Retirement Benefits: Key Points Family Law Attorneys Should Know

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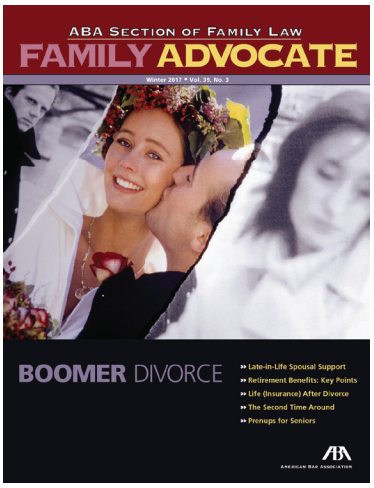

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What should every family law attorney know about retirement benefits? What are the different types of retirement benefits? Why divide with a qualified domestic relations order (QDRO)? How does the family law attorney ensure survivor benefits? Does it matter whether the plan is a public or private plan?

These questions have been presented to me as a QDRO attorney on a regular basis in my twenty-plus year practice. My intent in this article is to help the family law attorney navigate and issue-spot through this complex area of law. I will focus on plans governed by federal law under the Employee Retirement Income Security Act of 1974 as amended (ERISA), but I will also discuss briefly federal employee and military plans.

The Basics

The code section in ERISA that deals with the division of retirement benefits in a divorce with a QDRO is 29 U.S.C. § 1056(d)(3) (1984). The section is also identified as ERISA § 206(d)(3). A reciprocal cite can be found at I.R.C. § 414(p) (1984). The anti-alienation section of ERISA, as established by P.L. 98-397, the Retirement Equity Act of 1984 (REA), protects retirement benefits such that no creditors can collect against them.

There is one exception. Under federal law, a retirement plan can only pay benefits to the plan's participants or, in the event of death, beneficiaries *except* when a QDRO for marital property or support is payable to a participant's spouse, former spouse, child, or dependent (an "alternate payee").

ERISA states that the term "qualified domestic relations order" means a domestic relations order (DRO) that "creates or *recognizes the existence of* an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant under a plan. …" 29 U.S.C. § 1056(d)(3)(B(i)(I) (emphasis added). The term "domestic relations order" means "any judgment, decree, or order" that "relates to the provision of marital property or support under state domestic relations law, including community property law." 29 U.S.C. § 1056(d)(3)(B(ii).

It is important to note that the term "DRO" is used for public plans or ERISA plans not yet qualified. Without QDROs or DROs for public plans, there would be no way to obtain marital property rights or child or spousal support directly from retirement plans.

Generally, there are two types of retirement plans offered by employers: defined contribution plans and defined benefit plans. Defined contribution plans are 401(k) plans, profit sharing plans, money purchase pension plans, employee stock ownership plans, and savings plans. A defined contribution plan is generally pretax employee-

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funded, often with matching contributions or profit sharing from an employer. Defined benefit plans are pension plans, retirement plans, and cash balance plans. A defined benefit plan does not have any value until the date of retirement, at which time a participant's interest is actuarially calculated based on the plan rules. Except for cash balance plans, most defined benefit plans only pay benefits monthly over a participant's lifetime.

IRAs and SEP IRAs

Parties do not need a QDRO to transfer funds IRA to IRA incident to divorce. An IRA to IRA transfer is governed by § 408 of the Internal Revenue Code. However, we are often retained to prepare a DRO pursuant to I.R.C. § 408 in a dissolution case when the divorce judgment does not provide a clear enough description of the transfer. For a clear description, the divorce judgment should include the name of the custodian, the last four digits of the account number, and an amount or percentage as of date of the custodian's implementation. An IRA custodian will *not* calculate earnings and/or losses from a certain date to date of implementation.

