QDROs as Collection Vehicles for Keogh Plans and IRAs

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Can tax-qualified retirement plans which cover only owner-employees and their spouses and individual retirement accounts (IRAs), serve as enforcement devices? This article, which serves as a companion piece to our earlier article (December 1999) on the use of qualified domestic relations orders (QDROs) as recovery devices, will address this issue.

Keogh Plans
In general, retirement plans that covered only owners of a business were referred to as "Keogh," or HR-10, plans and, historically, were subject to some different requirements under the Internal Revenue Code. Today, after many reforms in pension tax law, those plans are largely governed by the same rules as other tax-qualified retirement plans. Nevertheless, they differ from other plans in one significant respect.

Under Employee Retirement Income Security Act (ERISA) regulations 2510.3-3(b), retirement plans that do not cover common law employees (because the only employees of the business are the owners and their spouses or because no employees other than owner-employees have satisfied the age and service requirements of the plans) are not covered by ERISA. However, because the same QDRO rules appear in both §206(d)(3) of ERISA and in §414(p) of the code and because §401(a)(13) of the code requires all plans to incorporate the rules of §414(p) as a condition for tax qualification, owner-employee plans should be subject to the same QDRO enforcement as plans that are subject to ERISA.

Case Law
In fact, the courts appear to draw no distinctions in this area. In Dallin v. Dallin, 225 A.D.2d 728, 640 N.Y.S. 2d 196 (2d Dept. 1996), the court implicitly recognized the use of a QDRO to "invade" a husband's Keogh plan to pay counsel fees awarded to his wife.

Thus, it appears that those plans that are not technically covered by ERISA may nevertheless be a source of recovery of the various items that matrimonial courts have held to be recoverable through QDROs from the tax-qualified retirement plans. So far, so good.

IRAs
The rules of the game change radically where the potential source of recovery is an individual retirement account. An IRA may be quite large if it is the repository of a spouse's rollover from a tax-qualified retirement plan or even if it represents the highly successful investment of small annual contributions. Therefore such an IRA may not only be an important asset for equitable distribution, but also may represent an attractive source of recovery for delinquent child support or maintenance obligations, or incidental fees of matrimonial litigation.

However, unlike tax-qualified retirement plans, most IRAs (other than certain employer-sponsored IRAs) are neither subject to ERISA nor to §401(a) of the code. Therefore, as a matter of statutory law, the QDRO rules may not be applicable to IRAs. In fact, code §408(d)(6) provides an entirely separate rule permitting tax-free transfers of funds between IRAs of spouses "under a divorce or separation instrument," without the requirement that such transfer proceed by formal QDRO.

The apparent absence of QDRO procedures for IRAs could limit the types of obligations that may be assessed against an IRA of a delinquent spouse. In Pauk v. Pauk, 232 A.D.2d 392, 648 N.Y.S.2d 134 (2d Dept.), a case predating a 1997 amendment of CPLR § 5205(c)(4), the court held that a judgment for attorney fees awarded to a spouse could not be executed against the delinquent spouse's IRA, on the grounds that CPLR § 5205(c) generated any exempted retirement plans and IRAs from satisfaction of money judgments. At that time, CPLR §5205(c)(4) provided an exclusion from the exemption only for QDROs.

1997 Amendment
In 1997, CPLR §5205(c)(4) was amended, effective in 1998, to extend the exclusion to orders of "support, alimony or maintenance." Thus, IRAs may now be invaded to obtain support arrears. See 1997 Laws Ch. 398 § 153.

However, a judgment for attorney fees (or any other incidental costs of a divorce) does not appear to come within the technical definition of an order of support, alimony or maintenance envisioned by CPLR §5205(c)(4).

Therefore, the practitioner may invade the nonpaying spouse's IRA to collect child support ad spousal maintenance arrears, but not to collect attorney fees. That a delinquent spouse's IRA should be exempt from attorney fee claims that could be made against his account in a qualified retirement plan seems to be an anomalous result. However, unless the courts rule to the contrary, or the legislature acts to correct the situation, that is the way things currently stand.

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