# RETIREMENT DIVISION BASICS

**PHILIP D. PHILLIPS**
101 Summit Avenue
Suite 700
Fort Worth, Texas 76102

State Bar of Texas
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**PHILIP D. PHILLIPS**
***101 Summit Avenue, Suite 700***
***Fort Worth, Texas 76102***
***(817) 984-7585***
***Fax (817) 984-7589***

***Education***:
*University of Texas at Austin (B.A. in Government, 1976)*
*University of Houston Bates School of Law (Doctor of Jurisprudence, 1979)*

***Licensed:***
*State of Texas - 1979*
*U.S. District Court, Northern District of Texas - 1981*

***Board Certification:***
*Family Law - Texas Board of Legal Specialization (1984)*

***Current Memberships:***
*Member, State Bar of Texas*
*Member, Family Law Section - State Bar of Texas*
*Member, Texas Academy of Family Law Specialists*
*Member, Tarrant County Bar Association*
*Past-President / Director / Member, Tarrant County Family Law Bar Association*

***Professional Activities and Honors:***
*President, Tarrant County Family Law Bar Association - 1995*
*Grievance Committee Member & Dist. 7A-2 Panel Chair - 1996 - 2001*
*Chair, Mentor Program Committee, Tarrant County Bar Association - 1995 - 1997*
*Board of Directors, Tarrant County Family Law Bar Association - 1990 – 1996, 2001- 2004*
*Fee Dispute Committee, Tarrant County Bar Association - 1991 - 1995*
*Board of Directors, West Texas Legal Services Corp. - 1986 - 1990*
*Volunteer Court Master, 233rd, 231st, 324th, 325th, & 360th District Courts*
*Texas Super Lawyers – Family Law*, Texas Monthly, 2003 - 2008

***Publications and C.L.E. Activities:***
*Editor,* Tarrant County Family Law Bar Newsletter, *1995 – 2000*
“Retirement”, *Marriage Dissolution Institute, Apr. 2014, Austin, TX*
“Retirement and Employment Contracts/Compensation: Division, Characterization and Orders – State Retirement”, *Advanced Family Law Course 2013, Aug. 2013, San Antonio, TX*
“Exploring Employment Plans and Benefits and Drafting QDROs – State & Local Government Plans”, *35th Annual Advanced Family Law Course, Aug. 2009, Dallas, TX*
“Defined Benefit Valuation Issues”, *34th Annual Advanced Family Law Course, Aug. 2008, San Antonio, Texas*
“Retirement Orders & Division – State & Local Government Plans”, *Advanced Family Law Course 2006, San Antonio, TX*
“A Practical Guide to the Grievance Process”, *Arlington Bar Assoc., Aug. 14, 2002*
“QDROs: Shared Interest v. Separate Interest”, *Tarrant County Bar Assoc. Bulletin, June 2001*
“Retirement Plans: What To Do When No QDRO Is Honored”, *Advanced Family Law Course 2000, Aug. 21-24, 2000, San Antonio, Texas*
“QDRO's: What You Need Before You Do the Order", *Austin Bar Assoc. – Family Law Sect., Feb., 2000; Nuts & Bolts Fam. Law Sem., June 16-17, 2000, Ft. Worth, TX*
"Special Problems for Divorcing Professionals & Valuation of Professional Practices" *(Co-Author), 24th Annual Advanced Family Law Course, Aug. 17-20, 1998, San Antonio, Texas*
"Practicing Family Law for Fun and Profit" *(Co-Author), Marriage Dissolution Institute, May 8-9, 1997, Dallas, TX*
"Divorce and Protective Orders", *Lawyer's Against Domestic Violence Seminar - Oct. 21, 1994, Fort Worth, Texas*
"Special Problems", *Third Annual Family Law Seminar, State Bar of Texas & West Texas Legal Services Corp. Private Attorney Involvement Program - June 16, 1993, Fort Worth, TX*
"Calculating the Present Value of Retirement Benefits", *Tarrant County Family Law Bar Seminar - May 16, 1991, Fort Worth, Texas*
"A Practical Guide for Receiving Direct Payment of Military Retirement Benefits", *51 Tex. Bar Journal 253 (1988)*

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# Retirement Division Basics

## I. INTRODUCTION

This paper attempts to provide a general overview of Private and Public retirement plans, with an emphasis on avoiding common traps and problems in a division upon divorce. Much more detailed information can be obtained from recent papers given at the Advanced Family Law Course on each type of plan, as there are entire papers written on State and Local Government Plans, Military Retirement and Federal plans, among others.

The Federal Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. Chapter 18, controls the transfer of an interest in a qualified retirement plan. State, local and federal government, church and charity plans are not subject to ERISA but generally have similar provisions and allow for division. ERISA's purpose is to prevent a plan participant from transferring or assigning an interest in his or her retirement plan to creditors or others, even on a voluntary basis. The exceptions to this prohibition are for a division of marital property, payment of alimony or payment of child support. If the transfer or assignment is for one of these purposes, it can only be accomplished by use of a Qualified Domestic Relations Order ("QDRO"). The standard Income Withholding Order is used for withholding child support from a person's current pay, but if the child support payments are to be withheld from a retired person's monthly annuity payments, a QDRO must be used rather than an Income Withholding Order. In the event the child support obligor has an arrearage, the arrearage can be taken from his/her defined contribution plan (such as a 401k). In addition to a recognized purpose, the transfer must be made to an Alternate Payee recognized by ERISA, which only includes a spouse, former spouse, child or other dependent. Please note that an attorney is not a recognized Alternate Payee and is considered just another creditor, so it is not possible to take attorney fees from a 401(k) or other retirement plan. The Plan Administrator will not accept a QDRO that attempts to pay attorney fees. This issue is discussed in more detail below.

The Court has the authority to divide a retirement plan, just as any other asset; on a "just and right" basis (Sections 7.001 and 7.003, Texas Family Code) and an equal division is not required. In fact, nothing in Texas law requires the division of a retirement plan, however, in the vast majority of cases, division will be required in order to obtain a just and right division of the community estate. In most cases, the retirement benefits will be the most valuable asset in the estate.

As discussed below, there are three general types of retirement plans: defined benefit, defined contribution and hybrid plans. It is important to know what kind of plan is being divided so that the parties will have a clear idea of how and when distribution of any awarded benefit will occur. Also, the Decree will require different provisions and language depending upon the plan type.

In the event there is a question of whether or not an employee participates in a retirement plan, adequate discovery will resolve that question. Examination of the employee's pay stub will indicate whether or not a contribution is being deducted for a defined contribution plan (definition to follow). That will not usually indicate participation in a defined benefit plan (definition to follow). I have dealt with clients that were truly ignorant of his or her retirement plans but I have also dealt with clients that were simply dishonest. It is recommended that by using either a release signed by the participant, a subpoena duces tecum or other discovery tool, the attorney can inquire directly with the employer as to any plan participation. You can't divide it if you don't know it exists.

The party that participates in the retirement plan is called a "participant" or "employee" below and the non-participant spouse is called an "alternate payee" or "former spouse".

## II. TYPES OF RETIREMENT PLANS

### A. Qualified vs Non-Qualified Plans

A retirement plan that meets the requirements of the Internal Revenue Code ("IRC") and ERISA is considered to be a "qualified" plan. There are two basic types of qualified plans: defined benefit plans and defined contribution plans. Some employers also offer retirement plans that are non-qualified, especially to highly-compensated executives. Most of the non-qualified plans can be identified by the use of certain words in the name of the plan, such as "supplemental", "executive", "excess" or "bonus", however, that is not always the case.

A non-qualified plan is not subject to the terms of ERISA and the plan does not have to accept a QDRO, DRO or other division order. It is important to identify non-qualified plans early in a divorce case and determine if the plan will allow a transfer of funds. In many cases, there is no way to accomplish a transfer from one spouse to another, so that must be taken into account in negotiating a settlement or trying the case. It can be a serious problem if a case is settled with a spouse to receive a portion of such a plan, only to find out after the Decree is final that the division can't be done.

Local, state and federal government plans are specifically not subject to ERISA, although most will accept a QDRO, DRO or similar division order. The plans of churches and charitable organizations are also except from ERISA, but most also allow division.

Some companies offer stock option awards, but very few are qualified or allow a division or transfer to a former spouse. In such cases, the Decree should contain very specific constructive trust language, including a mechanism for the employee to exercise his/her stock options upon certain conditions. The Decree should also specify the manner and time period in which the employee pays the former spouse his/her portion of the exercised stock option proceeds.

**B. Defined Benefit Plans**

1. Traditional Pension

This plan provides a monthly benefit payable upon retirement, usually computed using a formula that considers the number of years of employment, age and pay rate. These plans are totally funded by the employer and do not maintain individual accounts in the name of each employee/participant. Usually, the plan will provide a yearly statement that estimates the amount of the benefit that has accrued under the Plan and how it will be paid at different retirement dates and in different benefit forms. The form of benefit payment that is selected by the participant can affect the amount of each monthly payment.

