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RETIREMENT BENEFITS IN FAMILY LAW: PROCEDURES AND TIPS FOR PARALEGALS

BUTTERFIELD SCHECHTER LLP
ATTORNEYS & COUNSELORS
858-444-2300 • www.bsllp.com

RETIREMENT BENEFITS IN FAMILY LAW
Topic Overview

1. How To Determine The Type Of Retirement Benefits

   Overview of the different types of retirement benefits.
   Contacting plan administrators.
   Successfully subpoena benefit information.

2. How to Freeze Benefits

   When are joinder documents required?
   Notice of adverse interest versus order freezing benefits.

2. How to Draft MSA Language To Divide Retirement Benefits

   Determining which retirement benefits require a QDRO.
   Defined contribution versus defined benefit MSA language.

OVERVIEW OF TYPES OF RETIREMENT BENEFITS

Six Categories of Retirement Benefit Plans:

1. Qualified Defined Contribution Plans
   Plans which have a current account balance because the benefits accumulate based on the contributions made by the employer and the employee.
   Examples: 401(k), ESOP, Profit Sharing Plan

2. Qualified Defined Benefit Plans
   Plans which do not have a current balance and instead provide a fixed benefit at retirement which can be paid in a lump sum, monthly payments, etc.
   Example: Private Pension Plan

3. Government Plans
   Examples: CSRS, FERS, TSP, CalPERS, CalSTRS, Military, SDCERA, SDCERS, OCERS

OVERVIEW OF TYPES OF RETIREMENT BENEFITS (continued)

4. Individual Retirement Accounts

   An IRA is normally not associated with an employer. An IRA has a current account balance because it is based on contributions made by the individual. Can be a traditional (pre-tax) or Roth (after-tax).

   Examples: IRAs sponsored by Fidelity, Vanguard, E*Trade

5. Equity Based Compensation

   Retirement benefits earned by an employee based in part on equity ownership in the company. There is usually not an account balance.

   Examples: Qualified and Nonqualified Stock Options, Stock Appreciation Rights, Time Vested Units

6. Nonqualified Deferred Compensation Plan

   Retirement benefits that are the obligation of the employer to pay and based on credits by the employer. Employee may not have an account balance because benefits are the obligation of the employer to pay at a later date.

Contacting Plan Administrators

- FREE ERISA www.freeERISA.com or Google search
- Telephone or write to Human Resources or Employee Benefits Department (will need participant's permission)
- Ask for benefit statements, plan document, etc. (see subpoena language on page 7)
- Ask for names of all plans that the employee is a participant in and use the exact plan name in the MSA, joinder, and notice of adverse interest

Successfully Subpoena Benefit Information

- Request from the Participant (Husband or Wife) a list of employers where the Participant earned retirement benefits
- Request from the Participant the list of financial institutions which administer the retirement benefits
- Prepare subpoena to employers and financial institutions for information

Drafting Your Subpoena

- Subpoena should be worded broadly to include any retirement benefits earned during employment
- Many individuals accidentally do not disclose all of the names of their plans because they do not fully understand the types of retirement benefits they have
  - For example: many government employees are unaware that the Thrift Savings Plan (TSP) is separate from Civil Service Retirement System
  - Where there is a defined benefit plan, there is probably also a defined contribution plan

Sample Subpoena Description

Any and all account statements and documents related to the benefits for the employee [NAME](Social Security number XXX-XX-XXX) in any and all retirement plans sponsored by [NAME OF COMPANY] at anytime between [DATE OF HIRE] until the most current.

Documentation showing the dates of participation in any retirement plan(s) and the dates of employment.

Any and all statements which reflect a distribution(s), if any, made by the employee [NAME] from [DATE OF HIRE] including the distribution direction, any distribution rollover form for such distribution, and a copy of the distribution check, if any, showing to whom such distribution was made.

Documentation showing any beneficiary designation election or survivor benefit election.

Summary Plan Descriptions and Plan documents for every retirement plan that employee [NAME] participated in from [DATE OF HIRE] until current.

Understanding Benefit Information

- Sort benefit information by plan name. At the top of the benefit statement, there should be a plan name that normally includes the employer's name and the word "plan." Different benefits will normally be under a different plan name.
  - For example: AT&T Savings Plan is a defined contribution plan and contains different retirement benefits then the AT&T Pension Benefit Plan which is a defined benefit plan.
- Each plan should be addressed in the marital settlement agreement, so treat each plan separately. In addition, if you need to put a hold on benefits, the hold should be put on each plan separately.
- Benefit statements that show an accrued benefit expressed in a monthly payment at retirement are normally defined benefit plans. These may have a "cash out value," but that does not make the plan a defined contribution plan.

