

The IRS Giveth and the IRS Taketh Away!

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By Deb Johnson, ChFC, CDFATM

While they usually taketh away more than they giveth, there are a few provisions in the Internal Revenue Code that, when taken advantage of, can offer some valuable financial planning tools for a divorcing client. One of those provisions is found in code section (72)(t)(2)(C) which states that when money is taken from a **Qualified Plan** in accordance with a Qualified Domestic Relations Order (QDRO), the recipient of this money can spend some or all of it without paying the 10% IRS imposed penalty if they are under age 59 1/2. They would, of course, still have to report the distribution and pay ordinary income tax. This can be useful when an ex-spouse is awarded a portion of their former husband or wife's 401(k) or other **Qualified Plan** and need funds to put a down payment on a home or pay their legal bills or for any purpose for that matter. Once the QDRO is executed by the plan administrator, if it is handled properly (by the Alternate Payee) as the money is transferring from the QDRO to an IRA, a distribution can be taken and the 10% penalty is waived. This is a one-time provision available only to the Alternate Payee and does not apply to IRA's. So, if the distribution is not taken before the funds hit the IRA, the Alternate Payee has missed the one-time opportunity and would be charged with the 10% penalty.

There are very specific IRS rules that govern the handling of Alimony (Maintenance). Maintenance is deductible by the payor and must be included as income to the recipient. Some good news for the recipient is that alimony is treated as "earned income" for IRA deduction purposes. A planning tip for 2006 may be to designate \$4,000 (or \$5,000 for those 50 years and older) of a property settlement as spousal maintenance. This would mean that the payor could deduct this amount from their taxable income and it would not be treated as income to the recipient if contributed to a traditional IRA.

Send questions or comments to Deb Johnson, ChFC, CDFATM
at deb@drcofcolorado.com or call (303) 468-5626.
www.drcofcolorado.com