Legal Matters®

Family Law
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Can you divide retirement accounts in divorce without suffering tax penalties?

There is a common perception that divorcing spouses must liquidate retirement accounts for the purpose of splitting up property, and consequently accept the tax consequences for early withdrawal, which robs account owners of the tax advantages that make things like individual retirement account (IRAs), 401(k)s and other accounts popular vehicles for retirement savings in the first place.

But don't assume this is the case. Talk to a family lawyer.

Because of the penalties, as well as restrictions on the transfer of accounts from one living person to another, laws have been passed that allow for certain retirement accounts to be divided at divorce without tax penalties.

For example, an IRA can be divided by executing what's called a "transfer incident."

If under the terms of your divorce agreement you plan to split your IRA 50/50 with your now-ex-wife, she will still pay tax on any distributions she takes after receiving the funds, which means she may try to negotiate a bigger split to account for that. But you won't be taxed on the assets sent to her if you properly identify and execute the transaction as a transfer incident. That's why it's so important to consult with a divorce lawyer who understands these things and can make sure this is done properly.

Other types of retirement accounts, like pensions, 401(k)s and

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403(b)s, can be divided without tax consequences via a qualified domestic relations order (QDRO).

The court overseeing your divorce issues the order to split the account. But the wording of the order has to be approved by the entity that handles the account. For example, if you're a government employee, such as a teacher, a state worker or a member of the military, the plan must be approved by the government department that handles your retirement account. If you work in the private sector, the plan

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Dividing retirement accounts without suffering tax penalties?

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administrator (the financial institution handling the account) has to give its approval. Approval is typically granted if the order complies with rules and regulations on the division of retirement funds.

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So what are the mechanics of the payments once an account is divided through a QDRO?

That depends on the type of plan. Some plans, such as pension plans, make payments to a retired person in monthly installments. In this case, a QDRO will often call for payments to be split between the account holder and his or her ex-spouse based on how much of the marriage coincided with the years the pension was earned.

For example, if a couple marries and divorces within a few years of the account owner's retirement, his or her spouse wouldn't be entitled to as generous a split of future payments as he or she would be if they had been married for the owner's entire working life prior to divorce. Similarly, if a couple divorced just a couple of years after the owner started contributing to the account, the QDRO likely would not give the other spouse the right to collect much of the currently unvested payments in the future.

But what if the account provides for a lump sum payment upon retirement, as with a 401(k) or its public-sector version, a 403(b)? In such a case, the court might order that the account owner retain his or her share of the account while ordering a different tax-deferred account created for the other spouse. The transfer of assets into the new account wouldn't result in taxes or penalties, but the recipient spouse would still want to consult with a professional on how to handle the funds going forward.

Does any of this sound confusing? If so, that's OK, because this is complicated stuff, and there are other things to consider, like whether it's more advantageous for the receiving spouse to take a lump-sum division in cash or roll it into an IRA of his or her own. It's certainly worth getting in touch with an experienced family law attorney to explain things in more detail and decide what options work for you.

Mom gets years of unpaid support for 52-year-old daughter

States have gotten increasingly strict in enforcing child-support obligations. If you're a deadbeat dad (or mom) and think you can outrun your child-support debt by simply waiting until your kids are independent adults, think again.

If you spent years struggling to support a now-grown child without your ex's much-needed support payments and you think it's now too late to do anything about it, think again as well. As a California case shows, while diamonds may not be forever (at least as applied to wedding rings), support obligations might.

In the case, Toni Anderson's husband left when their daughter was three. After his first $160 check bounced, he stopped paying and moved to Canada. Meanwhile Anderson worked as an interior designer to support her daughter on her own. She was pretty successful. Though she lived paycheck-to-paycheck, she sent her daughter to college, and her now-52-year-old daughter runs the firm where her mother worked.

But Anderson, now 74, realized she'd gotten an unfair deal and life could have been much easier all those years. She learned that California has no time limit on support obligations.

She did some digging, learned her ex is now in Oregon, and sought to collect what was initially only a $160-per-month obligation. With interest and attorney fees, she determined he owed her more than $150,000. She took him to court and won.

Unfortunately, the same result won't happen everywhere. Some states have statutes of limitation for suing for unpaid child support. In other words, you may have only so many years to file before you lose your rights.

So if your ex isn't meeting his or her obligations, talk to a lawyer today.

Divorce agreements vague about college costs create risks later on

One of the most contentious issues in a divorce can be kids' college education.

For example, what percentage must each parent contribute? How will the college plan be funded? Will the parents be responsible for just tuition, or for room, board and expenses, too? How much say will each parent have on the choice of school? What if one parent's financial circumstances change for the better or worse?