How To Freeze Benefits

- Four ways to freeze benefits: notice of adverse interest, joinder documents, temporary restraining order, and interim QDRO
- Whether a particular method will freeze benefits depends on the Plan and the Plan Administrator. Ask and get confirmation of frozen benefits in writing.

When Are Joinder Documents Required?

- CalPERS, CalSTRS, UCRP, UCRS, and SDCERS

When Is A QDRO Required?

- A Qualified Domestic Relations Order ("QDRO") is required when benefits are assigned from a qualified plan to the spouse that is not the employee (this person is called the "alternate payee")
- Benefits that are not in a qualified plan may be assigned using a domestic relations order
- Almost all IRAs also require a domestic relations order

What Is A QDRO?

QDRO: Qualified Domestic Relations Order

Prior to the Retirement Equity Act of 1984 ("REA") an inherent conflict existed between the Internal Revenue Code ("IRC") Section 401(a)(13) and state domestic court proceedings which ordered payment of plan benefits to a spouse or other dependent in a dissolution

REA adopts the concept of a "qualified domestic relations order" so that no order of any state court will effect a transfer of qualified plan benefits to the spouse, child, or former spouse of a plan Participant unless is it a QDRO

What Does A QDRO Accomplish?

- Assigns retirement benefits to the former spouse (alternate payee) upon dissolution
- Avoids the 10% early distribution penalty pursuant to IRC 72(t)(2)(c) and the 2.5% California early distribution penalty
- QDRO is required for assignment of benefits in all “qualified” plans

What Is A DRO?

DRO: Domestic Relations Order

Assigns nonqualified plan benefits to former spouse (e.g., government plans)

A DRO is required for governmental retirement plans because the government can require that participants and alternate payees follow certain procedures in order to divide the benefits

Most IRAs need a DRO, but check with the IRA administrator to determine whether a particular IRA needs a DRO to divide retirement benefits

What Is A "Qualified" Plan?

- Qualified means that the ERISA plan is qualified under certain provisions of the Internal Revenue Code
- If the plan complies with the certain provisions of the Internal Revenue Code, then it will be qualified to have favorable tax status (i.e., contributions made to qualified plans are tax deductible and earnings in most tax qualified plans are not taxable until distribution)
- Most defined benefit and defined contribution plans are qualified
- Red Flag: Look for the word "nonqualified" to signal when a plan is not qualified, e.g., a Nonqualified Deferred Compensation Plan

Understanding Division Methods

- The six different types of plans can be divided in different ways.
- In order to draft your marital settlement agreement, it will be important to know what types of benefits the Participant has so that the appropriate division method can be matched with the type of benefits.

Defined Contribution Plan Versus Defined Benefit Plan

- The most common error in MSAs and QDROs is using the wrong division method for a defined contribution plan versus a defined benefit plan

Division Method for Defined Contribution Plans

- Instructs the plan administrator to add the contributions made by the employee and the employer due to employment from the date of marriage to the date of separation, adjust for earnings and losses, and award one-half to alternate payee.
- Contributions made by employer after separation for efforts during marriage are also community property.

Example of Calculation by Plan Administrator

DOM: 1/1/05 DOS: 1/1/07

Contributions:

- 2/1/05 $2,000 (made by employee)
- 2/1/06 $2,000 (made by employer for 2005 year)
- 2/1/07 $3,000 (made by employer for 2006 year)

Assume zero earnings during 2005, 2006, 2007

Community Property as of DOS equals $7,000

If QDRO is not entered until 1/1/09, $7,000 will be adjusted for earnings and losses in the plan investments during 2008 (approximate loss of 30%)

Alternate Payee is awarded 50% of $7,000 reduced by 30% equals $2,450

Division Method for Defined Benefit Plans

- Most common method is the time rule formula which instructs the plan administrator use a marital formula to assign benefits to the alternate payee
- Number of months of employment during marriage, divided by total number of months of employment, multiplied by 50 percent

Example of Calculation by Plan Administrator

DOM: 1/1/05 DOS: 1/1/07

DOH: 1/1/03 DOT: 1/1/10

QDRO is entered on 1/1/09, but plan will not pay benefits until termination of employment

Gross monthly benefit on date of termination is $500 per month

Time Rule Formula:

$$50\% \times \frac{\text{Years of Participation During Marriage}}{\text{Total Years of Participation}} \times \$500$$

$$50\% \times {}^{2}/_{7} \times \$500 = \$71 \text{ per month to alternate payee}$$

How do you divide retirements plans that are not "qualified" and are not governmental?

