

---

## **ESTATE PLANNING AND DIVORCE: SELECTED ISSUES**

---

**Jeremiah W. Doyle IV, Esq.  
Senior Vice President  
BNY Mellon Wealth Management  
Boston, MA  
December, 2015**

BNY Mellon Wealth Management <sup>1</sup>

---

### **Agenda**

- Pre-marital considerations
- Review estate plan
- Property settlement – income and gift tax issues
- Be careful when signing joint returns
- Stock options and deferred compensation – tax consequences
- IRAs and divorce
- Qualified Domestic Relation Orders (QDROs)
- Naming beneficiaries after divorce
- Trusts – exposure to marital claims
- Estate tax deductibility of transfers required by divorce agreement

---

BNY Mellon Wealth Management <sup>2</sup>

## PRE-MARITAL CONSIDERATIONS

BNY Mellon Wealth Management <sup>3</sup>

## Pre-Marital Considerations

### CONSIDER THE TAX AND LEGAL CONSEQUENCES

- Gifts before marriage are subject to gift tax
  - Example: \$9 million, 2.5 carat blue diamond engagement ring
  - Taxable gift
  - Sales tax issue
  - Deliver coupon redeemable for ring after wedding?
- Qualified plan
  - Rights to plan benefits cannot be waived in a prenuptial agreement
  - Prenuptial agreement should include a provision requiring the parties to execute a confirmation of a timely waiver after the wedding
- Prenuptial agreement
  - Independent counsel
  - Timing
  - Financial disclosure

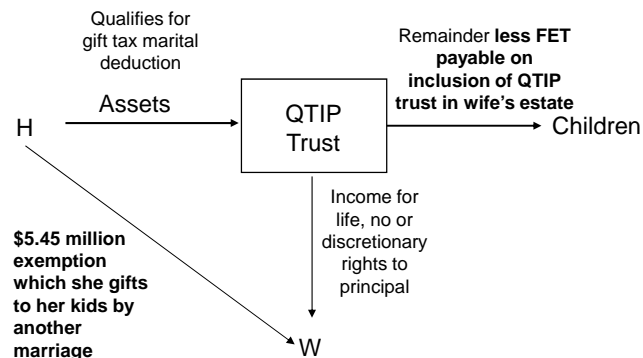
BNY Mellon Wealth Management <sup>4</sup>

## Pre-Marital Considerations

### PORTABILITY AND QTIP ELECTION

- Leave assets to QTIP, remainder to kids from prior marriage
- Gives surviving spouse a larger portable amount
- Agree in prenuptial agreement that portability election will be made if the surviving spouse agrees to waive reimbursement right under §207A
- QTIP won't be reduced by estate taxes attributable to increase in surviving spouse's gross estate due to inclusion of QTIP
- Otherwise, surviving spouse could make gifts of his/her assets to his/her own heirs using the deceased spouse's DSUE amount

BNY Mellon Wealth Management <sup>5</sup>



Result: H's kids pay tax on assets included in W's estate and W gets to use the full amount of H's exemption to make gifts to her children by a previous or subsequent marriage.

BNY Mellon Wealth Management <sup>6</sup>

## Pre-Marital Considerations

### PRESERVE TAX-FREE TREATMENT UNDER §1041 and §2516

- Premarital agreement should have provision to include financial provisions of prenuptial agreement in the divorce agreement so the financial provisions of the prenuptial agreement will be non-taxable under §1041 and §2516
  - For property transfers made more than a year after divorce, §1041 requires the property settlement be covered by the divorce agreement
  - For §2516 to apply, the property settlement must be in the divorce decree and the agreement must be executed one year prior to or two years after the divorce agreement

BNY Mellon Wealth Management 7

## REVIEW ESTATE PLAN

BNY Mellon Wealth Management 8

## Review Estate Plan

### REVIEW ESTATE PLAN FOR NECESSARY CHANGES

- State law may revoke will or certain provisions in favor of former spouse
  - MUPC §2-804 revokes will provisions in favor of a decedent's former spouse, and revokes any disposition of property, grant of a power of appointment, nomination as a fiduciary in favor of the decedent's former spouse or a relative of the former spouse under any governing instrument, including beneficiary designations executed by the decedent prior to the divorce.
- Review/change former spouse's designation as executor/personal representative, attorney-in-fact, health care agent, trustee, beneficiary of retirement plan/life insurance
  - Trusts may be needed to protect interests of minors e.g. minor as IRA beneficiary