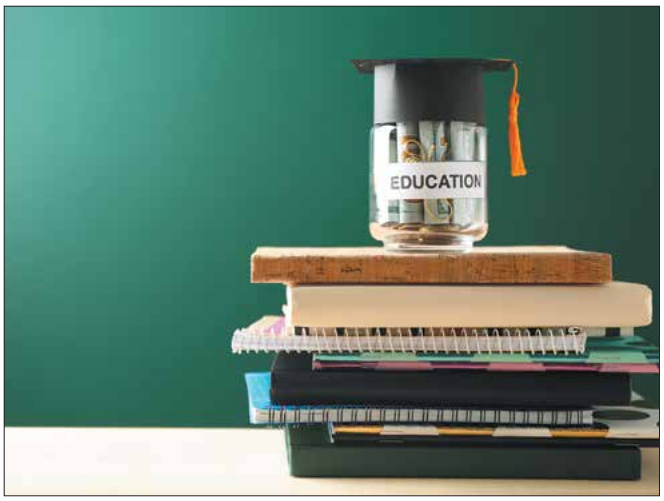
Divorce clearly can have a significant impact on kids' college plans, even if children are still very young at the time of the divorce. That's why it's best to work with a good divorce lawyer to predict potential issues and address them properly in your divorce agreement, leaving nothing to chance.

Take a recent New Jersey case. A couple had four kids, two of whom attended an in-state public university at the time of divorce. As part of the property settlement, the couple agreed to contribute equally to "all reasonable and agreed upon" college and secondary education costs above any financial aid the kids received. They also agreed to consult with the kids and each other about the "best education possible" in view of their particular circumstances and those of the kids.

The trouble started when the third child wanted to go to an expensive out-of-state school instead of the state university. The father said he couldn't afford it, but the child enrolled over his objection. At that point the father refused to pay half the costs, so the mother took him to family court, accusing him of violating the divorce agreement.

The judge determined that the father should not have to pay half the cost, since he did not agree to it. Instead, the judge ordered the father to pay what the contribution would have been had the kid gone to the state school, estimating the tuition to be $20,000 after financial aid, with 5 percent added each year for inflation.

Both parties appealed, and the New Jersey Appellate Division ruled that the lower court made a mistake, both by failing to weigh certain factors in the absence of a clear agreement and by engaging in "conjecture" regarding the cost the father would have paid for a state school.



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The court further found that the best interest of the child was indeed to go to the private school. Now the case is going back to family court, where a judge may well order the father to pay half those costs.

Another interesting case arose in Massachusetts, in a case where a divorce agreement vaguely obligated parents to confer on "major life decisions."

The mother enrolled the son at the University of Arizona without formal consultation, but also without the father expressing any formal concerns at the time. The father subsequently filed a contempt motion in family court arguing that the mother violated the divorce agreement by engaging in a "unilateral action" that affected his financial obligations.

The court found no contempt, but still modified the father's financial obligations. The Massachusetts Appeals Court reversed, finding that the father hadn't sufficiently demonstrated a material change in circumstances, and remanded the case back for further findings. This father, too, might end up paying more than he thought he bargained for.

A lot of these situations, and the court costs that accompany them, can be avoided if a divorce agreement includes language that specifically addresses what happens when parents can't agree on the choice of college. Each state has its own laws, however, so consult with a family lawyer in your state to learn more.

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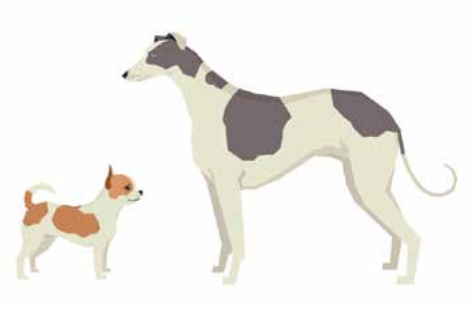
Visitation terms for couple's dogs enforceable as written

The terms of a visitation agreement for a divorcing couple's dogs was enforceable as written, even if the husband did a poor job caring for the pets, a state supreme court recently ruled.



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Before Diane and Paul Giarrusso divorced in 2017, they entered a marital settlement giving ownership and control of their greyhound and their chihuahua to Diane but giving Paul the right to have them every week from Tuesday morning to Thursday morning. The agreement was never officially merged into the final divorce decree, though it was incorporated by reference.

After a few months, Diane stopped the visits. Paul took her to family court, seeking to enforce the visitation schedule.

Diane countered by arguing that Paul did a lousy job caring for the dogs and that he tried keeping them from her, in violation of the agreement. She pointed to a day when the greyhound allegedly went missing at Paul's house, causing her to become so upset and hysterical that she was vomiting by the side of the road during the search effort. This rendered the visitation provision inequitable, she argued.

But a family court judge ruled that the visitation provision was fully enforceable as written and that Diane could not keep the dogs away from her ex. Specifically, the court viewed the agreement as a contract expressing both parties' rights to the dogs that the court could not alter, absent a mistake on both parties' parts.

The R.I. Supreme Court affirmed, emphasizing that it is not a court's job to set aside a settlement agreement just because one party no longer wants to be bound.

The lesson is to think twice before agreeing to share your pets with your ex and to talk to a good family lawyer to make sure any such agreement has conditions that can void it.