The SEP IRA ("Simplified Employee Pension" IRA) is an individual retirement account established or maintained for an individual by the individual's employer or by an employee organization of which the individual is a member, and therefore it would be covered by Parts 1 and 4 of Title I of ERISA. Basically, a SEP-IRA is neither all fish nor all fowl. The SEP part is subject to ERISA, but the pension is funded by an IRA, which is not. *See* ERISA Opinion Letter 75-14 (Sept. 30, 1975). Most custodians will divide the SEP IRA under I.R.C. § 408, with the division pursuant to the divorce judgment. Some will require a QDRO. If retained, we would prepare the DRO to satisfy both the provisions of § 206(d)(3) of ERISA and § 408(d)(6) of the Code to have all bases covered. The tax effect is controlled by § 408(d)(6) in all events.

The Importance of Correctly Identifying the Plan

It is fairly common for the parties to fail to properly identify a retirement plan in a divorce. In many cases, the divorce judgment identifies the employer or the custodian for the retirement plan but not the actual plan name. Moreover, it is not uncommon to omit a retirement plan entirely in the divorce. To avoid these errors, the rule of thumb for family law attorneys is to assume that most mid-size to large employers offer at least two plans: a defined benefit plan and a defined contribution plan.

The family law attorney can conduct online searches based on the name of the employer to determine the exact plan offered. *See* http://freeerisa.benefitspro.com/ or https://www.efast.dol.gov/welcome.html. I have found that when this simple step is taken at the beginning of a case, the likelihood of omitting a plan or not identifying it properly is greatly diminished. For a highly compensated employee, it is important to know if the employee is a participant in any nonqualified plans for highly paid executives. Nonqualified plans are governed by I.R.C. § 409(a) (not ERISA) and in most cases cannot be divided, although we are seeing a trend among some nonqualified plans to allow for division with a DRO allowing direct payment to the nonparticipant spouse. Often the parties with nonqualified plans negotiate an offset. You cannot find nonqualified plans online in most cases.

Why is it important to correctly identify all retirement plans in the divorce judgment? If a plan is not properly identified or it is omitted, the plan has no obligation to withhold the alternate payee's marital interest if served with the divorce judgment. 29 U.S.C. § 1056(d)(3)(H). Also, in the event a participant dies or retires before a QDRO is entered, failure to properly identify or omit the plan in the divorce judgment may result in the alternate payee losing his or her marital interest

in the plan and/or survivor benefits, which are discussed in further detail below.

ERISA does not require the plan administrator to suspend payment of benefits before the administrator receives a signed court DRO that can be reviewed as to whether it is qualified. Nevertheless, many plans will place a temporary administrative hold on disbursements upon receipt of joinder pleadings (California only), a notice of adverse interest, or a draft QDRO. Military and federal employee plans will not withhold until served with an appropriate division order.

Defined Contribution Plans

The most important inquiry when dividing a defined contribution plan is whether there is a premarital, separate property contribution. Almost all defined contribution plans will *not* calculate out of the total account balance the participant's premarital contributions and earnings and/or losses thereon through the date of separation or date of divorce, depending on the division date under state law (the "valuation date"). The parties will need to value the marital interest at the valuation date because the plans will not. And, if there are no statements available for valuation of the separate property that is the premarital share, that share can be determined pursuant to the time rule formula. The time rule formula awarding a former spouse a marital interest is generally the participant's accrued benefit as of the valuation date, multiplied by the following fraction: the time in the defined contribution plan while married divided by the time in the plan through the valuation date x 50%. Most plans will then calculate the earnings and/or losses from the valuation date to date of distribution.

I would only recommend applying the time rule formula when an accounting is not feasible. It is generally used for defined benefit plans. With a defined contribution plan, there is no way to know whether the marital estate is overstated or understated, but application of the time rule formula may be the only option for the parties.

The second most important inquiry with a defined contribution plan is the determination of whether any loans or withdrawals were taken during the marriage before the valuation date. If there is a loan, the parties should negotiate whether that loan value should be included or excluded in the QDRO. "Included" means that the participant's account balance on the valuation date is *not* reduced by the value of any loan or withdrawal taken prior to calculating the split amount. "Excluded" means the participant's account balance on the valuation date is reduced by the value of the loan or withdrawal taken prior to calculating the split amount. For example, if the total account balance is $15,000 with a $5,000 loan and if the alternate payee is supposed to receive 50% of the $15,000, then the QDRO language should state that the value of the loan amount is "included." If the loan is supposed to be marital debt and therefore the alternate payee should receive 50% of $10,000, then the QDRO language should state that the value of the loan amount is "excluded."