BNY Mellon Wealth Management <sup>9</sup>

## Review Estate Plan

### REVIEW ESTATE PLAN FOR NECESSARY CHANGES

- Filing of divorce complaint does not trigger MUPC §2-804 . Only actual divorce does.
- Documents should be changed when marriage has broken down.
- Many states impose automatic restraining order affecting finances.
- Estate liquidity – no spouse, no marital deduction. Estate liquidity an issue e.g. life insurance to cover estate taxes

BNY Mellon Wealth Management <sup>10</sup>

## Review Estate Plan

### REVIEW ESTATE PLAN FOR NECESSARY CHANGES

- Insurance policies
- If insured has “incidents of ownership” in policy, policy will be included in his gross estate for federal estate tax purposes.
- State law may allocate estate tax to the insurance proceeds, reducing the proceeds payable to the beneficiary.
- The divorce agreement should provide a clear statement on whether any estate taxes on the policy proceeds are paid from the insured’s assets or from the policy proceeds.
- See §2206 which states that unless the insured states otherwise in his will, the executor shall be entitled to recover from the insurance beneficiary the estate tax attributable to the insurance.

BNY Mellon Wealth Management <sup>11</sup>

## SALE OR TRANSFER OF A HOME AS PART OF DIVORCE

BNY Mellon Wealth Management <sup>12</sup>

## Sale of Home on Divorce

### TRANSFER OF HOME ON DIVORCE

- If the provisions of §1041 are satisfied, the transfer of one spouse's interest in home to the other spouse is protected from the recognition of gain

BNY Mellon Wealth Management <sup>13</sup>

## Sale of Home on Divorce

### GENERAL REQUIREMENTS FOR \$250,000/\$500,000 EXCLUSION:

- Principal Residence
- Owned and used for 2 of last 5 years
- \$250,000 exclusion if single, \$500,000 if married filing joint

BNY Mellon Wealth Management <sup>14</sup>

## Sale of Home on Divorce

### SELL HOME PRIOR TO DIVORCE TO GET \$500,000 EXCLUSION

- H and W owned and used jointly owned home for more than 2 of last 5 years
- Purchase price \$200,000, FMV \$700,000
- If H transfers his interest to W and she later sells, only \$250,000 exclusion available
- If H and W sell prior to divorce and file a joint return, \$500,000 exclusion available

BNY Mellon Wealth Management <sup>15</sup>

## Sale of Home on Divorce

IMPUTED *OWNERSHIP* OF HOME – SPOUSE WHO OWNS HOME TRANSFERS HOME TO OTHER SPOUSE PURSUANT TO DIVORCE, OWNER-SPOUSE'S PERIOD OF OWNERSHIP IS ATTRIBUTABLE TO THE OTHER SPOUSE'S OWNERSHIP I.E. TACKING OF OWNERSHIP PERIOD - §121(d)(3)(A).

- H purchases home in his name in 2006
- H and W occupy home from 2006
- Couple divorce in 2009 and W gets home under divorce decree
- W sells house in 2009
- W qualifies for \$250,000 exclusion as H's ownership period is added to her ownership period
- W satisfies both use and ownership requirement

BNY Mellon Wealth Management <sup>16</sup>



## Sale of Home on Divorce

IMPUTED *USE OF HOME* – SPOUSE OWNING HOME TREATED AS *USING HOME AS PRINCIPAL RESIDENCE* DURING ANY PERIOD OTHER SPOUSE IS GRANTED USE OF HOME UNDER DIVORCE OR SEPARATION AGREEMENT - §121(d)(3)(B)

- H (who owns house) moves out of home into an apartment
- H and W divorce – W granted use of home under divorce agreement
- W's use of home is attributed to H
- H can claim \$250,000 exclusion

BNY Mellon Wealth Management <sup>17</sup>

## PROPERTY SETTLEMENTS IN DIVORCE

BNY Mellon Wealth Management <sup>18</sup>

## Property Settlements in Divorce

### INCOME TAX CONSEQUENCES

- §1041 - Provides for income tax-free property transfers incident to divorce
  - Transfers to a spouse at any time and for any reason during a marriage is a non-recognition event for income tax purposes.
  - Transfers to a former spouse is also a non-recognition event if the transfer is incident to a divorce. Requirements:
    - Transfer is within one year of when the marriage ends or
    - Transfer is related to the end of the marriage
      - Transfer is related to the end of the marriage if the transfer is pursuant to a divorce or separation agreement and the transfer occurs not more than 6 years after the marriage ends
  - Lifetime, divorce motivated property transfers between spouses result in recipient spouse receiving the basis and holding period of transferor spouse

