COLLABORATIVE PracticeTips

December **2022**

A monthly bulletin from the CP Cal Practice Excellence Committee

The Practice Excellence Committee is pleased to offer tips to help you increase your Collaborative cases and achieve *practice excellence.*

Please send us your comments and questions! Email us at info@cpcal.com

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Walking Through the Maze of Dividing Retirement and Deferred Compensation Plans – Part II

Rule 72(t) allows penalty-free withdrawals from IRA accounts and other tax-advantaged retirement accounts like 401(k) and 403(b) plans. It is issued by the Internal Revenue Service.

This rule allows account holders to benefit from their retirement savings before retirement age through early withdrawal without the otherwise required 10% penalty. The IRS still subjects the withdrawals to the account holder's normal income tax rate.

There are over 50 subsections to IRC Section 72T, and several of them relate to divorce.

While some of the subsections are generally known and are commonly employed, such as 401k and IRA rollovers, others are less well known. The less-known applications of IRC Section 72T might be helpful in special circumstances. The following is intended to be a brief list. It is not all that needs to be known before recommending one of the 72T exceptions to a client. A web resource site: http://www.72t.net/Home might be helpful.

Generally for those 50 years and older: Equal & Periodic Payments from an IRA:

Determination of the payout method is critical and should be carefully considered. The three (3) calculations are:

Required Minimum Distribution Method;

Fixed Amortization Method; and

Fixed Annuitization Method.

It is possible to arrange to have money for support paid by Equal & Periodic payments from an IRA account. The owner of the account (payor of support) is taxed on distributions but without a 10% penalty.

In addition, assuming a client receives an IRA account in the settlement and is strapped for cash, it might make sense to begin Equal & Periodic payments on part or all of the IRA/401K funds received in the settlement.

ERISA qualified contribution plan payments to the Alternate Payee/Non-Participant - Early Withdrawal (not IRAs):

<u>Examples of qualified contribution plans: 401k, 403b, 459, and TSP (Thrift Savings Plan):</u> After a QDRO is approved by the plan administrator, the alternate payee (i.e. the spouse of employee, NOT the employee) will be sent a letter asking how they would like to receive their portion of the defined contribution plan. Four of the usual choices are: 1) rollover to another plan; 2) rollover to an IRA; 3) take a taxable distribution; or 4) some combination of both a rollover and a taxable distribution.

Under one of the 72T exceptions and depending upon the plan's terms, the Alternate Payee can have a portion or all of their share distributed to them directly without the 10% penalty, regardless of their age. While clients over 59 ½ would not pay any penalty due to their age, this exception benefits those younger than age 59 ½ by allowing them to avoid the 10% penalty. For either age group, the Alternate Payee will pay ordinary income tax on the cash distribution.

The cost of taking the early withdrawal distribution will depend on the amount received and the tax rate of the Alternate Payee. The larger the amount, the more tax there will be to pay.

With a careful analysis of the cost and other considerations, when weighing use of the money now or for retirement, it sometimes makes sense to take an early distribution.

These are only a few of the 72T exceptions. Each should be considered carefully with a thorough analysis of tax consequences and the long-term financial planning needs of the client. An in-depth discussion of the choices and cost of the choices with clients is necessary.

From the PEC:

The end of the year is a great time to run some numbers. How many Collaborative cases did you have this year? What did they net in revenue? Who referred them? If you don't have a system for keeping track of these numbers, now is a great time to create it so that you can have it set up for 2023. As long as you're setting things up, keeping track of time is important, too. Most Collaborative pros do a lot of work on committees and spend some time socializing/networking with other professionals. Are you keeping track of these non-billable hours? After you have it all set up, calendar an hour at the end of each quarter to review these and other numbers…and to consider making decisions based on them.

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