Transfer of an IRA Pursuant to Divorce.

Divorce is a problem. But that's all it is. It is precious little about anger, resentment, and revenge. It is, however, a lot about decision making and, more importantly, financial planning. Divorce is perhaps the most important financial decision most people in America will make in their lives. It's the one day they buy and sell everything they own. A fundamental knowledge about property in general and sound financial planning strategies will go a long way toward insuring the survivor's economic well being.

There seems to be some confusion out there between IRA trustees and family law attorneys regarding the transfer of an Individual Retirement Account (IRA) pursuant to divorce. Is a Qualified Domestic Relations Order required? Some say yes, some say no. Let's see what the Internal Revenue Service and the Department of Labor's positions are on this matter.

The creation of an IRA is controlled under Section 408 of the Internal Revenue Code. The transfer of an IRA pursuant to divorce is described in Section 408(d)(6) as follows:

> Transfer of account incident to divorce. The transfer of an individual's interest in an individual retirement account or an individual retirement annuity to his spouse or former spouse under a divorce or separation instrument described in subparagraph (A) of section 71(b)(2) is not to be considered a taxable transfer made by such individual notwithstanding any other provision of this subtitle, and such interest at the time of transfer is to be treated as an individual retirement account of such spouse, and not of such individual. Thereafter such account or annuity for purposes of this subtitle is to be treated as maintained for the benefit of such spouse.

This section of the Code is very broad. But one thing it does not do is require that an IRA be subject to the terms of 414(p), which is the qualified domestic relations order section of the Code. Section 414(p) applies to the following types of plans:

1. Section 401(a) plans (pension plans & profit sharing plans);
2. Section 401(k) plans (cash or deferred arrangements);
3. Section 403(b) plans (501(c)(3) organizations and public schools);
4. Section 409 plans (employee stock ownership plans);
5. Section 414(d) plans (governmental plans);
6. Section 414(e) plans (church plans); and
7. Section 457 plans (governmental plans)

Although Congress had an opportunity to include IRAs in the qualified domestic relations order section of the Code, as you can see, it chose not to.

P. O. Box 1569, Spring, Texas 77383-1569 * Tel. 281 / 288-4773 * FAX 281 / 528-6113
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Section 414(p) has various requirements that an order must follow in order to be qualified under that section as follows:

> **(2) Order must clearly specify certain facts.** A domestic relations order meets the requirements of this paragraph only if such order clearly specifies --
>
> (A) the name and the last known mailing address (if any) of the participant and the name and mailing address of each alternate payee covered by the order,
>
> (B) the amount or percentage of the participant's benefits to be paid by the plan to each such alternate payee, or the manner in which such amount or percentage is to be determined,
>
> (C) the number of payments or period to which such order applies, and
>
> (D) each plan to which such order applies.

> **(3) Order may not alter amount, form, etc., of benefits.** A domestic relations order meets the requirements of this paragraph only if such order --
>
> (A) does not require a plan to provide any type or form of benefit, or any option, not otherwise provided under the plan,
>
> (B) does not require the plan to provide increased benefits (determined on the basis of actuarial value), and
>
> (C) does not require the payment of benefits to an alternate payee which are required to be paid to another alternate payee under another order previously determined to be a qualified domestic relations order.

These requirements are missing from the IRA transfer section of the Code. Obviously, Congress intentionally left the transfer of an IRA very broad. A transfer just has to be pursuant to a divorce or separation instrument described in subparagraph (A) of section 71(b)(2). Section 71(b)(2) describes the term "divorce of separation instrument" to mean -

> (A) a decree of divorce or separate maintenance or written instrument incident to divorce to such a decree,
>
> (B) a written separation agreement, or
>
> (C) a decree (not described in subparagraph (A)) requiring a spouse to make payments for the support or maintenance of the other spouse.

A written separation order or a court support order which is not incorporated into one of the orders identified above will not be sufficient to meet the requirements of Section 408(d)(6)

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Simplified Employee Pensions (SEPs).

You should, however, be aware of the Simplified Employee Pension IRA or SEP IRA. When a SEP IRA is established by an employer for the benefit of an employee who is not the business owner, and contributions are made by the employer to that SEP IRA on the employee's behalf, the Department of Labor takes the position in its regulations that the SEP IRA is an employee pension benefit plan subject to Title I of ERISA. Title I of ERISA contains the anti-alienation requirement and the QDRO exception. In order to comply with ERISA and the DOL regulations, it appears that a QDRO would be required to partition an SEP IRA where one of the "participants" was not a business owner.

Conclusion – No QDRO is required for the transfer of a traditional or Roth IRA pursuant to a divorce. Language in a decree is generally sufficient. A QDRO, however, is advisable if the IRA is a SEP IRA where at least one of the participants in the SEP is not the business owner.

Practice Tip # 1 – For the transfer of an IRA, we suggest that you incorporate in your decrees, as an example, language similar to the following:

Under a heading titled, "Property Awarded to **Petitioner**":

1. **FIFTY AND NO/100 PERCENT (50.00 %)** of the account balance in **Respondent's Merrill Lynch** Individual Retirement Account, account number **123-456-789**, as of the **date of divorce**, **pro rata from all of the investment funds in such account**. The division of this IRA is deemed to be made pursuant to this decree (judgment or property settlement agreement) and is intended to be a tax-free transfer under Section 408(d)(6) of the Internal Revenue Code of 1986, as amended.

Items in **bold underline** change with each decree.

Practice Tip # 2 – Because there is so much uncertainty at the IRA custodian level as to how to accomplish transferring IRAs between spouses incident to divorce, we suggest that you consider dividing any IRA that will be the subject matter of a divorce into two (2) separate IRAs prior to the date of divorce and then awarding 100% of one of the IRAs to the spouse using the decree language discussed above. When you do this, you eliminate virtually all of the different transfer procedures that IRA custodians incorporate that make transferring IRAs difficult.

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