BNY Mellon Wealth Management <sup>19</sup>

## Property Settlements in Divorce

### INCOME TAX CONSEQUENCES

- Caution: post-divorce financial obligations under a prenuptial agreement are not protected under §1041 if the transfer is made more than a year after the divorce.
  - Transfers within one year of end of marriage automatically protected by the statute
    - Transfers don't need to be pursuant to a divorce or separation agreement
  - Transfers made more than a year after the marriage ends must be pursuant to a divorce or separation agreement to enjoy the protection of §1041
- Suggestion: incorporate the post-divorce financial obligations required under a prenuptial agreement into the divorce decree.

BNY Mellon Wealth Management <sup>20</sup>

## Property Settlements in Divorce

Example:

- H and W going through divorce
- Own a beach house with cost basis of \$1,000,000
- H wants beach house but W gets it pursuant to divorce agreement
- After the divorce, H wins the lottery and wants to buy the beach house
- Offers ex-wife \$5,000,000
- If sale occurs in year of divorce, no gain or step-up in basis
  - §1041 applies – transfer, not sale
- If sale occurs in later year, step-up in basis to \$5,000,000 for H and \$4,000,000 taxable gain realized by W
  - § 1041 does not apply - sale, not transfer

BNY Mellon Wealth Management <sup>21</sup>

## Property Settlements in Divorce

Example:

- H and W going through a divorce
- H transfers life insurance policy to W under the divorce decree
- Does the transfer for value rule apply?
- Treated as a gift, not a sale, under §1041
- Transfer for value rule doesn't apply

BNY Mellon Wealth Management <sup>22</sup>

## Property Settlements in Divorce

### GIFT TAX CONSEQUENCES

- GR: transfers of property between spouses incident to separation or divorce are taxable gifts
- Exceptions - Eight ways to accomplish transfer of property without taxable gift:
  - Transfer is covered by the \$5.45 million gift tax exemption
  - Transfer qualifies for gift tax annual exclusion (currently \$14,000)
  - Transfer qualifies as direct payment of medical or education payments
  - Transfer of property is accomplished prior to the legal termination of the marriage and the transfer meets the requirements of §2523 for the unlimited gift tax marital deduction
  - Transfer is made in exchange for relinquishment of spousal support obligations (alimony) or obligations to support minor children
    - Transfers in exchange for other marital rights (dower, curtesy, homestead, widow's allowance, elective share) do not constitute consideration in money or money's worth for gift tax purposes.
  - Transfer of property satisfies the requirements of §2516
  - Transfer of property is pursuant to a court order
  - Transfer for immediate enforceable property right

BNY Mellon Wealth Management <sup>23</sup>

## Property Settlements in Divorce

### GIFT TAX CONSEQUENCES

- Transfer is made in exchange for relinquishment of spousal support obligations (alimony) or obligations to support minor children
  - Transfers in exchange for other marital rights (dower, curtesy, homestead, widow's allowance, elective share) do not constitute consideration in money or money's worth for gift tax purposes.
  - Transfer may be outright or in trust
  - No gift if value of property transferred equals the value of the support rights relinquished
    - Valuation of support rights needed
    - If valuation of property transferred is greater than value of support rights relinquished, gift results
    - See PLR 201206005 for an example of valuation of marital obligations by actuaries approved by the IRS

