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Avoiding Mistakes in a Divorce in 5 Easy Steps

Retirement accounts and divorce. When a divorce occurs, the financial assets of a couple, including their retirement accounts, are often split. If mistakes are made during this process, the stress of a divorce can be compounded when one or both spouses find that they are subject to unnecessary taxes or penalties.

1. **IRAs in divorce.** To properly divide an IRA as a result of a divorce, specific language on the structure of "who gets what" should be included in the marital settlement agreement (MSA) or other divorce agreement. A copy of this executed agreement should be given to the IRA custodian. The money should NOT simply be withdrawn from the IRA and given to the other spouse, as this would be treated as a taxable distribution for the IRA owner. The funds should instead be transferred to the receiving spouse's IRA.

2. **ERISA plans in divorce.** ERISA plans can't be split by an MSA or divorce agreement. They require a special court order, known as a Qualified Domestic Relations Order (QDRO). Once a QDRO has been issued, it should be sent to the ERISA plan's administrator. The terms of the plan will determine when the spouse receives the funds. In some plans, a lump-sum distribution will be available immediately, while in other plans, benefits may not be payable until the ex-spouse has a triggering event.

3. **What to do with the received funds.** If you are receiving a portion of an IRA, you will likely want to move the funds over to your own IRA to avoid incurring tax and possibly the 10% early distribution penalty. However, if you are receiving a distribution pursuant to a QDRO, you will want to consider if you will be using any of the funds prior to age 59 ½. Funds received directly from a plan under a QDRO are exempt from the 10% penalty. If you roll those funds over to an IRA and later take a distribution prior to age 59 ½, the 10% early distribution penalty will apply.

4. **Name new/update beneficiaries.** One of the most common mistakes after a divorce is the failure to properly update beneficiary forms. This is NOT something that should be overlooked. There have been many documented cases where a failure to properly update beneficiary forms led to an ex-spouse receiving funds that were intended for children or even a new spouse. DON'T let this happen to you.

5. **Reassess retirement preparedness.** For many, a divorce is an emotionally draining and traumatic event. But for some, the emotional impact is compounded by a significant change to personal finances. So just like any other major life event, it's beneficial to reevaluate your retirement and financial plans to determine the best course of action.