Reuters

Your Money: Splitting retirement accounts is tricky for DIY divorce

By Beth Pinsker
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NEW YORK (Reuters) - If you are trying to have a low-cost, do-it-yourself divorce, it may seem reasonable to just split up the retirement assets and each go your separate ways.

While many couples dissolve their marriages without significant legal involvement, divvying up retirement accounts, particularly pensions, is thorny. Doing it without a proper legal agreement could stick you with a hefty tax bill and penalties. In some cases, one party may end up with nothing.

How much could a retirement mistake cost you? Michelle Buonincontri, a certified divorce financial analyst, reviewed one case after the fact, that amounted to $110,0000 in taxes and penalties. The higher-earning spouse had withdrawn $250,000 from a 401(k) account to give to the other spouse, without what is known as a qualified domestic relations order (QDRO). The tax, at 39.6 percent, was $85,000, and the 10 percent early distribution penalty was $25,000.

The couple could have avoided that financial hit by hiring an attorney who specializes in QDROs to file an agreement in conjunction with their divorce. Moving the money directly into another retirement account with the proper paperwork, would mean no penalties and fees. Cashing it out could save money by shifting the distribution to the lower-earning person's tax bracket.

"It's the do-it-yourself age, and we spend more time cleaning up mistakes," said Janis Cowhey, a partner at Marcum LLP, an accounting firm based in New York, who often sees divorced couples mishandling retirement funds.

When it comes to pensions, complications abound, because every one of them has unique rules. If you do not execute the legal agreement properly, at the time of divorce, the consequences can be severe.

Chris Chen, a certified financial planner in Waltham, Massachusetts, said state pensions in his state may not allow for the divorced spouse who is due a part of the pension to collect any funds after a remarriage. He said this often escapes notice in Massachusetts, where 70 percent of divorces are DIY.

PENSION PAPERWORK

Tim Voit, a QDRO analyst based in Bonita Springs, Florida, has seen a number of cases where the spouse with the pension died shortly after the divorce was final, but before any QDRO was signed. Without the proper paperwork in place, the surviving spouses got nothing.

Voit's best advice: Do not get divorced unless the QDRO is completed and ready to be signed simultaneously.

The cost of getting an agreement is reasonable. Experts say you should expect to pay $500 to a few thousand dollars. What is key to saving yourself headaches is finding a qualified preparer. Most family law attorneys will not know how to do it right and will waste a lot of time and money on drafts.

Look for somebody with financial training. Voit developed certification for QDRO preparers through the American Association of Certified QDRO Professionals (aacqp.com).

Another thing to look for is how the preparer launches into the process. Many will draft an agreement, and then send it to the retirement plan custodian for approval.

“A slight change in wording can cost tens of thousands of dollars,” said Voit.

Start first by asking the retirement plan sponsor for their model agreement, then adjust for state laws, Voit recommended.

Another important step is to make sure your attorney is digging up every possible retirement account, so as not to miss significant assets. Old pension plans sometimes lurk out there.

Finally, each spouse should decide if splitting the retirement assets, particularly with long-term payoffs like pensions, is the right way to go or if there should be some other kind of exchange.

“It’s like ‘Let’s Make a Deal,’” said Voit. “Do you want money now or do you want to get double in 20 years? It’s a trade-off.”