BNY Mellon Wealth Management <sup>24</sup>

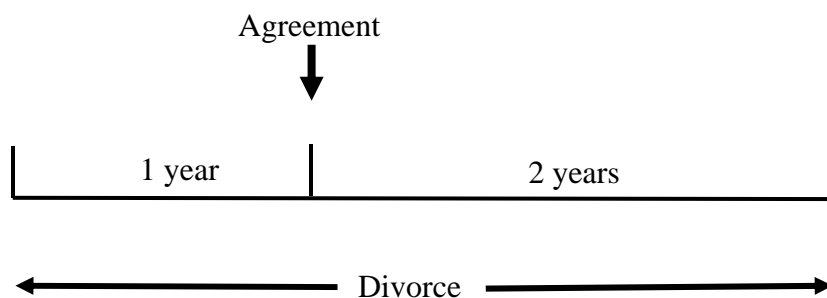
## Property Settlements in Divorce

### GIFT TAX CONSEQUENCES - §2516

- Payments of alimony, support for minor child and property settlements made under agreement meeting requirements of §2516 are deemed made for adequate consideration i.e. no gift
- §2516 requirements:
  - Must be a written agreement
  - Regarding spouse's marital or property rights or to provide support for *minor* children
    - §2516 does not apply to transfers to adult children
  - Final decree of divorce required for §2516 to apply
    - Decree of separation, separate maintenance or annulment will not suffice
    - Not necessary for agreement to be adopted, approved or even submitted to court
  - Only payments designated and required by the agreement qualify as non-gifts
  - Divorce must be final either one year prior to or two years after the written agreement
- Transferee takes transferor's basis and holding period
- Note: a divorce transfer not exempt under §2516 may escape tax under general gift tax principals

BNY Mellon Wealth Management <sup>25</sup>

## Property Settlements in Divorce - §2516



**Note: the property transfer can be made at any time**

BNY Mellon Wealth Management <sup>26</sup>

## Property Settlements in Divorce

### GIFT TAX CONSEQUENCES - §2516

- Caution: post-divorce financial obligations under a prenuptial agreement are not protected under §2516 unless there is a written agreement entered into 2 years before the divorce and 1 year after the divorce
- Suggestion: incorporate the post-divorce financial obligations required under a prenuptial agreement into the divorce decree.

---

BNY Mellon Wealth Management <sup>27</sup>

## Property Settlements in Divorce

### GIFT TAX CONSEQUENCES

- Payments made under an agreement incorporated into a divorce decree agreement or made pursuant to a court order
  - Deemed made for full and adequate consideration in money or money's worth

---

BNY Mellon Wealth Management <sup>28</sup>

## Property Settlements in Divorce

### GIFT TAX CONSEQUENCES

- Transfer made before the legal termination of the marriage if they qualify for the unlimited gift tax marital deduction under §2523

BNY Mellon Wealth Management <sup>29</sup>

## Gift Splitting

### GIFT TAX CONSEQUENCES

- If gift splitting is contemplated early in the year, divorce before year-end will terminate the right to split the gift
- May want to hold off on divorce until after year-end so gift-splitting will be available
- Example: Assume husband made \$28,000 in gift split annual exclusion gifts to 15 heirs at the beginning of the year. If husband and wife divorce before year end and the gift tax rate is 40%, delaying the divorce until after the end of the year could save the husband \$84,000 in gift taxes (or use of his exemption).
- Caution: Liability for gift splitting is joint and several

BNY Mellon Wealth Management <sup>30</sup>

## SIGNING A JOINT INCOME TAX RETURN

BNY Mellon Wealth Management <sup>31</sup>

## Filing a Joint Income Tax Return

### CAN A JOINT RETURN BE FILED?

- If couple are divorced, legally separated or the abandoned spouse rule applies, a joint return cannot be filed.
- Marital status determined at the end of the year.

### CONSEQUENCES OF FILING A JOINT RETURN

- Liability is joint and several
- Spouses can file a “separate liability election” under § 6015(c)(3)(C) which states that neither spouse has liability for the other’s tax reporting or taxes

BNY Mellon Wealth Management <sup>32</sup>



## Filing a Joint Income Tax Return

### CAN THE IRS LEVY OR SEIZE A SPOUSE'S SHARE OF A QUALIFIED PLAN FOR BACK TAXES?

- Per the terms of a divorce agreement, W receives share of a qualified plan under a QDRO
- Post-divorce, the IRS audits the couple's pre-divorce joint income tax return and establishes a large joint tax deficiency
- While ERISA prevents ordinary creditors from attaching qualified plan payments, courts have unanimously held that a federal tax lien or levy may be imposed on ERISA qualified plans.
- Authority: Ameritrust Co. N.A. v. Derakhshon, 830 F.Supp. 406 (N.D. Ohio 1993)

BNY Mellon Wealth Management <sup>33</sup>

## STOCK OPTIONS AND DEFERRED COMP

BNY Mellon Wealth Management <sup>34</sup>

## Stock Options, Deferred Comp and Divorce – Rev. Rul. 2002-22

### HOLDING

- An employee spouse who transfers interests in nonqualified stock options and nonqualified deferred compensation to his former spouse incident to divorce is not required to include an amount in gross income upon the transfer.
- The former spouse is required to include an amount in gross income when the former spouse exercises the stock options or when the deferred compensation is paid or made available to the former spouse.
- Stock options and unfunded deferred compensation are “property” under §1041
  - Entitled to non-recognition treatment under §1041
- Ruling does not apply to nonqualified stock options, unfunded deferred compensation or other future income rights to the extent such options or rights are unvested at the time of transfer or to the extent they are subject to a substantial contingencies at the time of transfer
- Negates FSA 200005006

