



As Dan and Sue prepare for their divorce, things seem pretty straight forward. Here is a list of their assets.

1. Principal Residence	
Market Value	\$750,000
Mortgage Balance	\$ 150,000
HELOC	\$ 200,000
Equity	\$400,000
2. Vacation Home	
Market Value	\$300,000
3. Dan's 401k	\$150,000
4. Checking and Savings	\$30,000
TOTAL ASSETS	\$880,000

Who is Keeping What

Dan says that he wants to keep the primary home and he will let Sue keep the vacation home. Sue agrees with this plan and therefore, to provide a 50/50 split, Sue will get half of the checking and savings, \$15,000 and \$125,000 of the 401k for a total of \$440,000 each. Ah, a perfect 50/50 split. No problem!!

	Dan	Sue
1. Principal Residence	\$400,000	
2. Vacation Home		\$300,000
3. 401k	\$25,000	\$125,000
4. Checking and Savings	\$15,000	\$15,000
TOTAL ASSETS	\$440,000	\$440,000

Dan plans to live in the primary home for 2-3 more years and then sell it and downsize. Sue plans to sell the vacation home and buy a new residence for herself. Since she's only 50 yrs old, she is also going to take advantage of her one-time opportunity to withdraw \$100,000 from the 401k subsequent to divorce with no penalty, although she will have to pay income tax on the money. Hmm, could these plans impact this settlement? Let's take a new look at each party.

The Aftermath

About 6 months after the divorce, Dan realizes that the upkeep on the home is more than he can afford on his own and decides to go ahead and sell. He's able to sell it for \$775,000. He pays off the \$350k mortgage and HELOC and has to pay 6% for sales fees or \$46,500 leaving him with \$378,500 in equity. The original price of the home, bought with his wife 25 years ago, was \$150,000. That means he now has a capital gain of \$228,500. As a single person, he can exempt \$250,000 of gain on a principal residence, avoiding any capital gains tax.

How did Sue fare? She moved into the vacation home for 6 months before putting it on the market. It actually sold for \$325,000 with selling expenses of \$19,500 leaving her with \$305,500. The property had been in her family for generations and the basis was \$60,000 so she assumed that her gain of \$245,500 was well under her personal exemption and she sold the property and used the money to buy a new condominium. When tax time came around, her accountant looked at her with big eyes and broke the bad news. The personal exemption is only applicable to a primary residence and you must live there for 2 years in order to use it. Since she didn't, the **entire gain is taxable**. She's also a highly compensated individual so her rate is not 15% but 20% and oh, don't forget to add the new Medicare surcharge which raises it to 23.8% so her **tax bill is \$58,429**.

Who Really Kept What

We also have to remember that she withdrew some of her 401k assets in cash and had to pay tax on those too! Let's look at a revised chart.

	Dan	Net	Sue	Net
1. Principal Residence *net after-sales cost & tax, no appreciation added	\$400,000	\$378,500		
2. Vacation Home			\$300,000	\$222,071
3. 401k *Dan @ 28%, Sue@ 39% tax	\$25,000	\$18,000	\$125,000	\$76,250
4. Checking and Savings	\$15,000	\$15,000	\$15,000	\$15,000
TOTAL ASSETS	\$440,000	\$411,500	\$440,000	\$313,321

Not a 50-50 Split After All

Dan's assets are worth \$98,179 more than Sue's. Once Sue figures this out, how do you think she will feel about the "fair" division that she agreed to?

There were much better ways to structure this settlement that would have been more equitable. But as you know, once that decree is written, it's pretty tough to go back and fix things. Take the time to really evaluate your settlement results or bring in an expert who can.

At the very least, review the plan with a CPA or CDFA®. Mistakes like these could turn your dream of the next phase of your life into a nightmare. At Smarter Divorce Solutions, we understand divorce financials and can prepare your documents fairly at an affordable cost.

Questions? Contact Us
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