A traditional pension plan will generally not pay total or partial lump-sum payments upon commencement, but only monthly benefit payments. There will be a stated normal retirement age and if a participant elects to take an early retirement prior to obtaining that normal retirement age, the monthly benefit will usually be actuarially reduced to account for the fact that benefits will be paid over a longer period of time. Other elections made at retirement can also reduce the monthly benefit payment, such as electing a surviving spouse benefit. ERISA provides that a surviving spouse form of benefit is required unless the non-employee spouse consents to waive the benefit in writing.

The terms of traditional pension plans vary. Most provide for cost of living adjustments ("COLAs") to account for inflation. Some offer early retirement supplements, subsidies or benefits to encourage older, higher paid employees to retire early. These components of the Plan are also divisible by the Court, but not required. Normally, if an employee retires prior to the Plan's normal retirement age, the amount of the monthly benefit will be reduced. That discourages most people from early retirement. In order to counteract that disincentive, some Plans provide that if the employee chooses to retire early, the Plan will pay an early retirement supplement to make up for the reduction in the regular retirement benefit so that the employee is not financially harmed by his/her early retirement. Those supplements, subsidies or benefits may be paid in a lump sum, as additional monthly benefit payments or a combination. A person who is retired and receiving benefit payments is said to be "in pay status".

Surviving spouse benefits should also be addressed in negotiation or trial and included in the Decree and QDRO or division order. There are two surviving spouse benefits under ERISA plans, the qualified pre-retirement survivor annuity (QPSA) and the post-retirement qualified joint and survivor annuity (QJSA). These benefits are more fully discussed below in IV.B.2.

Traditional pension plans have vesting provisions, which requires a participant to work a certain number of years before he or she can receive a retirement benefit from the plan. The normal vesting period is five years. If one terminates employment prior to vesting, no pension benefits will be paid at retirement age. Texas law allows the division of both vested and non-vested benefits (Taggart v. Taggart, 552 S.W.2d 422 (Tex. 1977)). In the event the divorce occurs prior to vesting, the Court may divide the benefits, however, if the benefits never vest, then no benefits will be paid upon retirement to either the participant or the former spouse.

Since the employer funds traditional pensions, if the employer goes out of business or files bankruptcy, there may not be a source of funding to pay current and future retirees. In such a case, the Pension Benefit Guaranty Corporation ("PBCG") takes over the plan as trustee and pays the monthly benefit. The PBGC is an independent agency of the federal government. Pension plans pay yearly insurance premiums to help fund the PBGC and general tax revenues are not used as a funding source. The down side to a PBGC takeover is that there is a statutory maximum benefit that can be paid, so highly-compensated employees may see a significant reduction in benefits.

Valuation of a traditional pension plan can be difficult. An actuary can be utilized to provide a present value analysis, using life expectancy tables and present value discount rates. There can be times when the valuation is useful, but normally, a present value is not needed and the parties or Court should simply divide the benefit by percentage.

2. Cash Balance Pension

Recently, many traditional pension plans have chosen to convert to a cash balance pension model. Under such a plan, there is an account maintained in the name of the individual participant, similar to a defined contribution plan. Usually, only the employer makes contributions to the account. Some employers have both a traditional pension and a cash balance pension, depending upon when the employee was hired. It is important to know which applies in order to properly word the Decree and the QDRO.

The terms for distribution of a cash balance pension vary. Upon retirement, the participant is

entitled to the amount in the cash balance account, with some plans allowing for a lump sum distribution for investment by the participant, outside of the Plan. Some plans allow the option of continued investment within the plan and payment of monthly annuity payments to the participant, similar to a traditional pension plan. Some plans require that an annuity be funded, and the only option is monthly annuity payments.

It is important for the parties and attorneys to know the terms of the plan that is being divided so that the non-employee former spouse will have an idea of when and how he/she will receive the portion awarded. Some cash balance plans allow immediate, lump sum distributions of the amount awarded to the former spouse; some delay distribution to the former spouse until the participant reaches early retirement age; and some don't allow a lump sum distribution at any time, but require that the account be used to fund an annuity at the time of retirement. The form and timing of the payment of benefits to a former spouse can significantly affect how a case is negotiated and/or tried.

**C. Defined Contribution Plans**

There are a number of defined contribution plans under the IRC, including 401(k), 403(b), 457(b), SEP, SIMPLE and the federal Thrift Savings Plan. They are all very similar and consist of an actual account in the name of the participant that contains the contributions of the participant, the matching contributions of the employer (if any) and the gains and losses on the investment of those contributions. The division of a defined contribution plan can be made using a percentage or specific dollar amount. Some plans allow a division using a combination of percentage and dollars, such as "50% of the account balance, less $5,000", but many don't. The settlement agreement and Decree can make a division in this manner, but the QDRO will have to provide for a specific dollar amount in this instance.

The division of a defined contribution plan should address whether or not gains and losses on the awarded amount will be included from the date of division to the date of segregation to an account for the benefit of the former spouse/alternate payee. It is traditional to include gains and losses when a percentage is awarded, but not as frequent in the case of the award of a specific dollar amount. If the intent of the parties is that the former spouse receives the exact amount awarded, then gains and losses should not be included. Since some plans don't allow gains and losses when a specific dollar amount is awarded, there will be none even if the agreement and Decree state otherwise. Also, many plans establish a separate account for the former spouse for a short time prior to distribution or rollover, so in that event the account will incur gains and losses from the date of segregation of the new account to the date of distribution or rollover.

Although the vast majority of defined contribution plans allow the former spouse to take an immediate distribution or rollover of the funds awarded in a property division, that should be confirmed prior to negotiation or trial of the divorce division. A few plans require that the participant terminate employment or retire in order for the former spouse to take a distribution and that information could affect the proposed division if the former spouse is in need of the money immediately.

The most common defined contribution plan is the 401(k), which derives its name from that provision of the Internal Revenue Code. Small employers many times use a very similar plan known as a SIMPLE IRA (Savings Incentive Match Plan for Employees) or a SEP IRA (Simplified Employee Pension). Participation in these plans are voluntary, with a percentage of the employee's pay withheld, usually pre-tax, and deposited into a separate account for the benefit of the participant. The employer usually "matches" the employee contribution, sometimes equally and sometimes to a lesser or greater percentage. An account that uses post-tax withholdings is known as a Roth 401(k). The terms of the plan determine whether pre-tax, post-tax or both are allowed. The percentage withheld is determined by the participant, although there usually are lower and upper limits imposed by the Plan. The usual percentage is between 3% and 6%. Also, there is a dollar limit to the contributions made by the participant, which is $18,000 for 2015. Employees who are 50 years of age or older are allowed an additional "catch-up" contribution, the limit of which is $6,000 for 2015.

Most plans have severe limits on the withdrawal of money from the account prior to the participant reaching age 59 ½. There are certain "hardship" exceptions, but generally, if a withdrawal is made prior to age 59 ½, a 10% penalty is imposed and withheld from the withdrawal. It is important to note that the 10% penalty does not apply to withdrawals made as a division of property in a divorce case pursuant to the terms of a QDRO, which is discussed later. This penalty is paid in addition to the usual federal income tax. There is also an exception for the penalty when the withdrawal is used to start a new business (Rollovers as Business Start-Ups).

Although withdrawal is restricted, many plans allow a participant to take a loan against his or her account balance. The loan is repaid to the account in monthly payments, usually at an interest rate lower than one can obtain on the open market. Although the 401(k) account can be divided, the outstanding loan must remain with the account and be paid by the participant. The loan balance may be taken into consideration in making the division but the former

spouse non-employee cannot be imposed with liability for repayment of all or a portion of the loan.

It is important to know if any loan balance exists when negotiating and/or trying the case. It is also important to have a clear understanding of how any loan balance will be considered in making the division. If the division is a percentage, is the loan balance to reduce the account balance prior to calculating the awarded amount or not? As an example, assume a total account balance of $10,000, with an outstanding loan value of $2,000. Since the plan is required to maintain an account balance sufficient to cover the loan balance, up to $8,000 is available for distribution to a former spouse. If the award to the former spouse is 50%, **excluding** the loan balance, the loan balance will reduce the total account balance and the former spouse is awarded $4,000 (($10,000 - $2,000) X 50%). If the award is 50%, **including** the loan balance, the loan balance does not reduce the total account balance and the former spouse is awarded $5,000 ($10,000 X 50%). Any agreements or Court decisions should be very specific and clear as to the affect of any outstanding loan balance. Although most plans use "include" and "exclude", I have found that can be confusing and prefer to describe what effect the loan balance has upon the division (reduce the total account balance or not).

Some plans, such as American Airlines $uper $aver 401(k), don't allow a choice as to inclusion or exclusion of a loan balance. The $uper $aver requires that the amount of any loan balance be deducted prior to the calculation of the percentage award. Attempts to change that will cause the QDRO to be rejected. In cases where the loan balance is to be included in the account balance (not deducted prior to calculation), a specific dollar amount will have to be awarded to properly account for the loan balance.

Many 401(k) plans have vesting provisions, at least for the company match contribution. The contribution from the employee's pay is always vested. However, many plans require the employee to continue employment for a certain number of years before the employee is entitled to the company matching funds. In the event the divorce occurs prior to vesting of the company matching funds, some plans allow the continued employment after the divorce to apply to any unvested portion that has been awarded to the former spouse, and upon vesting, the award to the former spouse can be distributed. Although Texas law does allow the division of both vested and non-vested benefits, some 401(k) plans do not allow the award or distribution of non-vested benefits, even if the benefits later vest. Again, it can be important for the parties and attorneys to have an idea of how that can affect the proposed division.

