Your Divorce Matters

How you can maximize your share of retirement accounts

In many divorces, retirement plans account for most of a couple's wealth, second only to the family home. There are different tax rules and valuation methods regarding the allocation of these assets, which can have a significant effect on your financial security.

IRAs

Individual Retirement Accounts (IRAs) can be easily transferred between spouses with minimal paperwork. The mutual fund company or Bank (custodian) will need a copy of your divorce decree that should clearly stipulate what accounts should be transferred. The key to this transaction is to make sure that you do not receive cash from an account prior to age 59 ½. If the cash is paid to you, you can avoid income tax and penalty only if you reinvest the entire amount in your own IRA within 60 days of receipt. If your share of an account is paid directly to you and you do not reinvest, either you or your spouse will pay income tax and a 10% IRS penalty on the total amount of the withdrawal. To avoid any income tax or penalty, direct the custodian of the account to allocate the funds according to the agreement, internally. You can then transfer the account to a custodian of your choice, once your account has been established.

Employer-sponsored Plans

Plans such as a 401(k) or Profit Sharing Plan can be likewise transferred to the other spouse's IRA. You and your spouse decide on the valuation date and the employer's plan sponsor can transfer your portion of the account directly to your own IRA. Once again, to avoid any income tax or penalty, the funds should be made in the form of a "trustee to trustee transfer." A very important element in this transaction (different from IRAs) is that your attorney must prepare a special document called a Qualified Domestic Relations Order (QDRO), which should be submitted directly to the plan sponsor. I would recommend that the QDRO be prepared prior to the date of final divorce to assure that the funds are transferred in accordance to your wishes.

An Unlikely Source of Cash!

I do not advocate the use of retirement funds for other uses; however, some couples find they are strapped for cash in the divorce process and an employer-sponsored plan, under certain conditions, can provide some needed relief. There is a provision in the tax law that allows the non-employee spouse to be paid their share of the account, in cash, *without IRS penalty.* The funds will be taxable and the plan sponsor will withhold 20% of the proceeds, when paid. With the proper planning and documentation, each spouse could receive cash, without penalty! You could even receive a partial distribution and transfer the balance to your IRA. The transfer would not be taxable and you would not have a 10% penalty.

Pension Plans

You or your spouse may have a pension plan that will pay monthly benefits at retirement. There are two methods that can be used to divide these benefits.

The “if, as and when” approach simply awards each spouse a share of the benefits if and when they are paid.

The second method uses a “present value” approach. Under this method, the value of the future payments is calculated and becomes a marital asset. The non-employee spouse is then given another marital asset of equal value, in return for the employee spouse’s right to keep the pension. An Actuary, who is an expert in valuing pensions, should complete the valuation of the pension. The cost of this valuation can be nominal in comparison to the amount awarded to the non-employee spouse.

The result of the “if, as and when” approach may give you a false sense of security, as your portion of the benefit may be viewed as a guaranteed source of retirement income. Beware of the risks in this decision. Suppose you “ex” does not retire as planned? Suppose he/she never retires? What if the company mismanages the fund and the pension is not worth as much in the future as is estimated presently? This decision must be carefully considered to avoid losing a large and important share of the marital assets.

Being aware of these rules and seeking the advice of a financial divorce professional can help you maximize your share of the retirement assets and secure your own financial future.

This article was written by John Faggio and was published in the Howard County’s Women’s Journal, February 2005. It has been updated by the author on June 24, 2009.