Retirement Benefits | *Elizabeth Sales, J.D., L.L.M. in Taxation* |
May 19, 2010

IDENTIFYING AND DIVIDING RETIREMENT BENEFITS

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IDENTIFYING AND DIVIDING RETIREMENT BENEFITS
Topic Overview

1. <u>How To Determine Type Of Retirement Benefits</u>

   Overview of the different types of retirement benefits.
   Successfully subpoena benefit information.
   Understanding benefit information.

2. <u>How to Draft MSA Language To Divide Retirement Benefits</u>

   Overview of the division methods for different types of retirement benefits.
   Determining which retirement benefits require a QDRO.
   Drafting appropriate MSA language.
   Avoiding common pitfalls in drafting MSA language.

OVERVIEW OF TYPES OF RETIREMENT BENEFITS

Six Categories of Retirement Benefit Plans:

1. <u>Qualified Defined Contribution Plans</u>
   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. <u>Qualified Defined Benefit Plans</u>
   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. <u>Government Plans</u>

   Examples: CSRS, FERS, TSP, CalPERS, CalSTRS, Military, SDCERA, SDCERS, OCERS

OVERVIEW OF TYPES OF RETIREMENT BENEFITS (continued)

4. <u>Individual Retirement Accounts</u>
   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. <u>Equity Based Compensation</u>
   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. <u>Nonqualified Deferred Compensation Plan</u>

   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.

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.

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.
- Again, there are six general categories of retirement benefits:

  1. Qualified Defined Contribution Plans; 2. Qualified Defined Benefit Plans; 3. Governmental Plans; 4. Individual Retirement Plans; 5. Equity-Based Compensation Plans; and 6. Deferred Compensation Plans
- The majority of retirement benefits fall into the first four categories. These categories can normally be divided using a Qualified Domestic Relations Order (for categories 1 and 2) or a Domestic Relations Order (for categories 3 and 4).

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

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 these plans are highly regulated and 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

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.

Potential Problems:

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.

Function of a QDRO 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

Distribution Options Available to Alternate Payee

An alternate payee has two distribution options:

1. Take distribution in cash into checking account

   $2,450 reduced by federal tax, 28%, and California state tax, 9.3%, equals $1,536.15

   No federal or state penalty

2. Roll over benefits to an IRA (have 60 days from receipt of payment)

   $2,450 is rolled over and $913.85 is deferred in taxes

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.

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:

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

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

Example of Survivor's Benefit Calculation by Plan Administrator

Family Code Section 2610, *Marriage of Nice*, (1991) 230 Cal.App.3d 444, 451

Nonparticipant spouse is entitled to community share of survivor benefits, not necessarily the entire survivor's benefit.

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

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

QDRO is entered on 1/1/09, and participant subsequently dies with a gross survivor's benefit of $300

nonparticipant spouse will not receive entire survivor's benefit, only 50% of the community portion of the survivor's benefit

$$50\% \times \frac{\text{Years of Participation During Marriage}}{\text{Total Years of Participation}} \times \$300 = \$43$$

Who receives the remaining $260?

Answer: The new spouse (whomever the participant has on the beneficiary designation form).

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

Drafting Your MSA: CalPERS

Two methods of division: Shared and Separate

1. Shared: time rule at retirement
2. Separate: two separate accounts as of date of dissolution (not available if participant is already retired)

Drafting Your MSA: CalPERS

Survivor Benefits - Family Code Section 2610, *Marriage of Nice*, (1991) 230 Cal.App.3d 444, 451.

Nonparticipant spouse is entitled to community share of survivor benefits

Pre-retirement survivor benefits are free

Post-retirement survivor benefits: 50% free, additional must be paid for (similar to life insurance policy)

Options 2, 2W, 3, 3W and 4 provide a joint and survivor annuity that will pay a monthly benefit as long as either the member or the beneficiary is alive

Nonparticipant spouse must decide whether to elect for survivor benefits

Cost of survivor benefits: Who pays?

Solution: Pay in the same proportion as the survivor benefit is received.

MSA Language for CalPERS Shared

Still use Family Code § 2337 as first paragraph, then add:

The parties agree to jointly retain _________ to draft the appropriate Qualified Domestic Relations Orders to divide the community property accumulated in the California Public Employees' Retirement System pursuant to the "shared method" whereby the nonparticipant spouse shall receive one-half of the participant's benefits 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. Nonparticipant spouse shall receive a portion of the pre-retirement and post-retirement survivor benefits pursuant to the ratio provided above, and nonparticipant spouse shall bear the cost of the post-retirement survivor benefits pursuant to the ratio provided above. Participant shall elect option ___ for survivor benefits at retirement.