A participant must begin taking distributions from the 401(k) no later that the April 1 of the calendar year after turning age 70 1/2., although there are exemptions for people that continue to work past that age. The required distributions are for both pre-tax and post-tax accounts. There are minimum amounts set by the IRC, which are beyond the scope of this paper.

A 403(b) Plan is a tax-sheltered annuity similar to a 401(k), but for apply to non-profits, self-employed ministers, public education employers and cooperative hospital services. Like a 401(k), the contributions are made pre-tax and taxes will be deferred on the growth of the plan until distribution occurs. The Plans don't have to be "qualified" under the Tax Code, so technically, the Plan does not have to accept a QDRO, DRO or other division order. However, the vast majority do. The restrictions on withdrawal prior to age 59 ½ are similar to those for a 401(k).

A 457(b) Plan is a deferred compensation plan that also is non-qualified but similar to a 401(k) and 403(b). It is for governmental and certain non-governmental employees. A key difference is that there is no 10% penalty for withdrawals prior to age 59 ½, although taxes must still be paid on the distributions. There are limitations on the amount of contributions during a year, similar to those for a 401(k). The vast majority of 457(b) plans will accept a division order, QDRO or DRO.

Some of these plans allow loans, just like a 401(k), so the cautions set out above also apply to these type of accounts.

The Thrift Savings Plan ("TSP") is for U.S. government civil service employees and members of the military. They are distinguished as the Civilian Thrift Savings Plan and the Uniformed Services Thrift Savings Plan. It is very similar to a 401(k) plan. There are participant contribution limits, as with a 401(k). For employees covered by the Civil Service Retirement System (CSRS), there are no matching contributions from the government, but there are for employees covered under the Federal Employees Retirement System (FERS). Participation in the TSP is voluntary.

There are no provisions in federal law for the division of the TSP, except to say that division is done pursuant to the divorce law of the State in question. So, division of this federal plan is subject to the "just and right" provisions of Section 7.001.

TSP does allow loans to be taken against the account and, like a 401(k), is repaid using a payroll deduction. The cautions expressed above for 401(k) plans and loans apply to the TSP also. There are maximum and minimum loan amounts. Withdrawals prior to age 59 ½ are restricted, similar to a 401(k).

### D. Hybrid Plans

A hybrid plan is a defined benefit plan in which the employee makes contributions as a certain percentage of his or her pay. The employee's contributions are maintained in a separate account and

usually accrue earnings. Upon retirement or termination, the employee may elect to take a refund of the contributions, with earnings, and waive any right to monthly annuity payments under the plan. Usually, only very short-term employees would elect a refund of contribution because that effectively waives any access to the "matching" funds from the employer that would fund the monthly annuity payments. Some plans allow a restriction on the ability of the employee to elect a refund of contributions (FERS and CSRS), while the State government plans do not allow a restriction of the participant's election at the time of retirement (TRS, TMRS, TCDRS and ERS). If the plan so allows, any restriction or prohibition of the employee taking a refund of contributions should be clearly spelled out in the settlement agreement, decision of the Court, the Decree and the QDRO or other division order.

1. State Government Plans

The most common state-wide plans are the Teachers Retirement System of Texas ("TRS"), Texas Municipal Retirement System ("TMRS"), Texas County & District Retirement System ("TCDRS") and the Employees Retirement System of Texas ("ERS"). All of these plans are statutory creations and are not subject to the terms of ERISA, however, Chapter 804, Subchapter A, Texas Government Code, provides anti-alienation provisions to these public retirement systems similar to ERISA and allows an assignment of a benefit to an alternate payee only by way of a qualified domestic relations order. (Sect. 804.003(a)).

All of the above-named State plans require contributions by the employee, usually as a percentage of pay. The employer also makes contributions, which vary depending upon the Plan and the employer.

None of these plans allow an immediate, lump sum distribution upon acceptance of a QDRO. Unlike private defined benefit pension plans covered by ERISA, the non-employee former spouse does not get to elect his or her form of benefit, but will receive benefits the same as elected by the employee. That is important for the parties to understand in negotiating or trying the division. Therefore, a lump sum dollar amount should not be negotiated or awarded in the Decree; only a percentage. TRS does not allow a lump sum dollar division, although the other State plans have a formula for converting a lump sum amount into the appropriate monthly annuity payment. If a lump sum dollar amount is awarded under TRS and the employee elects to receive monthly annuity payments, the plan won't know how to make the payments to the non-employee former spouse.

Award of a lump sum dollar amount should be avoided even if the plan will accept it because it usually indicates a lack of understanding of the parties in the timing and manner of distribution of the awarded amount and can create expectations that are not accurate. A lump sum amount may also indicate the plan was not properly valued by the parties, with the value being seen only as the amount of the participant's contributions as indicated on a yearly account statement, which is a significant and serious under-valuation of the plan.

Another issue to keep in mind in negotiating or trying the division of State plans is that unlike private pensions, neither the Decree nor QDRO can mandate which form of benefit payment will be taken by the employee and can't mandate that a particular beneficiary be named in the event of the death of the employee.

Additional detail on State plans can be obtained from my paper at the 2013 Advanced Family Law Course.

2. Local Government Plans

Local Government Plans are similar to the State Government Plans in that they are statutory and are exempt from the terms of ERISA. Examples of local plans are the Employees' Retirement Fund of the City of Fort Worth, the Dallas Police & Fire Pension System, the City of Austin Employees' Retirement System and the Houston Municipal Employees Pension System.

As with the state-wide plans, the local government plans include anti-alienation provisions and allow division only by QDRO or DRO. The terms of the local plans can vary widely and may have restrictions that one doesn't usually find in private company defined benefit plans. For example, the Fort Worth plan does not allow more than 50% to be awarded to the non-employee spouse, regardless of the "just and right" provisions of Sect. 7.001. Therefore, just as with the other types of plans, it is important to understand the provisions of a particular plan prior to division.

Almost all local government plans require contributions from the employee by way of payroll deduction as a percentage of pay. Many have an additional feature, known as a DROP (Deferred Retirement Option Program). Once certain age and service criteria are met, the employee can begin receiving his or her retirement pay as if he or she had retired, which is deposited in a special DROP account. The employee continues to work and continues to draw pay in addition to receiving the DROP payments. The additional service and any change in pay don't count towards the retirement calculation. DROP payments related to the community portion of the service are community property and divisible by a Court, even if the election for DROP occurred after the divorce and the actual DROP payments were made after the divorce (Stavinoha v. Stavinoha, 126 S.W.3d 604 (Tex. App. 2004). The reasoning is that the entitlement and

computation of the DROP payment relates to all of the participant's service, including service during the marriage. Most local government plans will allow the former spouse to take an immediate, lump sum distribution of the DROP portion of the award, but counsel should inquire with the particular plan to confirm that.

Those participating in TRS may or may not also participate in Social Security, depending upon the employer. A TRS employer can decline to participate in Social Security, although most do participate. Even though the employer may not participate in Social Security and the TRS benefit may partially be considered in lieu of Social Security (similar to Tier I benefits in Federal Railroad Retirement), there is no provision in Texas statutes or case law that prohibits the division of the entire TRS benefit. I have observed equitable arguments made to a Court to consider that there are no protected Social Security benefits in the case, but have yet to see a Court not divide the entire TRS benefit or otherwise adjust the division of property.

3. Federal Government Plans

The two hybrid defined benefit plans with the federal government are the Civil Service Retirement System ("CSRS") and the Federal Employees Retirement System ("FERS"). CSRS is the older plan, and for those employed after 1983, the appropriate system is FERS. CSRS members can transfer into FERS. The Plans are quite similar.

As with the other public plans, CSRS and FERS are not subject to the terms of ERISA. They both allow a division of benefits as a result of a divorce, but the division orders are not called QDROs, but are Court Orders Acceptable for Processing.

Each Plan actually consists of three distinct and separate parts: employee annuities, refund of employee contributions and survivor annuities. All of these should be addressed in negotiation or trial, in the Decree and in the division order. These Plans use very unique and use specific terms of art, so one should be familiar with them in order to properly draft a Decree or division order. For instance, the division can be made of the "self-only", "gross" or "net" retirement pay. A division of the "self-only" benefit means that the benefit is divided prior to any deductions of any kind. If "gross" is used, the benefit is divided after the deduction for any surviving spouse benefit cost. If "net" is used, the benefit is divided after all deductions have been taken, including surviving spouse benefits, health insurance, life insurance and the usual federal tax deductions. Normally, "gross" should be used unless the intent of the parties is to include the surviving spouse benefit but have the participant only pay the cost.

Whether or not in include provisions for a surviving spouse benefit depends upon the facts of the case. This benefit comes into play in the event the participant dies prior to the alternate payee/former spouse. Normally, when the participant dies, the benefits cease. If the former spouse is named a beneficiary for the surviving spouse benefit, he/she would continue to receive benefit payments after the death of the participant for the rest of his/her life. However, even if the surviving spouse benefit is included in the division, if the former spouse remarries prior to age 55, the benefit terminates. In the case of younger parties where it is very likely there will be another marriage for the former spouse, it may not be worth arguing over this benefit.