Examples: IRAs, Stock Option Plans, Nonqualified Deferred Compensation Plan, any other Nonqualified Plan

Answer: Ask the plan administrator if the plan will accept a DRO.

- If yes, can use DRO to assign the benefits or a private out of court division agreement. (Do not forget about taxes.)
- If no, use a private out of court division agreement to divide the benefits or negotiate a buy-out of the benefits (keeping in mind the high risk of error in a present value estimate)

Drafting Your MSA

If possible, entering a QDRO or DRO at the same time as dissolution can avoid many problems for your client.

<u>Potential Problems</u>:

1. Value of assets in plan have decreased or increased significantly since MSA
2. Loan balance in plan may exceed value of assets or plan administrator may be unwilling to transfer assets to alternate payee due to high loan balance
3. Plan administrator may not allow for division in the way previously anticipated (e.g., no survivor's benefits or cannot begin benefits until participant actually elects, necessity of Gilmore election, etc.)

Drafting Your MSA: Family Code § 2337

Each party [insert names and addresses] is provisionally awarded, without prejudice and subject to adjustment by a subsequent domestic relations order, a separate interest equal to one-half of all benefits accrued or to be accrued under the plan [name each plan individually] as a result of employment of the other party during the marriage [or domestic partnership] and prior to the date of separation. In addition, pending further notice, the plan shall, as allowed by law or, in the case of a governmental plan, as allowed by the terms of the plan, continue to treat the parties as married or domestic partners for purposes of any survivor rights or benefits available under the plan to the extent necessary to provide for payment of an amount equal to that separate interest or for all of the survivor benefit if, at the time of the death of the participant, there is no other eligible recipient of the survivor benefit.

Drafting Your MSA: Defined Contribution Plans

The parties agree to jointly retain _________ to draft the appropriate Qualified Domestic Relations Orders to divide equally the community property accumulated in the [names of plans] where the community property interest is defined as the sum of all contributions due to employment during marriage and adjusted for any earnings and losses until the final date of distribution to the nonparticipant spouse.

Pitfalls in Drafting Your MSA for Defined Contribution Plans

- Using a specific dollar amount: Solution, insert an effective date and provide for adjustment of earnings or losses or state specifically that the amount shall not be adjusted for earnings and losses

  Effective date may not be appropriate where two assets are used to offset each other and one does not bear the market risk
- Using the time rule formula: Not appropriate for defined contribution plans unless plan administrator lacks records to perform calculation
- Calculating an equalizing payment in an uncertain market
- Calculating an equalizing payment without full information

Drafting Your MSA: Defined Benefit Plans

Still use Family Code § 2337, then add paragraph:

The parties agree to jointly retain ________ to draft the appropriate Qualified Domestic Relations Orders to divide the community property accumulated in the [names of plans] pursuant to the "time rule" formula whereby the nonparticipant spouse shall receive one-half of the participant's benefits, including but not limited to, the normal retirement benefit, early retirement benefit, and any survivor's benefit, in the ratio that the years of participation during marriage and prior to the date of separation bears to the total years of participation earned by participant on the date the benefits become payable and are distributed to the nonparticipant spouse.

Pitfalls in Drafting Your MSA for Defined Benefit Plans

- Using a specific dollar amount
- Using the benefit tracing definition of community property which is only appropriate for a defined contribution plan
- Calculating an equalizing payment without advising clients of risks (discussed later)
- Defining "community property" so as to leave out COLAs

Drafting Your MSA for Governmental Plans

Each government plan is different

Consider each government plan individually and resolve government specific plan questions before MSA is signed

Questions and Answers

For more information

please contact Elizabeth Sales at:

Butterfield Schechter◆LLP
10616 Scripps Summit Court, Suite 200
San Diego, California 92131-3961
Telephone: (858) 444-2300
Facsimile: (858) 444-2345
www.bsllp.com
esales@bsllp.com