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MATRIMONIAL VOLUME 9 / ISSUE 2 NEWSLETTER

2008

10% EARLY WITHDRAWAL PENALTY EXCLUSIONS

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Individuals may find that money within their qualified retirement plan (401(k), 403(b), pension plan, etc.) or individual retirement account (IRA) may be a source of income. Withdrawn funds are taxed at ordinary income tax rates and may be subject to a 10% early withdrawal penalty if removed prior to retirement age (currently 59½). However, in certain divorce situations, the parties can execute a Qualified Domestic Relations Order (QDRO) and avoid the 10% penalty.

Qualified Retirement Plans


The Retirement Equity Act of 1984 added to the Internal Revenue Code (I.R.C.) §414(p), providing for distribution of retirement rights in qualified plans upon dissolution of marriage. I.R.C. §414(p) permits the creation, assignment and recognition of any right in eligible retirement plans of a participant through a Qualified Domestic Relations Order (QDRO).

If the alternate-payee spouse takes an early distribution from a qualified plan pursuant to a QDRO, the 10% penalty does not apply [I.R.C. §72(t)(2)(C)]. Other potential 10% penalty exclusions for qualified plans include:

- Payments made due to separation of service to participants over the age of 55
- In the event substantially equal periodic payments are made over the life expectancy of a participant
- Disability, as long as certain conditions are met
- Medical expenses as defined under I.R.C. §72(t)(2)(B).

Individual Retirement Accounts (IRA)

IRAs are not qualified plans. An IRA account falls under the provisions of I.R.C. §408 and §1041, permitting *the transfer of tax-free funds without a QDRO*. All that is needed is a judgment or decree of divorce or separate maintenance.

Even with a decree or QDRO, distributions or transfers not made to the former spouse's IRA *will be taxed at ordinary rates plus a 10% penalty if before the age of 59½*. To escape the 10% penalty in an early distribution of an IRA, the funds must be used for higher education expenses or for first time homebuyers. 

Note: Brisbane Consulting Group strongly recommends consulting with a professional with expertise in this area. Penalties and exclusions may not be applicable in all cases as circumstances may vary.

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