Note that the participant is always responsible for any loan from the plan, but if the value of the loan amount is excluded, the alternate payee pays his or her share of the loan by taking less from the plan.

When our firm is retained in a case, it is most often after the divorce judgment has been filed. The parties believe there are no further issues other than to draft a QDRO based on the judgment language. We find that the parties are dismayed and frustrated with their family law attorneys for *not* dealing with both these issues before the divorce judgment. Often there are additional fees to perform any premarital separate interest calculation. The parties have to search for statements from long ago. And the parties have to negotiate and deal with each other again! The best practice is to retain a QDRO attorney before the divorce judgment is finalized so that these issues may be fleshed out before everyone signs the divorce judgment.

Defined Benefit Plans

When dividing a defined benefit plan, it is critical to know whether a participant has retired and begun to receive benefits. If the participant has not commenced benefits, generally the plan will be divided as a "separate interest" QDRO. If the participant has commenced benefits, then the QDRO must be a "shared interest" QDRO. Almost all ERISA plans allow division with a separate interest QDRO when a participant has not yet retired. However federal and military plans will only divide as a "shared interest" DRO, regardless of whether the employee has commenced benefits.

With a separate interest QDRO, the alternate payee does not need to wait for the participant to retire and can commence benefits at any time after the participant reaches earliest retirement age which, in most cases, is age fifty-five. The benefit is actuarially adjusted and paid over the alternate payee's lifetime. With a shared interest QDRO, the alternate payee marital interest is determined based on the form of benefit selected by the participant at retirement, which may or may not include survivor benefits depending on whether the parties were married at the date of retirement. If married at the participant's benefit commencement, for both ERISA and federal/military plans, the participant must take the benefit with a survivor annuity unless the spouse waives the survivor benefit, as discussed further below.

Note that if the participant is retired, the plan may not withhold the monthly benefit until its administrators are served with a domestic relations order enabling them to determine whether the plan is qualified. 29 U.S.C. § 1056(d)(3)(H). The time rule (discussed above) is the best way to divide most defined benefit pensions.

Survivor Benefits

Harm to a client and risk of malpractice are most commonly caused by failure to ensure survivor benefits to the nonparticipant spouse in a divorce. The surviving spouse ERISA sections are found in ERISA § 205(a)(2), 29 U.S.C. § 1055(a)(2), which describes the qualified preretirement survivor annuity (QPSA), and ERISA § 205(a)(1), 29 U.S.C. § 1055(a)(1), which describes the qualified joint and survivor annuity (QJSA). Both a QPSA and QJSA provide for a 50-percent joint and survivor annuity to a spouse. ERISA mandates that a QPSA and QJSA be payable to a surviving spouse unless a spouse waives his or her interest *before a notary.* However failure to specifically award survivor benefits to the nonparticipant spouse in a divorce judgment or QDRO may cause the nonparticipant spouse to lose all rights to survivor benefits. *If there is no award of survivor benefits to the alternate payee in a divorce judgment or QDRO and the participant dies preretirement, then in almost all cases, benefits stop being paid to an alternate payee. If there is no award of survivor benefits in a divorce judgment or QDRO before the participant commences benefits, then in almost all cases, if the participant later dies before the alternate payee, benefits will stop being paid to the alternate payee.*

To obtain spousal rights for former spouses, a QDRO is needed. ERISA § 206(d)(3)(F)(i), 29 U.S.C. § 1056(d)(3)(F). Federal law permits a QDRO to designate a former spouse as the surviving spouse to the extent of the marital interest, and the actual spouse will then not be treated as the surviving spouse. For a good overview of how ERISA protects a surviving spouse against other beneficiaries, see *Hamilton v. Plumbers & Pipefitters Nat'l Pension Fund*, 433 F.3d 1091 (9th Cir. 2006).

Survivor Benefits and Federal Public Plans

For the Federal Employees Retirement System (FERS), the default survivor annuity is a 50-percent qualified joint and survivor annuity. For the Civil Service Retirement System (CSRS), the default survivor annuity is a 55-percent joint and survivor annuity.

