

Divorce and Retirement Accounts

When dividing up retirement accounts during a divorce, it is important to know that:

- An individual can transfer all or part of a qualified retirement plan or individual retirement account to the owner's former spouse income tax free if the transfer is done pursuant to specific transfer rules.
- Retirement plans are individually and not jointly owned, even in community property states. The spouse who contributed to the retirement plan ("the participant") is the sole owner until the account has been divided or transferred pursuant to a court order or divorce decree.
- Different rules apply to qualified plans and individual retirement accounts.

Qualified Plans

A **qualified domestic relations order** ("QDRO") is the legal document that identifies which benefits from a qualified plan will transfer to the former spouse (called the "alternate payee" in the QDRO), and which plan benefits remain with the plan participant. A separate QDRO is required for each qualified plan, and the QDRO must conform to the specific rules determined by the plan administrator.

Once the QDRO is in effect, there are several options for the alternate payee to receive the funds.

- For a **defined benefit plan**, the alternate payee will have his or her own separate account with the plan and will receive a lump sum or a series of payments upon the retirement date pursuant to the payout options in the plan.
- For a **defined contribution plan**, the alternate payee has three options:
 - ❖ Transfer the amount to a rollover IRA in the alternate payee's name;
 - ❖ Keep an account with the employer's plan; or
 - ❖ Take a lump sum distribution.
- Distributions from the qualified plan are taxed as if the alternate payee is the participant, but distributions avoid the 10% penalty tax even if the alternate payee is under age 59½. IRC §§ 402(e)(1)(A) and 72(t)(2)(C).
- If the qualified plan account is transferred to the alternate payee's IRA, any subsequent distribution from the IRA before the alternate payee's age 59½ triggers a 10% early withdrawal penalty unless another exception applies. IRC §72(t)(3)(A).

Individual Retirement Accounts (IRAs)

IRAs are not divided via a QDRO. Rather, an IRA transfer following a divorce is accomplished on a tax-free basis if there is a transfer of an “interest in an IRA” via a valid divorce decree, decree of separate maintenance, or similar written instrument as permitted under Section 408(d)(6).

Methods to Transfer IRA funds to Ex-Spouse

There are two commonly used methods to transfer of some or all of the IRA funds to the former spouse.

1. **Trustee-to-trustee transfer:** transferring a fixed dollar amount or percentage of assets directly from the owner’s IRA trustee to the former spouse’s IRA trustee; or
2. **Assignment:** The account owner sets up a separate IRA, containing the amount to be transferred, and then assigns the entire separate IRA to the former spouse by changing the name on the account to the former spouse.

The IRA transfer should never be in the form of a check payable to the IRA owner or the former spouse.

The transfer of IRA funds should be made after the divorce decree is final. If the IRA owner transfers part or all of the IRA before the divorce decree is final, the owner will be taxed on the distribution and likely incur the 10% early distribution penalty for persons under 59½. The IRA owner should transfer the IRA funds to the former spouse no later than one year of the divorce decree being finalized.

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