If a surviving spouse benefit is including, the Decree should and the division order must, address the amount of the surviving spouse benefit. Options include awarding the "maximum" benefit, a "pro-rata" portion or some other portion using a formula. If the "maximum" benefit is used, then this former spouse will be the only beneficiary allowed. If the "pro-rata" benefit is used, then the participant could name another beneficiary (such as a new spouse) to share the benefit.

These plans also have options as to who pays the cost for the surviving spouse benefit. If the "self-only" annuity payment is divided, then the participant pays all the cost. If the "gross" annuity payment is divided, then the cost is taken off the top, resulting in both parties sharing in the cost in the same proportion as the overall annuity payment division. Regardless of how the annuity payment is divided, the Decree and/or division order can mandate that the non-employee former spouse pay the entire cost of the benefit. Unless there is agreement otherwise, I normally would have both parties share in the cost if a "pro-rata" surviving spouse benefit is awarded and have the former spouse pay the entire cost if a "maximum" surviving spouse benefit is awarded.

Unlike the State plans, CSRS and FERS allow a limitation in the form of benefit that an employee may choose. The Decree and division order can instruct the Office of Personnel Management ("OPM") to not allow a refund of contributions, thus requiring the employee to elect annuity payments.

Both plans require employee contributions using payroll deduction and a separate account is maintained for that employee as to his or her contributions. Unless restricted by the Decree and/or division order, upon retirement, the employee may elect to receive a refund of contributions, waiving the right to receive a monthly annuity payment, or elect the annuity payments. The monthly annuity payment is calculated using a formula that takes into account years of service and pay. As with the State plans, the Federal plans require that payment of the non-employee spouse's share of the

benefits commence when the employee's commence, not before.

## E. Military Retirement

Pursuant to Federal law, military retirement is divisible by a State family law court, although there was a brief time in the early 1980s when that was not the case. The technical name for military retirement is the Uniformed Services Retirement System and it is not subject to ERISA.

Unlike private ERISA plans, the concept of "accrual" of benefits does not apply to military retirement. One must serve 20 years or more in order to receive retired pay. For those in the reserves, there must be 20 or more "good years" of service where a certain number of reserve "points" are earned during the year. While an active duty member may commence benefit payments upon retirement, a reservist can't commence benefit payments until age 60.

Retired pay is calculated using a formula, which varies a bit depending upon when the service began. The formula takes the number of years of service times 2.5% times the high-36 month average of pay (those with service that began prior to 9/1/1980 just use the final pay rate). For active duty personnel, the actual years of service are used. For reservists, the total number of points earned is divided by 360 to compute the number of years of service for the formula. The former spouse may only begin receiving benefit payments when the service member commences payment.

By federal law, no more than 50% of the "disposable retired pay" will be paid directly to the non-service member former spouse pursuant to a court order (10 USC 1408(e)(1)). That is the correct terminology to use, not "gross retired pay" or other variations. The maximum allowed percentage increases a bit if child support is also included.

In negotiation or trial, keep in mind that although federal law allows the division to exceed 50%, there will not be direct payment by the Defense Finance and Accounting Service ("DFAS") for more than 50% and the service member will have to pay the balance directly.

It is important that the Decree and division order address whether or not a benefit under the Survivor Benefit Plan (SBP) is included. Unlike FERS and CSRS, military retirement only allows one beneficiary for SBP, so if the former spouse is designated, a future spouse cannot also be named. There is a cost in electing SBP, which is taken from the retirement benefit <u>before</u> the benefit is divided. This means the cost is "taken off the top", effectively dividing the cost between the parties. Unlike CSRS and FERS, DFAS will not honor an order that attempts to handle the cost of SBP differently, such as requiring the cost be paid totally by the former spouse. In considering whether or not to provide for a survivor benefit, keep in mind the age and circumstances of the former spouse. If the former spouse remarries prior to age 55, he/she becomes ineligible to receive a surviving spouse benefit, even if the Decree or division order so provides.

Perhaps the most important concept to remember in dividing military retirement is the "10/10 Rule". The rule requires that there be at least 10 years of marriage, during which there was at least 10 years of service. For reservists, that means at least 10 "good years" during the marriage. If this requirement is not met, the court can still divide the military retirement, but DFAS will not make direct payment to the former spouse, creating significant enforcement issues.

In cases where there was active duty service prior to the marriage, a simple Berry formula (discussed below) can be used to compute the community property portion. For example, if there was a 15 year marriage and a total of 20 years of service, with 5 occurring prior to the marriage, the community portion would be 15/20 or 75%. In the case of reserve service, the calculation must be made using points, where 1 point equals 1 day of reserve service. Assuming the total points earned were 3,450, with 2,335 during the marriage, the community portion would be 2,335/3,450 or 67.68%. Do not calculate the community portion of a reservist's service using "good years", since one "good year" likely may not contain the same number of points as another. It is not uncommon for a service member to begin his or her career as active duty, then transfer to the reserves. The active duty service will earn 365 or 366 points, depending upon the year, while the reserve service may earn 60 points or so. When the active duty is prior to marriage, it can greatly affect the calculation of the community portion.

Some service members qualify for V.A. disability benefits upon retirement. By federal law, V.A. disability is not divisible by a divorce court (10 USC 1408, et seq) and Mansell v. Mansell, 490 U.S. 581, 109 S.Ct. 2023 (1989). In the past, the election of a V.A. disability reduced the amount of the military retirement benefit dollar for dollar and had an adverse effect upon the former spouse. However, the law has been changed such that the amount of the reduction is no longer dollar for dollar and decreases every year until it disappeared in 2015. Some courts attempted to provide in the Decree that the service member could not make any election that would decrease the former spouse's benefits, however, that provision was rejected in Loria v. Loria, 189 S.W.3d 797 (Tex. App. – Houston [1st Dist.] 2006) and Gillin v. Gillin, 307 S.W.3d (Tex. App. – San Antonio 2009).

Texas case law requires that when a divorce occurs and the military retirement is divided while the service member is still active or earning points, the

division must be set at the pay rate/grade, service length and rank/rate as of the date of divorce. Grier v. Grier, 731 S.W.2d 931 (Tex. 1987). Limiting the division to these factors is known by DFAS as a "hypothetical" division and DFAS provides acceptable model language for drafting such divisions, which should be used.

There are a number of excellent Advanced Family Law papers by James Higdon of San Antonio that goes into greater detail than I am able to do here.

### F. Federal Railroad Retirement

The Railroad Retirement Act of 1974 (45 USC 231, et seq) provides for Tier 1 and non-Tier 1 benefits. Those covered by Railroad Retirement don't participate in Social Security. If one participated in both Social Security and Railroad Retirement during his or her working career, benefits from both can be received, although there are offsets that limit the total benefit payments. Tier I benefit are a Social Security replacement and as such, are not divisible upon divorce (45 USC 231m(a)), just as Social Security is not divisible. Tier 2 and other non-Tier 1 benefits are divisible.

The division of this asset should address whether or not cost of living allowances ("COLAs") are included. It is traditional to include COLAs.

A careful effort should be made to determine if the railroad employee has other retirement plans in addition to the federal Railroad Retirement. For instance, salaried employees of BNSF and Union Pacific will have a defined benefit plan sponsored by the employer. Hourly employees don't have a similar defined benefit plan. Both hourly and salaried employees may participate in the appropriate defined contribution plan (401(k))sponsored by the employer.

A confusing element of Railroad Retirement is the Divorced Spouse Annuity. That is a benefit that can be paid to the ex-spouse of a person who participates in Railroad Retirement and is separate and distinct from the employee's Tier 1, Tier 2 or other non-Tier 1 benefits. There are similar provisions under Social Security.

The Divorced Spouse Annuity is statutory and either the ex-spouse qualifies or doesn't. It is not awarded by Decree or QDRO. I have seen examples where a Decree "awarded" this benefit and the party and her counsel mistakenly believed the provision was actually awarding wife a portion of husband's Tier 2 benefit, only to discover after the Decree was final that it did not. In order to qualify for a Divorced Spouse Annuity, a marriage must have been ended by divorce after at least 10 years of marriage. Additionally, the ex-spouse can't be married to someone else. There are other age requirements that are beyond the scope of this paper. The Railroad Retirement Board publishes "Spouse/Divorced Spouse Annuity", Form RB-30, that provides much more detail.

### G. IRAs and Annuities

The division of an IRA or annuity is similar to the division of any other defined contribution plan.

Although IRAs and annuities are types of personal retirement vehicles, they are not employer-sponsored and most don't require a QDRO or DRO to transfer to an ex-spouse. Counsel should check with the financial institution to determine what is required to make a transfer upon divorce. Some financial institutions do require a QDRO or DRO; some require only very specific language in the Decree, including account numbers; and some require other paper work and a Letter of Instruction.

Many attorneys enter a QDRO for IRAs and annuities even if the financial institution doesn't require it out of an abundance of caution. The IRC provides that there is no 10% penalty when a retirement plan is transferred by a QDRO and many attorneys and CPAs are of the opinion that a QDRO must be used for IRAs and annuities in order to avoid the penalty, even if the financial institution doesn't require it.