BNY Mellon Wealth Management <sup>35</sup>

## Stock Options, Deferred Comp and Divorce – Rev. Rul. 2002-22

### HOLDING

- Also holds that the transfer of an ISO to a spouse in connection with a divorce results in the disqualification of the option under §§422(b)(5) and 423(b)(9)
  - Thus, if ISOs are transferred in connection with a divorce, the ISO is disqualified and is thereafter treated as NQSOs

BNY Mellon Wealth Management <sup>36</sup>

## Stock Options, Deferred Comp and Divorce – Rev. Rul. 2002-22

- See also PLR 201016031 where the IRS extended Rev. Rul. 2002-22 to apply to non-vested restricted shares.

BNY Mellon Wealth Management <sup>37</sup>

## Stock Options, Deferred Comp and Divorce – Rev. Rul. 2004-60

### HOLDING

- Nonqualified stock options and nonqualified deferred compensation transferred by an employee to a former spouse incident to a divorce are subject to FICA, FUTA and income tax withholding to the same extent as if retained by the employee
  - They are payable at the time the non-employee spouse exercises the options or received payments under the deferred compensation plan, not when they are transferred to the non-employee spouse
- The method of collecting and reporting the FICA, FUTA and income tax withholding are detailed in the ruling. See also PLR 200646003.
- Rev. Rul. 2004-60 replaces the previously issued Notice 2002-31 which was issued as a proposed revenue ruling on these issues

BNY Mellon Wealth Management <sup>38</sup>

## Stock Options, Deferred Comp and Divorce – PLR 200519011

### RELEVANCE

- Illustrates a creative way to divide ISO and NQSO in divorce in a community property state
- Provides a roadmap for dividing ISOs in divorce
- Avoids the prohibition of transfers of ISOs
- IRS issued favorable ruling on income, AMT and gift tax issues
- See also PLRs 8451031 and 200737009 for similar holdings

---

BNY Mellon Wealth Management <sup>39</sup>

## Stock Options, Deferred Comp and Divorce – PLR 200519011

### FACTS

- NQSO transferred directly to NES
- ISO continued to be held in name of ES but the NES retained all legal and beneficial ownership of ES's share of the ISO
  - Reason: maintain status of options as ISOs by avoiding transferring title to NES
- After ISO exercised, shares transferred to NES
- Advantages of maintaining status of options as ISOs:
  - Avoid employment taxes (social security, medicare)
  - Avoid regular tax when option is exercised (assuming stock not sold at time of exercise)

---

BNY Mellon Wealth Management <sup>40</sup>

## Stock Options, Deferred Comp and Divorce – PLR 200519011

### HOLDING

- Naming the NES as beneficiary of the ISO and the transfer of the stock from the exercise of the ISO qualifies as non-taxable property division of marital property under §1041
- The ES's designation of the NES as the beneficiary of the ISO didn't disqualify the options as ISOs
- When NES exercises the NQSO, income will be taxable to NES and income tax W/H will be credited to NES's tax liability
- When ES exercises the ISO:
  - There is no income recognition for regular tax purposes
  - The AMT adjustment (difference between the FMV at time of exercise and the strike price) is reported on the NES's income tax return
  - NES allowed to offset the AMT credit against the regular tax reported when the NES sells the stock
  - ~~□ The transfer of the stock to the NES is not a disposition under §424(c)(4)~~

BNY Mellon Wealth Management <sup>41</sup>

### IRAs AND DIVORCE

BNY Mellon Wealth Management <sup>42</sup>

## IRAs and Divorce – Section 408(d)(6)

TRANSFER OF IRA ON DIVORCE *NOT TAXABLE* IF:

- IRA is *transferred* from one spouse to the other spouse
- Transfer is pursuant to a valid divorce decree or under a written instrument incident to a divorce

BNY Mellon Wealth Management <sup>43</sup>

## IRAs and Divorce – Section 408(d)(6)

“INSTRUMENT INCIDENT TO A DECREE”

- Not defined in IRC or regulations
- Safe approach – writing memorializing the terms of the divorce settlement which is referred to, incorporated into or approved by the court entering the decree of divorce or legal separation

