HOW QDROS DIVIDE RETIREMENT PLANS ON DIVORCE OR SEPARATION & WHAT DIVORCE FINANCIAL ANALYSTS NEED TO KNOW

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BASIC "MUST KNOWS"

- What is a Qualified Domestic Relations Order (QDRO)
- Whether the plan benefits are divisible by QDRO or similar Order
- Type of retirement plan
- When benefits are payable – defined contribution plan – defined benefit plan
- Taxation – shifts burden except for CS; IRC (t)(2)(C) exception to10% penalty
- Valuation & offset vs. dividing plans separately – gains and losses; size of plan
- How the QDRO process works – timeline
- Main benefits awarded – defined contribution plan – defined benefit plan
- Know the particular plan
- Has the participant retired; if so, the form of benefit elected and beneficiary

WHAT A QDRO IS

- ERISA and the Code do not permit a participant to assign his or her interest in a pension plan. The Retirement Equity Act of 1984 (REA), however, amended ERISA to allow for assignment of benefits pursuant to domestic relations matters without violating the anti-alienation provisions of ERISA, via QDRO.
- A QDRO is a Qualified Domestic Relations Order. It is a court order that divides a private sector retirement plan pursuant to state domestic relations law that relates to child support, spousal support or marital property rights for the benefit of a spouse, former spouse, child or other dependent of a plan participant. The formal definition of "QDRO" can be found in the Internal Revenue Code (the Code) at 26 U.S.C. 414(p) and in the Employee Retirement Income Security Act (ERISA) Sec. 206(d)(3) (now codified in the U.S. Code at 29 U.S.C. 1056(d)(3). There are parallel statutes allowing division of federal, state and municipal retirement plans. The regulations for dividing federal pensions by court order can be found in the Code of Federal Regulations at 5 C.F.R. 838. The statute governing the division of military pensions is the Uniformed Services Former Spouse Protection Act (USFSPA), 10 U.S.C. §1408.

WHETHER PLAN BENEFITS ARE DIVISIBLE BY QDRO OR SIMILAR ORDER

- ERISA qualified employer sponsored plans are divisible by QDRO
- Federal government retirement benefits such as the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) are divisible by Court Order Acceptable for Processing (COAP). The Federal Thrift Savings Plan is divisible by a Retirement Benefits Court Order (RBCO).
- Military retired pay is divisible by a Military Pension Division Order (MPDO).
- State sponsored and municipal sponsored retirement plans may by divided under state statutes and local ordinances. State or municipal defined contribution plans are usually 401(a), 403(b) or 457 plans subject to QDROs.
- Non-qualified plans might permit division by DRO. If not, a “workaround” might be required, such as agreed to terms for the employee spouse to pay the former spouse upon receipt when the benefit is eventually paid.
- IRAs – are divisible under IRC 408(d)(6); not by QDRO.

TYPES OF RETIREMENT PLANS

- ERISA plans are divided into "pension" plans, and welfare plans. We are concerned with pension plans. Pension plans are divided into two types: defined contribution plans and defined benefit plans.
- The terminology gets confusing here, because outside the ERISA language context, defined contribution plans can be either pension (Target Benefit or Money Purchase) plans, or profit sharing plans. Profit sharing plans can be a type of plan unto itself wherein the employer can make profit sharing contributions, or a profit sharing plan can be a general broad category encompassing most of the defined contribution plans with which we're familiar, such as 401(k)s, stock bonus plans, employee stock ownership plans (ESOPs), 403(b)s and 457 plans.
- Defined benefit plans can be either a traditional defined benefit plan, or a cash balance plan. There are no defined benefit profit sharing plans. Everything that is not a traditional defined benefit plan or a cash balance plan is a defined contribution plan.
- IRAs are not in the above categories and are not ERISA qualified plans, but the employer or custodian might require a DRO to divide it.

WHEN BENEFITS ARE PAYABLE

- Defined contribution plans – for alternate payee's under QDROs benefits are usually payable as soon as administratively feasible after the DRO is approved by the Plan as a QDRO. The unusual exception is for certain defined contribution plans sponsored through a municipality or certain of the skilled trades and the underlying investment is an annuity.
- Defined benefit plans – normally the alternate payee can draw benefits either:
  - any time after the participant's earliest eligibility for retirement (if the separate interest method of division is used – the alternate payee's benefit is separately carved out from the participant's benefit and based on the alternate payee's lifetime), or
  - when the participant commences (if the shared payment method is used – the alternate payee's benefit remains based on the participant's lifetime and)

TAXATION

- A QDRO shifts the tax burden to the alternate payee, who will get the IRS form 1099 if they are the former spouse or spouse. If the alternate payee is a child or other dependent, then the participant still pays the taxes.
- An alternate payee who receives a distribution directly from the plan that is the subject of the QDRO is NOT subject to the 10% penalty for early withdrawal. This exception is lost if the funds are rolled or transferred out of the plan that is the subject of the QDRO into an IRA or other qualified plan that accepts the funds, and then the distribution is requested.