### H. Match the Language of the Decree to the Plan Type

As discussed above, defined benefit plans significantly differ from defined contribution plans and therefore, require different considerations upon division and different language in the Decree. I see many Decrees that divide a defined benefit plan and reference "interest, dividends, gains or losses" on the awarded portion. Unless the defined benefit plan is one of the newer Cash Balance accounts, such language is not appropriate. Traditional pension plans don't have interest, dividends, gains or losses. Such language is appropriate for a defined contribution plan.

Defined benefit plan divisions should refer to COLAs, early retirement supplements and subsidies and survivor benefits. Keep in mind, some plans don't have early retirement benefits but inclusion of this term in the Decree should not cause a problem. Also, remember there are two types of survivor benefits, as more fully discussed below, so only refer to the appropriate ones for the facts of your case and the manner in which the division is made.

As mentioned in more detail above, the Decree should also address how a loan balance against a defined contribution plan should be handled in calculating the amount awarded. The QDRO will have to address this issue, so also address it in the Decree. The discussion of loans is not appropriate for division of a defined benefit plan since those plans don't allow loans.

When drafting division language for a Decree, pay special attention in situations where there was service credit (defined benefit) or contributions (defined contribution) prior to the marriage. The Decree should clearly state that only the community portion is being divided, using that language or something similar, such as accrued/accumulated during the marriage or from date of marriage to date of divorce. In the rare instance where the intent of the parties is to divide the entire benefit as of the date of divorce, including the separate property interest, that also should be clearly stated. There are three harsh Texas Supreme Court cases where the Decree was not clear and the Court ruled the entire benefit was divided, not just the community portion.

Sample Decree language provisions have been provided as an Addendum to this paper and can be used to double check the language needed and used in the settlement agreement, Court decision and/or Decree.

### H. Characterization

This issue will arise whenever there are contributions (defined contribution plan) or credited service (defined benefit plan) prior to the marriage. Unless otherwise agreed, any plan participation prior to the marriage is the separate property of the participant and not subject to division by the Court.

For defined benefit plans, the method by which one determines the community property portion depends upon whether the participant is retired at the time of divorce or not. For participants already retired at the time of divorce, the Taggart formula is used. (Taggart v. Taggart, 552 S.W.2d 422 (Tex. 1977)). That formula uses a fraction to determine the community property interest, with the numerator being the number of months (or days for more precision) married while participating in the plan and the denominator being the total number of months (or days) of plan participation, times the percentage awarded, times the retirement benefit received. This formula makes the division as of the date of retirement, which occurred prior to the divorce.

For participants not yet retired, but with service prior to the marriage, the Berry formula is used. (Berry v. Berry, 647 S.W.2d 945 (Tex. 1983)). That case changed the way we apportion the community interest, making the division as of the date of divorce, as if the participant ceased participation in the plan as of the date of divorce. The result is that the alternate payee does not benefit from any increases in service or pay that occur after the divorce. That formula also uses a fraction to determine the community property interest, with the numerator being the number of months (or days) married while participating in the plan and the denominator being the total number of months (or days) of plan participation as of the date of divorce, times the percentage awarded, times the vested accrued benefit as of the date of divorce. The parties may agree on a division date different than the date of divorce, such as the date a mediated settlement agreement is reached and if so, the formula would use that date rather than "date of divorce".

For participants that are not yet retired or not in pay status, no fraction is needed under Berry. Simply make the division as of the date of divorce (or other agreed date) applying the accrued benefit as of that date.

In the case of military retirement, the Taggart and Berry formulas are used, depending upon the facts, however, if Berry applies because the service member is still in the military, the division of the community interest must be based upon the service member's rank/rate held on the day of divorce. (Grier v. Grier, 731 S.W.2d 931 (Tex. 1987)). If there was service prior to marriage and the service member has service in the reserves, DFAS requires that the division be made using reserve points rather than months or years. That formula would have the numerator as the number of reserve points earned during the marriage and the denominator as the total number of reserve points earned as of the date of divorce. DFAS has additional language for other hypothetical awards, depending upon the facts of the case and/or agreement of the parties.

For defined contribution plans, the starting point in the determination of the community property interest is for the account balance as of the date of marriage to be subtracted from the account balance as of the date of divorce (or other agreed date) with the result being the community property interest. The Family Code now allows for the separate property interest to be determined using the tracing and characterization principles that apply to a non-retirement asset. (Sect. 3.007 (c)). In theory, that would allow tracing to determine the change in value of the separate property interest and that change would be separate property, even though the change occurred during the marriage. In practice, this kind of tracing will be all but impossible unless the facts indicate that there were no contributions to the account during the marriage. If that is the case, then the entire account, including changes in value, remain separate property.

Also, note that special rules apply to the characterization of stock options, if the option was granted prior to marriage but required continued employment after marriage before the grant could be exercised or if the option was granted during marriage but required continued employment after marriage. (Sect. 3.007 (d)).

## III. COMMON SPECIFIC DIVISION ISSUES

It is important to know some of the details of the plan that is being divided to avoid mistakes and

unhappy clients. The first determination should be whether the plan is a defined benefit or defined contribution plan, since each require different language in the Decree, as discussed above. This also allows the client to understand and adjust, if necessary, his or her expectations as to when and how benefits will be paid.

**A. Immediate Withdrawal of Defined Contribution Plans**

The vast majority of 401(k), 403(b) and 457(b) plans allow an immediate, lump sum distribution of benefits awarded to an alternate payee/ex-spouse upon qualification of the QDRO. Although I use the word "immediate", it should be remembered that most plans take 60 – 90 days, on average, to process a QDRO once it is received. Some take longer, some are quicker, but the client must have reasonable expectations. I can't count the number of times I have received a phone call from an alternate payee/ex-spouse who thought the distribution would be within a matter of days after the QDRO was signed by the Court. The person had planned on buying a house or a car or pay off a debt and I had to explain that the process simply is not that fast.

There are a few defined contribution plans that do not allow immediate distribution, but require that the employee terminate or retire before the payment to the alternate payee will be made. This is important to know as the case is being negotiated or tried and important for the clients to know. In the case of accounts held by TIAA-CREF, some allow immediate distribution and some don't, depending upon the rules of the educational employer and the type of investment fund.

Use of the term "immediate, lump sum distribution", whether in this paper or in a QDRO, does not mean that the alternate payee/ex-spouse must cash-out and be required to pay income taxes. It simply refers to the timing and form of the distribution and does not preclude a rollover to an IRA or other qualified plan, thus deferring any tax liability.

**B. Immediate Withdrawal of Cash Balance Defined Benefit Plans**

Cash Balance Accounts have not been on the scene for that long, but my experience has been that they are about evenly divided on whether or not an immediate, lump sum withdrawal will be allowed upon division. Some plans don't allow immediate distribution, but require that the employee terminate employment or retire before the alternate payee/ex-spouse can obtain a distribution. Further, some plans don't allow a lump-sum distribution even at termination or retirement but require that the cash balance account be used to fund an annuity.

Most of the time, a review of the model QDRO from the plan will answer distribution questions and if there are any restrictive provisions, they will usually be stated in the QDRO. If in doubt, contact the plan administrator about the timing and form of any distribution.

**C. Commencement of Benefit Payments for Traditional Defined Benefit Plans**

The wording of the Decree and/or the QDRO can significantly affect when the alternate payee/ex-spouse can begin receiving monthly benefit payments. A more detailed explanation of the difference between a "shared interest" and a "separate interest" is provided below. If a "shared interest" is provided, then the alternate payee's portion of the benefit will begin if, as and when the participant's benefit commences and the participant has total control over this. However, if a "separate interest" is provided, then the alternate payee may begin benefit payments at any time after the participant reaches early retirement age. Although this allows for earlier commencement, the benefit payment will be reduced (due to actuarial adjustment). However, the alternate payee now controls his or her timing for commencement, although the alternate payee will be required to commence benefits once the participant commences.

For most plans, if the participant has commenced benefit payments prior to the divorce, a "shared interest" division is required and the "separate interest" option is not available. Further, the choices made at the time of retirement as to survivor benefits and benefit form usually are locked in and can't be changed at the time of divorce. For example, if the parties opted to have the benefits payable for the lifetime of the participant only, with no surviving spouse benefit upon the participant's death (which gives the highest benefit payment), then the Decree or QDRO will not be able to change that decision and now allow a surviving spouse benefit.

**D. Special Problems with State & Local Hybrid Plans**

As stated above, a lump sum dollar amount should never be awarded with these hybrid plans. Although TMRS and TCDRS have special provisions for dealing with lump sum awards when the QDRO is prepared, TRS and ERS do not. Lump sum awards can lead to other problems and assumptions as discussed below.

1. <u>Valuation Issues</u>

As previously mentioned, the employee makes mandatory contributions that are maintained in an account for the benefit of the employee/participant. Annual statements are sent to the employee containing the account balance. On too many occasions, I have seen a party or even an attorney mistakenly believe that this account balance is the actual value of the plan, as with a 401(k). I have seen them trade that account

balance for the balance of the other party's 401(k), which is a huge mistake for the non-employee spouse.