BNY Mellon Wealth Management <sup>44</sup>

## IRAs and Divorce – Section 408(d)(6)

### REQUIREMENT

- Agreement to transfer the IRA must be approved by the court to enjoy the protection of §408(d)(6)
  - Divorce decree or written separation agreement should address the IRA and stipulate how it is to be divided
  - IRA transfer may be used to meet a support obligation (not just a division of the marital property) as long as the transfer meets the requirements of §408(d)(6) that the instrument requiring the transfer for support be a divorce decree or a written instrument “incident to a decree of divorce.”
  - Not “incident to a decree” until the decree is entered
    - Thus, transferor spouse should make sure the agreement states that the transfer of the IRA is to be made after the divorce decree has been entered

BNY Mellon Wealth Management <sup>45</sup>

## IRAs and Divorce – Section 408(d)(6)

### ALTERNATIVE WAYS TO TRANSFER IRA IN DIVORCE:

- Change the name of the IRA owner
- Trustee to trustee transfer - IRA owner sets up new IRA
  - In IRA owner's name, then assigns to spouse
  - In name of spouse
  - Ex-spouse sets up own IRA and IRA owner transfers to ex-spouse's IRA

BNY Mellon Wealth Management <sup>46</sup>

## IRAs and Divorce – Section 408(d)(6)

### ALTERNATIVE WAYS TO TRANSFER IRA IN DIVORCE:

- Don't do a rollover!!!
- Must distinguish between a distribution and a transfer
  - §408(d)(6) requires a *transfer* - §408(d)(6) authorizes a "transfer of an interest: which, strictly speaking, is not the synonymous with a transfer of IRA assets
  - A distribution is a taxable event
    - If IRA owner takes a distribution from the IRA, his interest in the IRA ends upon the withdrawal and no longer has an interest in the IRA to "transfer"
    - Example: IRA owner withdraws entire amount from IRA in form of a check which he endorses over to his ex-wife who is entitled to the IRA under the divorce agreement. Doesn't qualify as a transfer. Husband liable for tax on withdrawal plus 10% penalty. Jones v. Commissioner, 80 T.C. 76 (2000); See also Bunney v. Commissioner, 114 T.C. 259 (2000), Czepiel v. Commissioner, TC Memo 1999-289, Paul D. Harris, 62 T.C.M. 406 (1991).

BNY Mellon Wealth Management <sup>47</sup>

## IRAs and Divorce – Section 408(d)(6)

### SUGGESTIONS:

- Include language in divorce or separation agreement stating intention of parties that the transfer of the IRA be tax-free under §408(d)(6)
- Have actual IRA transfer papers incorporated into the divorce or separation agreement which is approved by the court
- Do a trustee to trustee transfer
- Make sure the divorce or separation instrument is approved by the court
- Do the transfer after the divorce decree is final

BNY Mellon Wealth Management <sup>48</sup>



## IRAs and Divorce – Section 408(d)(6)

ONCE TRANSFERRED, THE IRA IS TREATED AS OWNED BY THE EX-SPOUSE AS OF THE DATE OF TRANSFER:

- Ex-spouse is taxed on distributions
- 10% penalty applies if ex-spouse is under 59 ½
- Ex-spouse must take MRD when he/she is 70 ½
- Ex-spouse names own IRA beneficiary
- Ex-spouse not bound by his or her former spouse's election to receive SEPP from the IRA

BNY Mellon Wealth Management <sup>49</sup>

## IRAs and Divorce – Section 408(d)(6)

CONFLICT BETWEEN §408(d)(6) AND §1041:

- Can married couple not in the process of a divorce transfer an IRA from the husband to the wife tax-free.
- IRS says no. PLR 9422060 and PLR 8820086
  - Not tax free under §1041
  - §408(d)(6), being more specific than §1041, supercedes §1041
  - §408(d)(6) limits tax-free transfers between spouses to divorce situations

BNY Mellon Wealth Management <sup>50</sup>

## IRAs and Divorce – Section 408(d)(6)

### TIMING THE TRANSFER OF THE IRA:

- Wait until the divorce decree approved by the court
- Otherwise parties risk loss of tax-free treatment if IRA is transferred but divorce is never finalized
- Possible scenarios of transferring an IRA after entering into a divorce or separation agreement but before obtaining a divorce decree:
  - Divorce never finalized
  - One of the parties dies prior to the divorce decree
  - Parties reconcile