VALUATION AND OFFSET VS. DIVIDING THE PLANS SEPARATELY

- Gains and losses – the only way to absolutely make certain the gains and losses from all the defined contribution plans are shared equally is to divide them each separately via QDRO for each plan. Sometimes, however, there is a small account where the gain/loss would be negligible. There may also be cases where the plans have identical investments and allocations. There may also be cases where the parties are aware of the potential unequal sharing of gains and losses, but to avoid the cost of preparing many QDROs, they decide to value and offset the defined contribution plans to minimize the number of QDROs necessary.
- Pension valuations – usually these are requested because the parties and their attorneys want an idea of the value of the defined benefit plan. It is not generally recommended that defined benefit plans be offset against defined benefit plans because pension valuations are based on assumptions, which are based on estimates of future benefits. However, it may make sense to offset small pensions, or to offset pensions if the parties understand the inherent potential inconsistencies.

HOW THE QDRO PROCESS WORKS

- Agreement is reached about division of the Plan
- Info. is obtained from the Plan: model QDRO and guidelines and procedures, and the Summary Plan Description or formal plan document itself
- The QDRO is drafted and sent to the attorneys, and the plan administrator for conditional preapproval, if allowed.
- Once preapproval is obtained and all agree to its provisions, the QDRO is entered in court with the Divorce Judgment/Decree, then the QDRO is sent to the plan administrator for formal qualification.
- The plan then sends notice of receipt to the parties, then sends another notice upon formal qualification or non-qualification determination. If qualified the plan informs the alternate payee of the alternate payee's rights and provides plan contact information, as well as a tax notice. The alternate payee frequently has the option of a rollover or cashout.

MAIN BENEFITS AWARDED

- Defined contribution Plans
  - All or part of the accumulated benefit
  - Gains and losses on the specified amount
  - Include loans (treat as if never taken) or exclude loans (divide only non-loan assets
  - Contributions attributable to the period of the marriage made after the valuation date (e.g. forfeited profit sharing contributions, or profit sharing contributions made in the subsequent calendar year.
- Defined benefit plans
  - A portion of the accrued benefit ("basic" benefit per the benefit formula)
  - A proportionate share of "ancillary" benefits such as early retirement supplements, post-retirement cost-of-living adjustments, early retirement "windows," etc.
  - **Survivor benefits** – qualified preretirement survivor annuity (QPSA) attributable to the period of the marriage. Also, if the shared payment method of division is used, the qualified joint survivor annuity (QJSA) attributable to the period of the marriage.

KNOW THE PARTICULAR PLAN

- So often the correctness of the division comes down to how well the benefits and features of the plan are understood.
- There are inherent differences in types of plans. Even when plans are of the same type, different plans may have different formulas, benefits and features.
- Defined benefit government (public sector) sponsored plans are invariably very different from defined benefit ERISA (private sector) plans.
- Church plans are not subject to any rules, even if they voluntarily allow DROs
- Non-qualified plans rarely allow DROs, so creative solutions are needed.

IS THE PENSION IN PAY STATUS

- If the defined benefit pension is in pay status, were the parties married at the time of retirement? If so, then the default form of payment for ERISA plans is a joint survivor option, which if not elected would have to be waived in writing by the plan participant, with the written consent of the former spouse.
- If the pension is in pay status and the former spouse can only receive a benefit for the participant's lifetime and is not eligible for a survivor annuity, consider valuing the lost survivor benefit and replacing it with life insurance .
- If the pension is in pay status, consider how to handle the former spouse's share of the benefit until the QDRO is submitted to the plan and the plan begins to account for future benefits to the former spouse.

...MORE... DEFINING MARITAL PORTION

- Defining the marital portion
  - Defined contribution plans – will you be simply dividing the difference between the date of marriage value and the date of divorce value, or will you be excluding from division the gains on the premarital balance
  - Defined benefit plans
    - Prospective coverture = benefit accrued as of retirement X marital service/total service
    - Accrued coverture = benefit accrued as of divorce (or other agreed-to date such as the date of filing of the complaint) X marital service/total service as of date of divorce
    - Tracking method = increase in accrued benefit earned as of date of marriage to date of divorce

…MORE… DRAFTING QDROS

- Should you draft QDROs? Maybe…
  - Easy to make mistakes
  - Do you like word problems and puzzles? How well to you write technical works? Can you write an airtight, unambiguously clear set of instructions using terms of art for the industry? Do you even want to, or do you just want to make sure you understand the issues so you can understand the award and apply it to your clients' divorce planning and financial planning?
  - Technical legal document – be an attorney or prepare for an attorney – homework – service intensive
  - Check with unauthorized practice of law committee of the state bar in the state
  - E & O coverage – don't leave home without it, and make sure preparation of QDROs is covered!

Q & A

- Survivor benefits?
- Marital portion?
- Gains and losses?
- Liability?
- Other?

PLEASE FILL OUT YOUR EVALUATION FORMS

THANK YOU !!!