The reason that the statement account balance is not the present value of the plan is because the employer's "matching" contributions are not listed. Now, in the event the employee/participant elected to take a refund of contributions upon termination or retirement, then the employee's contribution statement amount would be an accurate value, but few take a refund of contributions and I believe we must assume that an employee/participant will make the election that most benefits him or her financially. Further, in the case of TRS, because the monthly retirement benefit is calculated using a set formula, the amount of the employee's contributions have little relevance to the actual present value of the plan.

It is safest to simply divide the hybrid plan and be done with it, but if a present value must be obtained due to the unique facts of the case, an actuary must be hired to give a present value as would be done with a traditional defined benefit plan.

2. Payment Form & Commencement Issues

By statute, the employee/participant decides what form of payment to receive and neither the Decree nor the QDRO can attempt to instruct him or her in that regard. A QDRO that attempts to do so will be rejected. Payment form options include a refund of the employee's contributions, monthly annuity payments or, with some plans, a partial lump sum, then monthly annuity payments at a reduced amount. For instance, TRS allows the participant to take a lump sum equal to 12, 24 or 36 months of benefits along with a reduced monthly annuity payment. The monthly payments may be for the lifetime of the participant only, or can provide for surviving spouse benefits in the event the participant dies before the alternate payee. Whatever form is elected by the employee/participant is what the alternate payee/ex-spouse receives.

The employee/participant also gets to choose when he or she retires and begins to collect benefit payments. The alternate payee/ex-spouse is bound by that decision, except for a limited exception under TRS for people over a certain age. There is no option for the alternate payee to begin receipt of his/her portion of the benefits once the participant reaches early retirement age but continues to work.

3. Beneficiary Designation Issues

By statute, under the hybrid statewide plans, the employee/participant alone determines his or her beneficiary in the event of his or her death. A Decree and/or QDRO can't attempt to instruct the participant to name a certain person and any QDRO that does so will be rejected. What, if anything, an alternate payee/ex-spouse would receive on the death of the employee/participant is determined by statute and can't be changed by the Decree or the QDRO.

### E. Federal Retirement Issues

Unlike the State hybrid plans, CSRS and FERS allow a survivor annuity to be awarded, but do not require it. The level or amount of the survivor annuity can also vary, depending upon the terms of the Decree and/or division order. Since these plans consider a survivor annuity to be one of three separate components, distinct from the annuity benefit, if it is intended to award such a benefit, it must be stated specifically. The nasty surprise waiting here is in the instance where the Decree is silent as to a survivor annuity. In that instance, unless the parties reach an agreement, the Court will very likely rule that the alternate payee/ex-spouse is not entitled to the benefit. The Decree and/or division order can require that the alternate payee be the only surviving spouse (award the "maximum" surviving spouse benefit) or can allow additional surviving spouses (award a "pro-rata" surviving spouse benefit).

Also unlike State hybrid plans, CSRS and FERS allow the Decree and/or division order to restrict the options of the participant concerning requesting a refund of contributions in lieu of monthly annuity payments. OPM can be directed to not allow a refund of contributions, thus requiring monthly annuity payments. That protects an alternate payee from a spiteful participant who elects a refund of contributions to financially harm the alternate payee.

The participant still gets to decide when to retire and begin receipt of benefits and, as with the State hybrid plans, there is no commencement for the alternate payee once the participant reaches early retirement age.

### F. Military Retirement Issues

Failure to meet the 10/10 Rule is the most common nasty surprise in dividing military retirement. As discussed above, that Rule requires at least 10 years of military service during a marriage of at least 10 years in order for direct payment to be made to the former spouse of his or her awarded share. The Court still has the authority to divide the benefit, but without direct payment, the former spouse must rely on payment of his or her portion directly from the retired service member. This can be a real problem when the Decree is final before counsel realizes that the Rule has not been met. For reservists, be sure to look at the reserve points statement to determine the number of "good years" during the marriage, since those are the only ones that apply to satisfy the Rule.

As with CSRS and FERS, DFAS considers the Survivor Benefit Plan to be separate and distinct from the annuity payments. If the division order doesn't specifically provide for it, you don't get it. As with

CSRS and FERS, if the Decree is silent as to the SBP, unless there is an agreement, the Court will very likely decline to include it. If you intend to award it, say so in the Decree.

### G. Public Plans from Other States

With the large immigration of people from other States to Texas, it is likely at some point a public pension plan from another State will need to be divided. I have done a number from California (CALPERS) and a few from Washington, Minnesota, Georgia and Mississippi.

The trap here is in confirming, prior to finalizing the divorce, that the foreign state plan can be divided, and if so, under what circumstances. Most States allow the division of its public plan and will accept a QDRO or division order from a Texas court, however, there are a few States that do not statutorily allow for a division of its public plan and will not accept a QDRO or other division order. Find out early. Every such plan I have dealt with has a web site from which you can determine if the benefit is divisible and what will be required.

One State I dealt with allowed division and would accept a QDRO signed by a Texas judge, but required the use of its form order. I retyped it since I don't use check-the-box and fill-in-the-blank forms but that was rejected by the plan. I was instructed to use the two-sided form as it printed off the web site and complete it, by hand if necessary.

Several States allow division of the public plan benefit but will only honor an order issued by a court of that State. Find out this requirement early and let the parties know that there will be additional expense to hire an attorney from that State to complete the division with a local order.

### H. Non-Qualified Plans

If the case involves a plan that is not qualified under ERISA and the IRC, that fact needs to be discovered as soon as possible. While some non-qualified plans accept DROs, most don't and won't allow a division of benefits. A non-qualified plan can usually be spotted due to the inclusion in the name of certain words, such as "supplemental", "excess", "bonus" or "executive". Most employees participate in no more than one defined contribution plan and one defined benefit plan, so if there appear to be multiple plans, suspect that one or more may be non-qualified.

In the case of a stock option plan, they are almost always non-qualified and very few accept DROs or allow for a division.

If a non-qualified plan does not allow a division or transfer, other community assets can be considered to make up for that fact, if you know about it prior to concluding the case.

### I. Change the Beneficiary Designation

Most plans provide that a beneficiary can be designated by the employee/participant to receive any death benefit or other surviving spouse benefit in the event of the death of the employee/participant. This is accomplished by the completion of a form provided by the plan. Most people designate their spouse and very often forget about that designation upon subsequent divorce.

Although the Family Code provides that a pre-divorce designation of a spouse as beneficiary is not effective (Section 9.302), one cannot and should not rely on that statute and an attorney should always remind the client, preferably in writing, to change beneficiaries once the divorce is concluded. The U.S Supreme Court has ruled that ERISA preempts state statutes such as Section 9.302 and have no effect on retirement plans that are qualified under ERISA. Egelhoff v. Egelhoff, 532 U.S. 141, 121 S.Ct. 1322 (2001).

The result of Egelhoff is that the designation on file with the Plan at the time of death must be followed and attempts to invoke Section 9.302 will fail. New spouses and/or children may be shocked to find that the ex-spouse is still the designated beneficiary because the old designation was never changed.

Some plans, such as General Motors' defined benefit plans go so far as to require a court order, similar to a QDRO, for termination of a beneficiary designation.

A few plans, such as TIAA-CREF, have specific language in the QDRO that voids the prior designation, but most do not.

## IV. PREPARATION OF THE QDRO, DRO OR OTHER DIVISION ORDER

### A. Use of Model Orders

For simplicity, I will refer to all division orders as QDROs, even though that term may not apply to a specific plan. A few attorneys place the QDRO language within the Decree, however most use separate QDROs or other division orders. For years, DFAS required that military retirement division language be in the Decree, but that no longer is the case.

1. Private Plans

Almost all private defined benefit plans and most large defined contribution plans have model QDROs or sample QDRO language and will provide them upon request. Many are available through third-party administrator web sites, such as Fidelity and AON Hewitt, and in the case of Fidelity, the QDRO can actually be prepared online if one knows the correct choices to make.

I always obtain a model, when available, and these days rarely tinker with it. In the past, some plans

were notorious for providing models that did not address all the options available when drafting the QDRO, especially plans through unions. That is not really the case anymore although precautions should still be taken and careful study of the model and plan procedures should be done. DO NOT USE the generic defined benefit QDRO available in the Texas Family Practice Manual. It will rarely be acceptable to the Plan.

Model QDROs are especially helpful with defined benefit plans, since their provisions are more complicated and can vary from plan to plan. Some have early retirement benefits, some don't. Some have death benefits, others rely on surviving spouse designations. For a time, I added early retirement benefit provisions to every defined benefit plan order, but I was getting rejections when the plan involved did not offer such benefits. Now, I review the source material and if there is still a question, I contact the plan to determine if that is an issue.

Use of model orders has additional benefits other than acceptance being more likely. Their use normally speeds up the qualification process since the plan is familiar with it. The model may specifically identify and highlight unusual restrictions in the benefit form, timing or payment that will alert everyone to a potential problem. Since ERISA specifically states that a QDRO can't change the terms of a plan, it is important to know those terms.

