments may end up being golden handcuffs that keep a person from seeking a better potential situation.

This does not mean that a person does not recognize the overall needs of their family and situation. Marlene M. Browne, the author of *The Divorce Process: Empowerment Through Knowledge,* comments that other factors need to be added into the equation for settlements—things that are often overlooked. These can include the value of raising children versus the cost of day care. The operation of a household and managing the day-to-day maintenance versus hiring domestic help and laundry services. Then, beyond the physical tasks, is the personal support offered as physical and emotional help. All these have financial considerations that courts are more likely to look at, as such issues become elevated in social awareness. That adds to the value of support as well as consideration in other respects. Especially in flexible processes like divorce mediation and collabotaive cases, these are elements of discussion for consideration between the couple.

A place where legal advice is important is determining the type of support that should be paid. Will this be permanent, rehabilitative, reimbursement, or for a limited duration? Based on the facts and circumstances, this will most likely be different from one situation to another.

Not Everything Is What You Think It Is

After support, the property is taken into consideration. This includes things that are owned, as well as debts that are owed.

First, looking at assets—the things owned—always take into consideration the tax aspects of property. The value of a stock is the net value after taxes are paid or capital losses are realized. For example, if there is cash amount of $100,000 and stock of $100,000, which is worth more? That depends. If the stock was purchased for $75,000, then there is a gain of $25,000 and tax will be due on that amount if it is sold. If the tax rate of the gain is 25% for state and federal taxes, that is a cost of $6,250 plus any commission charges. Suddenly the $100,000 in stocks is worth a bit less than $93,750.

But what if the stock was purchased for $125,000 and is now worth $100,000? Odd as it sounds, the stock may be worth more. If the stock is sold and the seller gets $100,000 in cash, they also have a capital loss of $25,000 that they can use to offset taxes going forward. That also has an economic benefit.

Every asset has a tax consideration to it, and courts do not always acknowledge it. Each asset should be valued based on its economic worth and the tax considerations for each side of the negotiation. Looking at these elements from each side may result in different values. If one person is at a lower income level, that capital gain will be taxed at a lower rate. Further, the loss from a capital loss will be worth less to the low-income person.

This is a part of thinking financially as well as legally. It is too easy to get an asset and end up with less than you thought. This also goes for retirement accounts, and how easy it is to get a settlement that includes a pension if the recipient needs cash now. If they are careful, they will first understand the use of a QDRO (Qualified Domestic Relations Order) that can allow for a one-time qualified pension plan distribution (not an IRA) without paying a 10% early withdrawal penalty. But once again, what is the tax that must be paid to get at those assets? That tax reduces the value of the plan overall.

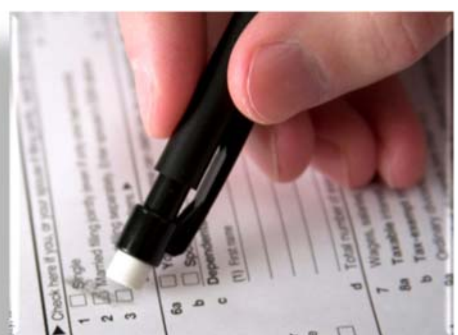
On the reverse side of assets are the debts—those things that you owe. When couples split, debt is often one of many reasons for the marriage ending. Ideally debts are divided like assets when both sides are signed on to an obligation. The problem is that both remain equally responsible to the lender regardless of any agreement for each person to pay their own half. Even with a court order requiring one person the take responsibility for the debt, if that person defaults, the lender is coming after the other person as someone else that is responsible for paying.

The best way to handle this is to open new accounts and transfer the debt from any joint account to the new separate account. To the extent that it is possible, getting names off auto loans and leases is advisable, as well. Houses are larger and more complex, so it is advisable that if one person is keeping the home, the lender should be contacted to review options for getting the non-resident spouse off the mortgage. Typically, this is accomplished through a refinance of the residence.

One particular case involved IRS debts, which are common in divorce. However, this was an unusually large amount that was due. The problem with IRS debt is that both sides are obligated, and there is no recourse to have the other person pay. If the return was filed as joint, the filers are "jointly and severally liable" for the tax due. This means that the government can go after any person for the entire amount due. If the court ordered each side to pay their separate amounts due, that only leaves the paying party pursuing the other side for reimbursement of their share of the liability.

However, there may be a couple of options to avoid this. Each of these depends on the facts and circumstances of the situation as to whether they apply.

First, the return can be amended by filing separately. This will result in a higher amount of tax due overall, but it can make each side liable for their portion only. Second, it is possible that one person qualifies for tax relief. These options include Innocent Spouse, Separation of Liability or Equitable Relief.



The "Innocent Spouse" option requires that one person demonstrate that the income reported and deductions were incorrect, and beyond that person's ability to have known or discovered the error. In many cases this is difficult to prove. The IRS and the courts tend to assume that the spouse claiming innocence would have knowledge or suspicion about the income based on a lifestyle being enjoyed.

"Separation of Liability" is a request that the taxes be allocated based on income earned and deductions allocated to each person. This form of relief is also based on items not being reported correctly. However, instead of asking for total relief from the taxes due, the person petitioning for relief is requesting that only the tax allocated to that person is the amount for which they are held responsible.

“Equitable Relief” may apply when you do not qualify for innocent spouse relief or separation of liability relief.

This area of tax law is a specialized form of practice that is beyond the scope of this discussion. However, it is important to be aware that there are possible options to handle tax issues.