And for military, the default survivor benefit, called the Survivor Benefit Plan, is a 55-percent joint and survivor annuity. State public plans survivor options vary from state to state and are beyond the scope of this article.

If an ERISA Participant Dies Before Retirement

If a participant dies before retirement and before dissolution, ERISA benefits will vest in the spouse unless the spouse has clearly waived his or her interest in the survivor benefits. *Carmona v. Carmona,* 603 F.3d 1041 (9th Cir. 2010); *Kennedy v. Plan Adm'r for Dupont Sav. & Inv. Plan*, 555 U.S. 285 (2009). Note that for most defined benefit plans, if a participant dies preretirement, benefits are *only* payable to a surviving spouse (or a former spouse treated as a surviving spouse in a QDRO). Since the participant cannot leave that monthly benefit to a beneficiary, the ERISA plan keeps the funds that would have been payable on a participant's account if no spouse or former spouse with a QDRO exists.

If a participant dies before retirement *but after dissolution* and a QDRO has not been entered, there could be problems. There is a limit on the ability to obtain survivor benefits for a former spouse after death or retirement *if the judgment does not specifically award survivor benefits and the participant died or retired with a second spouse. Carmona v. Carmona*, 603 F.3d 1041 (9th Cir. 2010).

In *Carmona*, the participant retired with a joint and survivor annuity with his fourth spouse. The participant subsequently divorced that spouse, who clearly waived all survivor benefits in the divorce. The participant married a fifth spouse, and then died. The fifth spouse sought to have the survivor benefits paid to her, rather than to the fourth spouse, because the fourth spouse waived her interest in survivor benefits in the dissolution. The Ninth Circuit held that survivor benefits could only be paid to the fourth former spouse "[b]ecause ordinarily at retirement the surviving spouse's interest irrevocably vests." *Carmona*, 603 F.3d at 1060. The Ninth Circuit followed the landmark case, *Hopkins v. AT&T Global Information Solutions Co.*, 105 F.3d 153 (4th Cir. 1997), *which is followed by most circuits throughout the United States.*

However, in footnote 13, the *Carmona* court discussed the exceptions for when a QDRO post-death can be obtained. Footnote 13 states:

> We say "ordinarily" because we recognize that there may be other situations, not present in this case, in which a contrary result may be appropriate. For example, it is possible that a former spouse could obtain a DRO prior to the annuity start date and present it to the plan. … [B]ut the actual determination of whether the DRO is a QDRO might not be finalized prior to the date on which the benefit would normally become payable. *See e.g.*, 29 U.S.C. §1056 (d)(3)(H).

Carmona, 603 F.3d at 1060.

The Ninth Circuit has also dealt with a post-death QDRO for support in *Trustees of the Dirs. Guild of America-Producer Pension Benefits Plans v. Tise*, 234 F.3d 415 (9th Cir. 2000). The court held that a post-death QDRO for support was enforceable where there was no surviving spouse involved, citing *Hopkins*. *Tise* held that a DRO for support that existed before the participant's death was sufficient to be perfected into a QDRO post-judgment. (Note also that *Tise* awarded attorney's fees to the former spouse for portions of the case relating to the QDRO support division.)

My mantra is to always include survivorship language in a divorce judgment in case the participant dies or retires before a QDRO is entered. The bottom line is that, unless a divorce judgment specifically protects survivor benefits for the alternate payee, it is *very* difficult for a post-death QDRO to be effective, given *Carmona* and

Hopkins. However, under *Carmona* footnote 13, we know that it is possible to perfect a DRO awarding survivor benefits into a QDRO post-judgment and post-participant's death. *Every time I speak to family law attorneys, I warn that, no matter the size or type of retirement plan, always include one sentence awarding survivor benefits to the alternate payee on the alternate payee's marital share.*

If a Participant Fails to Switch Beneficiaries after Divorce

The U.S. Supreme Court finally dealt with this issue in *Kennedy v. Plan Administrator for Dupont Savings & Investment Plan*, 555 U.S. 285 (2009). In *Kennedy*, there was a clear waiver in a dissolution by the former spouse of any interest in a retirement benefit. However, the participant failed to change his beneficiary form. Plan administrators were unsure as to whether they had an obligation to follow the beneficiary form or the divorce judgment.