MSA Language for CalPERS Separate

The parties agree to jointly retain __________ to draft the appropriate Qualified Domestic Relations Orders to divide the community property accumulated in the California Public Employees' Retirement System pursuant to the "separate account method" whereby the nonparticipant spouse shall receive one-half of the participant's contributions and service credits earned by Participant during the marriage in a separate and distinct account set up for the nonparticipant spouse as of the date of dissolution.

Drafting Your MSA: CalSTRS

Two methods of division: Shared and Segregated

1. <u>Shared</u>: time rule at retirement
2. <u>Separate</u>: two separate accounts as of the date of separation (not available if participant is already retired)

Drafting Your MSA: CalSTRS

Survivor Benefits - Family Code § 2610, *Marriage of Nice*, (1991) 230 Cal.App.3d 444, 451.

nonparticipant spouse is entitled to community share of survivor benefits

Pre-retirement survivor benefits are free

Post-retirement survivor benefits must be paid for (similar to life insurance policy)

Options for 100%, 75%, or 50% are available

nonparticipant spouse must decide whether to elect for survivor benefits

Cost of survivor benefits: Who pays?

MSA Language for CalSTRS Shared

The parties agree to jointly retain _________ to draft the appropriate Qualified Domestic Relations Orders to divide the community property accumulated in the California State Teachers' Retirement System pursuant to the "shared method" whereby the nonparticipant spouse shall receive one-half of the participant's benefits 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. Nonparticipant spouse shall receive a portion of the pre-retirement and post-retirement survivor benefits pursuant to the ratio provided above, and nonparticipant spouse shall bear the cost of the post-retirement survivor benefits pursuant to the ratio provided above. Participant shall elect the option to receive _____% as a survivor benefit at retirement.

MSA Language for CalSTRS Segregated

The parties agree to jointly retain __________ to draft the appropriate Qualified Domestic Relations Orders to divide the community property accumulated in the California State Teachers' Retirement System pursuant to the "segregated account method" whereby the nonparticipant spouse shall receive one-half of the participant's contributions and service credits earned by Participant during the marriage in a segregated and distinct account set up for the nonparticipant spouse as of the date of dissolution.

Drafting Your MSA: TSP

TSP is a defined contribution plan through the federal government

Tip: Usually if a party has benefits under CSRS or FERS, they also have benefits with TSP

Language:

The parties agree to jointly retain _________ to draft the appropriate Domestic Relations Orders to divide the community property accumulated in the Thrift Savings Plan 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.

Drafting Your MSA: CSRS and FERS

Civil Service Retirement System - commenced employment with U.S. Government before 1983

Federal Employees’ Retirement System - commenced employment with U.S. Government after 1983 (or went back to work for U.S. Government after 1983 with less than 5 years of service)

CSRS and FERS benefits are defined benefit plans through the federal government

Tip: Usually if a party has benefits under the TSP, then they either have benefits with FERS or CSRS or both

Drafting Your MSA: CSRS

Core Benefits Under CSRS:

1. Employee Annuity - Normally divided pursuant to time rule
2. Refund of Employee Contributions - This is in lieu of receiving a monthly pension benefit, so normally best practice is to prohibit the employee from taking a refund of contributions
3. Survivor Benefits - Normally divided pursuant to time rule

   (Note: There is a cost to survivor benefits--normally member and alternate payee share in the cost pursuant to the time rule)

Drafting your MSA: CSRS

ISSUE: OPM does not allow for the modification of a decree if made after the retirement or death of the employee. *Vaccaro v. Office of Personnel Management,* 262 F.3d 1280, 1287 (Fed. Cir. 2001)

If your MSA is too detailed regarding the CSRS benefits so as to qualify on its own as a "court order acceptable for processing," a later COAP will be rejected

Example: Member is retired and currently receiving a benefit

- MSA has all required language except leaves out survivor benefit
- Parties enter into a COAP to provide for a survivor annuity to the former spouse
- COAP will be rejected by OPM and no survivor annuity will be awarded to former spouse

Solution: File the COAP at the same time as the MSA or use general Family Code § 2337 language knowing there are going to be issues that need to be resolved after the MSA is entered

Drafting Your MSA: CSRS

ISSUE: Survivor annuity will not be paid if member dies after leaving work with the government and before member applies for benefits. *Hubbard v. Office of Personnel Management, 247 F.3d 1236 (Fed. Cir. 2001)*

- Former spouse bears the risk

Solution: Draft MSA to require purchase of life insurance for the time period between leaving work with the government and applying for benefits

Drafting Your MSA: CSRS

ISSUE: CSRS members will not receive social security benefits (FERS members do receive social security)

- Currently, California law provides CSRS benefits are divided equally, but social security benefits are not divisible
- Other states allow for CSRS benefits paid to alternate payee to be offset by alternate payee's social security benefits
- CSRS members often feel "cheated" because they will not receive social security benefits and the alternate payee will receive social security benefits

Solution: Appellate Courts and California Supreme Court

Questions and Answers

For more information

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