Also, something that is often forgotten is to make sure the insurance carriers for auto, homeowners, and other similar property coverage are notified of the separation. Otherwise the owner of the asset – a car – may not get the check issued by the insurer if the other spouse is named on the insurance contract.

Does This All Require Court Intervention?

Of all cases filed in the United States, the estimate is that 90% to 95% of divorce cases settle before they get to court[vi]. First, understand what “going to court” is versus filing with the courts.

All divorce cases start by filing with the court, regardless of a couple doing it themselves, in mediation, collaboratively or contested. It is the court that reviews the settlement agreements and issues the final judgment granting the divorce. This is different than showing up at court on an assigned date, standing before the judge and pleading your case. In this latter situation, the judge is left with the power to decide your fate.

The reason couples end up before a judge is more often the result of a fight and a sense of seeking justice. Yet, family courts are not courts of justice. They are referred to as courts of equity. They function outside the normal operations of the legal system, and there are no juries or others to hear the stories of injustice. It is only a judge, who has broad discretion to make rulings that meet the judge’s standards of what is fair and equitable. The only recourse from that point is an appeal.

The good news is that people do not typically end up in court. The negative is that bitter arguments that are emotionally charged may, and do, lead people to be on the steps of the court before they settle. Given the costs for legal representation, that is an expensive use of resources for an outcome that, in most cases, could have been negotiated based on the financial mindset rather than the emotional cloud of fear and uncertainty.

Going Back to the Basics

To have a preferred outcome, it is important that both sides be prepared. We often tell the most informed spouse that it is in their best interest to disclose and help the other person to get up to speed on assets, debts, income and liabilities. If one side is unfamiliar with the marital situation, there is no way for them to understand if they are getting a good deal or a bad deal. Education is in everyone's best interest.

Education is also the way to protect each side as they move through the divorce process. Knowing about the income and expenses allows both sides to come up with a marital standard of living, which is part of filing and disclosures. This all goes in a detailed affidavit. It is also the basis for creating realistic settlements.

In every divorce mediation case we take on, we insist that couples create a cash flow chart showing all their income and expenses. Sadly, we often find that one side (if not both sides) is clueless as to what is happening in their financial lives. Everything from utilities to incidental needs is misunderstood. Periodic payments such as insurance for auto and homes are forgotten, even when the item is listed on the budget forms.

It is important to get grounded in these basic elements. By creating a detailed picture of how life is in the present, it gives a couple the ability to work out a future. Even something simple like a mortgage payment of $2,500 a month with deductible interest becoming rent for two non-deductible apartments at $1,500 each builds the economic reality that life will change going forward.

Courts will not look at anything beyond what you give them. Like a computer, bad information going in creates bad results coming out.

Final Thoughts

This article is based on the notion that people need to be financially educated about their world before, during and after the divorce. It also means that awareness of how the law works in divorce process is also important. That is where an attorney can be an invaluable resource.

Divorce laws will differ from state to state and the laws within any state may be applied differently from one judge to another. Regardless of a desire to seek a divorce trial or not, it is in everyone's best interest to consult with an attorney. An attorney can help determine how judges look at different types of settlements, what a likely outcome may be for a particular set of facts or circumstances, and the attitudes of the courts about custody of children, moving away with children and support. As noted earlier, these are called courts of equity and the judges have wide discretion. While no one can promise an outcome, at least a lawyer can educate each person about the prevailing attitudes and how the law is applied.

In the end, settlements are based on the couple's desire to craft an agreement that works. Self-interest is part of that settlement process. Working towards something that is sustainable and workable can result in a settlement that both sides can live with. Having a settlement that they can "live with" will probably not be a settlement either side is happy with. But it is a path forward with as much possible opportunity being negotiated for both sides.

One anonymous writer noted that, "It's easier to write laws than to enforce them." It can also be said that it is easier for a judge to impose a settlement than to enforce a settlement. Couples that do not want to come back to court in an endless fight over money and children are encouraged to think financially and to get their financial house in order as they approach divorce.

About the Authors

Armand D'Alo is a Certified Divorce Financial Analyst (CDFA™), a Certified Financial Planner (CFP®) and an Enrolled Agent licensed to practice in tax matter before the IRS. Robbin D'Alo is a Certified Divorce Financial Analyst (CDFA™), a Certified Legal Assistant (CLA) and an Enrolled Agent licensed to practice in tax matter before the IRS. Together they team mediate with couples thinking about and working through divorce. The offer a unique program called One Last Look™ which gives individuals and couples a chance to see what divorce is really all about before they take that final step (www.oaktreemediation.com). They also teach a monthly online class, "Crossroads of Marriage and Divorce," which teaches about divorce and how to navigate the process emotionally and economically (www.youronelastlook.com).

---

[i] History of family law: http://law.jrank.org/pages/6744/Family-Law-Historical-Background.html
[ii] 10 Countries With the Highest Divorce Rates by Cory Barclay http://www.therichest.com/rich-list/the-biggest/10-countries-with-the-highest-divorce-rates/
[iii] http://scocal.stanford.edu/opinion/marriage-davis-34427
[iv] Nolo Press - Divorce & Money: How to Make the Best Financial Decisions During Divorce by Violet Woodhouse, CFLS, CFP with Matthew J. Perry.
[v] http://www.gao.gov/products/GAO-12-699
[vi] http://www.cbsnews.com/news/the-divorce-process/