Many defined contribution plans now charge a fee for reviewing and processing a QDRO and failure to use the model order can cost the parties additional fees. Many plans use Fidelity Investments as its third party administrator and Fidelity has an online QDRO preparation service that generates the QDRO. Although the order generated is not in the usual format we are used to in Texas, the order should be used as is and not retyped. Simply retyping the order results in the fee rising from $300 to $1,200! Recently, I ran into a hospital that indicated the review fee would be $300 if its model was used and $2,500 if not.

2. State and Local Government Plans

All of the State retirement plans have model QDROs available online or by phoning the plan. Since the plans are statutory, there are few options in drafting, unlike private plans covered by ERISA. It is strongly recommended that the model orders be used without significant changes. In the event the facts of a case require that a model be changed, the plan should be contacted so that the proposed Order can be reviewed.

Although the Texas Family Law Practice Manual has an ERS QDRO that mostly follows the ERS Model Form, there are some differences. On its web site page, Common QDRO Questions, ERS specifically states that it will not accept the Family Law Practice Manual form without changes, so don't use it.

TMRS even specifically states that "NO changes should be made to paragraph 5" of the model order without consulting TMRS. (*Divorce and Retirement*, page 12).

TRS is particularly sensitive to changes in its model. On one occasion, I simply added a sentence in the first part of the order finding that a certain percentage of the plan benefit was accrued during marriage and half of that equaled another percentage. This didn't modify any standard language but only served as an explanation to everyone as to how I arrived at the final percentage award. TRS rejected the QDRO and required that I remove the additional language, although there was absolutely no legitimate reason for it. I now explain my calculations in the cover letter to the attorney. Also, TRS has new models as of January 1, 2015, and will reject a QDRO that doesn't use them.

In its publication, *Divorce and Retirement*, TMRS states that in the event the parties agree to award 100% of the benefit to the alternate payee, TMRS should be consulted. In such a case I handled, TMRS eventually decided it would not approve a 100% award and required the benefit be split 99% to the alternate payee and 1% to the member. I was told it had something to do with assuring the member continued to receive certain notices and staying in touch with TMRS, but I never fully understood the issues.

One of the few drafting options available in QDROs under TMRS and TCDRS is whether the formula for determining the community property interest is calculated using the "credited service" formula or the "accumulated contributions" formula. The use of one formula over another can substantially change the amount the alternate payee/ex-spouse eventually receives. The details of the different calculations that occur can be reviewed in the *Divorce and Retirement* publication from TMRS.

If the Decree does not specify which formula to use, counsel may attempt to draft the QDRO with the formula that benefits his or her client. In the event there is disagreement between the parties as to this issued and the Court is asked to decide, be aware that no appellate court of this State has approved the use of a formula that does not follow a time apportionment scheme (credited service), although a court has been requested to do so in three instances. *Berry v. Berry,* 647 S.W.2d 945 (Tex. 1983), *Shanks v. Treadway,* 110 S.W.3d 444 (Tex. 2003) and *Humble v. Humble,* 805 S.W.2d 558 (Tex. App. – Beaumont 1991, writ denied).

3. Federal Plans

As previously mentioned, a division order under CSRS or FERS is not to be titled a QDRO, since these

plans are not subject to ERISA. These plans do not provided an actual model division order but do offer significant examples of suggested language for different sections of the division order. Since the terminology of these plans is unique in many ways, the sample language provided should be carefully reviewed and used as appropriate. If the intent of the parties is to also award a surviving spouse benefit, that must be specifically stated in the division order.

The Thrift Savings Plan ("TSP") publication, *Court Orders and Powers of Attorney*, states that a QDRO is not required, however, there must be an appropriate division of the account in some court order. Some put the language in the Decree, while most use separate division orders. That publication does provide sample language for a separate order, it is simple and straightforward and should be used.

**B. Defined Benefit Orders**

1. Separate Interest vs. Shared Interest

In drafting a QDRO under an ERISA plan, usually there is an option to draft awarding the alternate payee/ex-spouse either a separate or shared interest. This concept normally does not apply to State, local or federal plans.

A separate interest is where the benefit awarded to the alternate payee is "carved" out of the participant's accrued benefit and there are now two, separate benefits. The alternate payee's portion is converted to his or her lifetime, rather than for the lifetime of the participant. The benefit will be actuarially adjusted to account for any difference in life spans. This has several advantages for both parties. Since the alternate payee's portion is now payable for his or her lifetime, the death of the participant will have no affect on the alternate payee's continued receipt of benefits. This makes any post-retirement surviving spouse benefit irrelevant as it concerns the alternate payee, unless the participant specifically desires to continue the alternate payee as such a beneficiary. If not, the participant is free to name a new spouse as the beneficiary for participant's portion upon the participant's death.

Also, under a separate interest, the alternate payee is usually free to elect his or her separate form of benefit payment, within the terms of the plan and to decide when to begin benefit payments, independent of the participant's commencement. Once the participant attains early retirement age, the alternate payee can elect to commence benefit payments, even if the participant has not yet retired or commenced payments. Of course, the earlier the alternate payee commences payment, the less the payments will be, due to actuarial adjustment. The alternate payee can't delay commencement of payments past the date the participant commences payment. At that point, commencement is required.

A shared interest is where the alternate payee will share in the participant's benefit payment, if, as and when the participant elects to begin receiving benefit payments. In the event the participant is retired and has already commenced benefit payments at the time of divorce, almost all plans require the use of a shared interest. It also is an option when the participant is not retired, but is seldom used. The alternate payee does not get to elect a form of payment, but receives the same form as the participant elects. The benefit is paid to both parties for the lifetime of the participant and that means that unless alternate payee is named as a post-retirement surviving spouse, upon the death of participant, benefit payments to the alternate payee cease. The alternate payee must specifically be named as a surviving spouse in the QDRO. Unfortunately, most Decrees don't address that issue, so it is common for the parties to disagree post-divorce about naming the alternate payee as a surviving spouse, usually resulting in additional court involvement.

2. Surviving Spouse Benefits

As stated above, there are two surviving spouse benefits under ERISA plans, the qualified pre-retirement survivor annuity (QPSA) and the post-retirement qualified joint and survivor annuity (QJSA).

When either a separate or a shared interest is used, the alternate payee should be named as a beneficiary for the pre-retirement survivor benefit (QPSA), except in cases where the participant is already retired and has commenced benefits. Then, the QPSA is irrelevant. In the event the participant dies prior to either party commencing benefits, if the alternate payee has been named a QPSA beneficiary, the alternate payee will receive benefit payments or a specified death benefit. Otherwise, when the participant dies, alternate payee gets nothing.

Most plans allow the election of the amount of the QPSA that is awarded to alternate payee and the QDRO should state that amount. Examples of options are 100% of the QPSA, a different stated percentage, the same proportion as the alternate payee's awarded amount compares to the whole or the same dollar amount as the alternate payee's awarded portion. There is no "cost" for the QPSA, as there is for election of a post-retirement survivor benefit (QJSA) and therefore no reduction in benefit payment should the participant not die prior to either party commencing benefit payments.

A post-retirement survivor benefit (QJSA) is usually only provided under a shared interest award. When a separate interest is awarded, the alternate payee's portion is converted to payments for the alternate payee's lifetime, so the death of the participant has no affect. Although the alternate payee could also be named a QJSA beneficiary, that is usually not done, unless it is the intent of the parties

that the alternate payee receive all survivor benefits; the alternate payee's awarded portion plus the QJSA benefit associated with participant's portion.

In the case of a shared interest, unless the alternate payee is named as a QJSA beneficiary, upon the death of the participant, payments to the alternate payee cease. Naming the alternate payee as a QJSA beneficiary has a "cost", which reduces the amount of the benefit payable to the participant. In a shared interest award, this cost is deducted prior to splitting the benefit payment between the parties, having the effect of the cost being passed to each party proportionately. This reduction in benefit amount is usually the main reason participants don't want to name the alternate payee as a QJSA beneficiary. Using a separate interest approach eliminates this potential disagreement.

When a participant retires and commences benefit payments, he or she must elect the form of the benefit (life only or some level of surviving spouse benefit). In cases where the divorce occurs after retirement, the decision on a surviving spouse benefit will have already been made and can rarely be changed. For the participant to waive a surviving spouse benefit, the participant's spouse has to sign the waiver also. Many times that benefit is waived so as to not reduce the monthly benefit by the cost of the surviving spouse option, then the divorcing spouse desires to have surviving spouse benefit when the QDRO is prepared. However, the decisions made upon retirement are almost always locked in and can't be changed, even by QDRO.

3. Early Retirement Benefits

Some employers include an early retirement supplement or subsidy in their defined benefit plan to encourage older workers to retire early so that the position can be filled by a younger, and usually less paid, employee. Normally, if an employee chooses to retire prior to the plan's regular retirement age (but on or after the early retirement age), the benefit received is actuarially reduced. The earlier the participant commences, the less the benefit received each month. That reduction causes most employees to want to wait to the regular retirement age. An early retirement subsidy or supplement acts to restore the benefit to be paid to its original amount, as it the participant had waited to regular retirement age. This encourages the participant to retire early, since there is no reduction, which usually is beneficial to the employer.