The Supreme Court held that designation of a former spouse as beneficiary remains valid even if the judgment revokes the beneficiary designation and awards all benefits to participant. The same law also applies to life insurance. *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001).

I always like to point out *Kennedy* to family law attorneys so that they can make sure to let their clients know to change their beneficiary form after the QDROs have been filed.

Heirs' State Law Claims against a Former Spouse for Distribution Proceeds

The Ninth Circuit reconvened after its initial *Carmona* determination for the sole purpose of reconciling that holding with *Kennedy*. In the *Carmona* opinion revised after *Kennedy*, the Ninth Circuit added footnote 15, stating that, "[i]n *Kennedy*, the Court explicitly declined to express a view on whether an action could have been brought to obtain benefits from the former spouse after they had been distributed to her. 129 S. Ct. at 875 n.10." *Carmona*, 603 F.3d at 1062. However, in *Carmona*, the court held that when a state court creates a constructive trust with the explicit purpose of avoiding ERISA rules, it must be preempted. *Id.*

Accordingly, at least in California, *Carmona* indicates that it would currently be difficult for the heirs to prevail in a state court claim to the distribution proceeds against a former spouse. We are, however, starting to see recent cases outside of California where participants' heirs have prevailed in state law claims against former spouses for the distribution proceeds received. *Estate of Kensinger v. URL Pharma, Inc.*, 674 F.3d 131 (3d Cir. 2012); *Andochick v. Byrd*, 709 F.3d 296 (4th Cir. 2013). I predict this issue will ultimately be before the U.S. Supreme Court.

The Impact of Death on Some Public Plans

For military retirement benefits, a survivor benefit plan (SBP) is offered to participants to provide survivor benefits to a spouse or former spouse with a DRO. Failure to award the SBP in a divorce judgment has a draconian effect if the participant retires or dies before a DRO is served. Only one spouse (or former spouse) can be the beneficiary for the SBP. Also, proper forms must be timely served—within twelve months of the initial order—for the SBP to be effective, regardless of any court order.

Federal employees are offered a defined benefit plan under either the Federal Employee Retirement System (FERS) or the Civil Service Retirement System (CSRS). Under either of these plans, a former spouse survivor annuity (FSSA) is offered to ensure survivor benefits to a former spouse. Again, there is a draconian effect for failure to award the survivor benefit in the judgment (or the first court order, if earlier) under the "first order rule." If a participant retires or dies before filing a

DRO that clearly awards the FSSA, it will likely *not* be possible for that former spouse to obtain survivor benefits. In fact, there is a regulation that the first order (often the judgment) cannot be amended nunc pro tunc to provide for survivor benefits. Note that federal plans do, however, allow survivor benefits to be paid to multiple spouses.

For both federal and military employees, the former spouse will lose survivor benefits with remarriage before age fifty-five unless the parties were married for more than thirty years.

Conclusion

To the extent possible, always try to identify all possible retirement plans in the divorce judgment. In addition, to protect survivorship rights, it is *always* a good idea to include one sentence in the divorce judgment awarding the alternate payee survivor benefits to the extent of the marital interest.

When a DRO is received by a plan, the plan administrator is supposed to promptly notify the participant and each alternate payee of the receipt of the order and the plan's procedures for determining the qualified status of a DRO. Within a reasonable time, the plan administrator must determine whether the DRO is a QDRO and notify the participant and alternate payee of the determination. 29 U.S.C. § 1056(d)(3)(G). When plan administrators are determining whether a DRO is a qualified order, withholding and segregation of plan benefits are triggered. 29 U.S.C. § 1056(d)(3)(H). ERISA plan requirements under 29 U.S.C. § 1056(d)(3)(H) create an obligation to withhold for the alternate payee when served with a DRO sufficient for review regarding whether it is qualified.

So before you close your file, serve a copy of that divorce judgment on the plan! By serving on the plan, if the participant dies, there may at least be a chance to perfect the DRO with a post-death QDRO. FA

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