BNY Mellon Wealth Management <sup>51</sup>

## IRAs and Divorce – Section 408(d)(6)

### CONFLICT BETWEEN §408(d)(6) AND §72(t):

- What happens if IRA owner is taking substantially equal periodic payments (SEPP) and splits the IRA in a divorce
- Normally, the modification of SEPP results in a retroactive 10% penalty plus interest
- IRS position: IRA owner who is taking SEPP will not be deemed to modify the SEPP on a transfer of a portion of his IRA to his ex-spouse if he continues to receive SEPP on his remaining proportionate portion of the IRA. PLR 9739044, 200027060, 201030038, 200040046, 200202074, 200202075, 200202076, 200717026, 200225040, 200214034, 200116056, 200050046, 200052039

BNY Mellon Wealth Management <sup>52</sup>

## IRAs and Divorce – MRD

### MINIMUM REQUIRED DISTRIBUTIONS:

- Amounts transferred incident to divorce will not reduce amount of MRD in the year of transfer
  
- Transferor spouse: MRD will be based on account balance as of December 31 of the prior year even though there is less money in the IRA as a result of the transfer of a portion to the ex-spouse.
  - Make sure divorce agreement allows IRA owner to take MRD before transfer to ex-spouse
  
- Transferee spouse: doesn't have to take MRD in year of transfer. First MRD is in year after transfer of IRA and is based on the prior year-end balance in the IRA.

BNY Mellon Wealth Management <sup>53</sup>

## IRAs and Divorce – Failure to Comply

### TAX CONSEQUENCES FOR FAILURE TO COMPLY WITH §408(d)(6)

- Taxable distribution to IRA owner/transferor spouse
  
- IRA owner/ transferor spouse liable for 10% penalty if under 59 ½
  
- Transferee spouse receives distribution income tax free
  
- If transferred to IRA fbo transferee ex-spouse, subject to 6% excess contribution excise tax for each taxable year until corrected
  
- Tax-free growth lost

BNY Mellon Wealth Management <sup>54</sup>

## Qualified Plans – QDRO

### WITHDRAWAL FROM QUALIFIED PLAN BY ALTERNATE PAYEE SPOUSE PURSUANT TO QDRO

- Not subject to early withdrawal penalty. §72(t)(2)(C).
- Alternatively, alternate payee spouse could R/O distribution to an IRA
  - However, there is a 20% withholding requirement. §3405(c).
- A direct trustee to trustee transfer from the qualified plan to the IRA will avoid the 20% withholding requirement

BNY Mellon Wealth Management <sup>55</sup>

## Qualified Plans – QDRO

### WITHDRAWAL FROM QUALIFIED PLAN BY ALTERNATE PAYEE SPOUSE PURSUANT TO QDRO

- Why transfer payment to IRA?
  - Control over money, can select investment options, distance from ex-spouse
- Distributions from IRA subject to 10% early withdrawal penalty if IRA owner is under age 59 ½
- Option if spouse needs money while under 59 ½
  - Leave some in qualified plan until age 59 ½
    - Withdrawals from qualified plan pursuant to QDRO not subject to 10% penalty
    - No time limit on when money received under a QDRO must be rolled over to an IRA
  - R/O balance to IRA

BNY Mellon Wealth Management <sup>56</sup>

## Qualified Plans – QDRO

### USING A QDRO AS COLLATERAL

- A QDRO can be used as collateral
- Exempt from the anti-alienation and anti-assignment provisions of ERISA

BNY Mellon Wealth Management <sup>57</sup>

## Qualified Plans – QDRO

### USING A QDRO AS COLLATERAL

- Participant spouse's retirement plan is QDRO'ed
- Certain percent assigned to the alternate payee, remainder is a QDRO to participant spouse
- Judgment of divorce assigns security interest in participant's QDRO to the alternate payee spouse
- Can secure equitable distribution, alimony/child support, education obligation and, depending on state law, even attorney fees
- Authority: PLR 9234014, PLR 200292093

BNY Mellon Wealth Management <sup>58</sup>

## NAMING BENEFICIARY AFTER DIVORCE

BNY Mellon Wealth Management <sup>59</sup>

## Naming Beneficiary After Divorce

### Case #1 - Facts

- Wife named as beneficiary on husband's IRA
- Couple gets divorced
- Wife agrees she's not entitled to husband's assets
- Also waives any right she has in husband's assets
- Husband remarries
- Completes new paperwork for IRA but names no beneficiary
- Husband dies – ex-wife and new wife claim the IRA

## Who Gets the IRA???

BNY Mellon Wealth Management <sup>60</sup>

## Naming Beneficiary After Divorce Case #1 - Reasoning

- Wife #1's right in IRA was revocable prior to death
- At time of divorce she had no property interest in IRA
- At time of divorce, wife #1 had no rights to surrender
- At death, IRA beneficiary became irrevocable
  - Wife #1 was the beneficiary

## The Ex-Wife

PaineWebber, Inc. v. East, Maryland Court of Appeals (March, 2001)

---

BNY Mellon Wealth Management <sup>61</sup>

## Naming Beneficiary After Divorce Case #2 - Facts

- Wife named as beneficiary on husband's pension
- Couple gets divorced
- Husband neglects to change pension beneficiary
- Husband dies in car accident 2 months after divorce
- State statute says divorce revokes beneficiary designation of ex-spouse
- Ex-wife and kids by previous marriage claim pension

## Who Gets the Pension???

---

BNY Mellon Wealth Management <sup>62</sup>

## Naming Beneficiary After Divorce

### Case #2 - Reasoning

- ERISA preempts state law that revokes beneficiary designations
- ERISA says beneficiary is determined by plan documents which includes the beneficiary designation form
- Under state law (Washington), ex-wife was named the beneficiary

## The Ex-Wife

Egelhoff v. Egelhoff, 532 U.S. 141 (2001)

---

BNY Mellon Wealth Management <sup>63</sup>

## Naming Beneficiary After Divorce

### Case #3 - Facts

- Wife names as beneficiary on husband's pension
- Couple gets divorced
- Wife gives up all rights to pension under divorce decree
- Husband neglects to change pension beneficiary
- Husband dies
- Estate sues claiming rights to plan benefits

## Who Gets the Pension???

---

BNY Mellon Wealth Management <sup>64</sup>



## Naming Beneficiary After Divorce Case #3 - Reasoning

- ERISA plan documents trump the waiver in the divorce decree
- Plan documents, of which beneficiary designation is part, govern who gets plan benefits
- Bottom line: plans documents govern who gets plan benefits
- Aside: estate may have contract claim against ex-wife

## The Ex-Wife

Kennedy v. DuPont, 555 U.S. 285 (2009)

BNY Mellon Wealth Management <sup>65</sup>

TRUSTS – EXPOSURE TO MARITAL CLAIMS

BNY Mellon Wealth Management <sup>66</sup>

## Trusts – Exposure to Marital Claims

### IS INTEREST IN TRUST MARITAL PROPERTY?

- Revocable trust
- Irrevocable trust
  - Income and principal interest
    - Mandatory v. discretionary
  - Remainder interest
    - Vested v. contingent
  - General power of appointment
  - Special power of appointment
  - Spendthrift provision
  - Self-settled trust
    - DAPT statutes

BNY Mellon Wealth Management <sup>67</sup>

## ESTATE TAX DEDUCTIBILITY OF TRANSFERS REQUIRED BY THE DIVORCE AGREEMENT

BNY Mellon Wealth Management <sup>68</sup>

## Estate Tax Deductibility of Transfers Required by the Divorce Agreement

- A liability accruing pursuant to a divorce settlement is not necessarily a deductible debt of the deceased's estate.
- The payment won't qualify for a marital deduction because the parties are divorced
- It is important to make sure the divorce documents create an enforceable debt against the estate to create an estate tax deduction rather than creating a taxable transfer

BNY Mellon Wealth Management <sup>69</sup>

## Estate Tax Deductibility of Transfers Required by the Divorce Agreement

- Must be based on consideration
- Surrender of the marital rights to the couple's property is not valid consideration. See §2043(b).
- The same items that constitute consideration for gift tax purposes (surrender of support rights of spouse or minor child, §2516, Harris rule) are valid substitutes for consideration
- Must be actually paid or unpaid amount is ascertainable with reasonable certainty and will be paid
- Recurring payments deductible but only when paid.
- No need under §2053 regulations to present value the payments

BNY Mellon Wealth Management <sup>70</sup>

## Summary

- Pre-marital considerations
- Review estate plan
- Property settlement – income and gift tax issues
- Be careful when signing joint returns
- Stock options and deferred compensation – tax consequences
- IRAs and divorce
- Qualified Domestic Relation Orders (QDROs)
- Naming beneficiaries after divorce
- Trusts – exposure to marital claims
- Estate tax deductibility of transfers required by divorce agreement

BNY Mellon Wealth Management <sup>71</sup>

**Thank You!**

BNY Mellon Wealth Management <sup>72</sup>