For a plan with such an early retirement benefit, the QDRO should specifically state whether or not the alternate payee is to share in that benefit. Some plans have a default position if no mention is made and that default is usually that the alternate payee does not share in the benefit.

In the event the alternate payee commences benefits before the participant and a separate interest has been used, some plans provided that the alternate payee has waived any interest in the early retirement benefit. If that is the case, the QDRO can't change that plan provision. Other plans allow the alternate payee's portion to be recalculated once the participant elects early retirement, so that the alternate payee shares in the early retirement benefit, so long as it was so awarded in the QDRO.

Some plans pay or offer to pay a lump-sum or partial lump sum as an early retirement benefit and the alternate payee will receive his or her proportionate share if an early retirement benefit has been awarded. Some attorneys include provisions for division of the early retirement benefit in all defined benefit plan QDROs, even if the model doesn't address it or the plan says it doesn't exist for them. I used to take that approach, however, once plans began to reject my QDRO because of inclusion when the plan didn't have early retirement benefits, I stopped. If the model doesn't cover early retirement benefits, I contact the plan to confirm that it does not offer such benefits and don't add that language.

4. Cost of Living Adjustments

Commonly referred to as COLAs, this adjustment acts to increase the benefit payments based on inflation. It is best to specifically address whether or not the alternate payee is awarded a proportionate amount of COLAs. If the issue is not addressed, many plans have a default position, with most considering the COLA to have been awarded, but it does vary from plan to plan.

## C. Defined Contribution Orders

1. Gains and Losses

Whether the award is a percentage or a specific dollar amount, the QDRO should address whether or not gains and losses are to be applied and if so, the division date from which they are applied. Hopefully, the Decree also addresses this issue.

It is traditional that gains and losses be included when a percentage is awarded, but when a dollar amount is awarded, it depends upon the intent of the parties. Some parties award a dollar amount and don't want that to change. Others prefer that each party take the same risk/reward as to their portion.

Be aware that a number of plans will not award gains and losses from the division date to the date of account segregation when a specific dollar amount is awarded, regardless of what the Decree states and any attempt to do so in the QDRO will result in rejection of the order. You can usually tell if that is the case from review of the model order or QDRO Procedures.

2. Loans

Not all defined contribution plans allow loans to be taken against the account, but many do. The QDRO should tell the plan how to handle any loan balance when calculating the amount awarded to alternate payee/ex-spouse.

The language used to describe how to handle a loan is not always clear or consistent, so use the nomenclature in the model order, if there is one, so the plan will understand. Usually, if the loan balance is included in the participant's account balance, that means that the loan balance will not be first deducted from the account balance prior to determining the alternate payee's portion. For instance, if the total account balance is $10,000, with a loan balance of $2,000, and 50% is awarded, then the alternate payee receives $5,000 as if there was no loan balance. If the loan balance is excluded, the loan balance will be first deducted from the account balance before the percentage is applied. With the above example, alternate payee would receive $4,000.

A few plans have a default position when loans are not mentioned, such as TSP (loan balance is included). The American Airlines $uper $aver 401(k) only allows the loan balance to be excluded and will reject the QDRO if the loan is included. In the event the intent of the parties is to include the loan balance, the QDRO will have to award a specific dollar amount that accomplishes that intent.

A loan balance can never be assigned, in whole or in part, to an alternate payee. It must remain the obligation of the participant to repay. Also, the amount awarded to the Alternate Payee cannot exceed the "net" account balance (loan balance first deducted), also known as the available balance. The Plan is required to keep enough money in the account to cover the outstanding loan balance.

3. Division Problems

There are a number of common issues that arise with division of defined contribution accounts. One is a lack of past records. The plan doesn't have to keep records back more than seven years and will likely not have records prior to the current record keeper taking over. Usually, the model order and/or QDRO Procedures will state the earliest date on which a division may be made.

Related to the above is when the Decree makes a division between two dates, such as 50% of the community portion or 50% accumulated from the date of marriage to date of divorce. Unless the marriage was recent, the plan likely won't have records as to the account balance on the date of marriage. Further, many plans just won't accept a QDRO that attempts a division between two dates, even if it has the records. When this occurs, the parties will have to consult their own records and determine a dollar amount to be awarded. Texas law provides that separate property must be proven by clear and convincing evidence, so if a party can't provide adequate proof of the separate property portion, it's probably all going to be considered community property.

Another issue is that many plans don't allow a mix of dollars and percentage, such as 50% plus an additional $7,500.00. Although most third graders can handle that math exercise, I guess some plan administrators haven't been taught how to use a calculator. Probably the most frustrating thing is when a plan requires a whole percentage and the parties have spent time calculating the award to four decimal places. Many plans that will accept other than whole percentages won't accept a percentage with more than two decimal places.

4. Review Fees

For years, the U.S. Department of Labor, Employee Benefits Security Administration, prohibited plans from charging a party a fee for reviewing and processing a QDRO. That has changed and many plans now charge fees that range from $250 to $2,500. Usually, the fee can be split between the parties or one party can pay 100%. How the fee is to be handled should be in the QDRO, although some plans have a default position if it isn't mentioned. As noted in the section dealing with model orders above, failure to use the model provided can increase the amount of this review fee.

Any fee charged is usually just deducted from the parties' accounts once the QDRO is processed. If a QDRO is rejected, the fee is still charged but there is usually no addition review fees for amended orders.

### C. Inclusion of Social Security Numbers

There are a few plans that still require the inclusion of social security numbers in the QDRO, while the vast majority will allow them to be provided in a cover letter or addendum that is not filed with the Court. On the State retirement level, TMRS and ERS allow the numbers to be completely omitted from the QDRO and provided separately, TCDRS requires that the last four digits of the social security number be in the QDRO, with the rest provided separately. TRS will allow the numbers to be provided separately only if there is specific wording added to the model order and use of an approved addendum.

The following language should be added to the opening paragraph of the TRS model in order to omit the social security numbers:

*The Court finds that omission of the social security numbers of the parties is necessary to reduce the risk of identity theft and authorizes the parties to use an alternate method acceptable to*

*TRS to verify the social security number of the Participant and Alternate Payee.*

If the Social Security Numbers are not in the QDRO, TRS Form 629 must be completed and attached to the QDRO when it is sent for approval. A copy of that form is available online from TRS.

Although the publication from the federal Thrift Savings Plan states that Social Security Numbers may be provided separately, TSP has rejected any division order I have submitted that didn't have them in the order proper.

Although ERISA does not require that the Social Security Numbers and dates of birth be contained in the QDRO, it does require addresses. Pursuant to the recent change in Rule 21c, Texas Rules of Civil Procedure, inclusion of any of these items requires that a notice be placed at the top, left of the first page of a document. Every QDRO should have the following notice:

NOTICE: THIS DOCUMENT CONTAINS SENSITIVE DATA.

Adding this notice to online Fidelity orders will not cause the higher fee to be charged.

**D. Pre-Approval**

I don't get proposed QDROs pre-approved often since I do so many and for the same plans again and again. However, in unusual circumstances or when a model is not available from the plan, I will usually ask the plan to review the proposed order prior to getting it entered with the court, if time allows. For anyone that doesn't prepare a lot of QDROs, pre-approval is a good idea and can save time and money later.

Some plans are quite prompt in reviewing proposed order and some are not. I usually give a plan about 30 days and if no response, I will go ahead and enter the order. There will be cases in which time is a problem and pre-approval won't be feasible. In the case of a plan that uses Fidelity as the third party administrator, Fidelity will not pre-approve or review a proposed QDRO, unless it is an amended order to fix a rejected order.

I always seek pre-approval when the QDRO is for a defined benefit plan and there is no model, which is not that often. Defined benefit plans are too complicated and too varied to attempt without review by the plan.

**E. Online Order Preparation**

There are several third party administrators that offer online preparation of QDROs for plans which they administer. The most common are Fidelity Investments and AON Hewitt. I use the Fidelity site but not AON Hewitt's.

The Fidelity site produces an order that is not in the format we are used to in Texas, but it is important to use it. In the case of the plan charging a fee to review the order, the fee will increase from $300 to $1,200 if the order is changed, even if it is simply retyped word for word. Almost all Judges are familiar with Fidelity QDROs and understand the reason I use them. Occasionally, a Judge will balk at signing the strange looking order, but I've never had one refuse once the review fee issued was disclosed. The only time I manually prepare a Fidelity order is when the choices offered don't match the facts of the case. That is common for defined benefit plans where there is service prior to marriage. Although one of the choices offered by Fidelity is a "marital fraction", the formula generated is the Taggart formula and not the Berry formula.

As to AON Hewitt, I pull the model orders off its online site but I don't like to prepare the QDRO online because it produces a fill in the blank, check the box looking order. Since AON Hewitt doesn't charge more for reviewing orders not using its online service, I prepare my own using its model.

Use of an online preparation service does not necessarily mean it's easier than doing it manually. The Fidelity site has many options and requires the preparer to make choices that can significantly affect the parties. One must have a sound understanding of the terms and issues involved in order to properly make the various choices.

There are also a number of web sites for QDRO preparation services that will prepare the order for you for a fee. I would urge caution in using a nationwide preparation service since they may not be aware of Texas law, such as when to use the Taggart formula and when to use the Berry formula. There are also several Texas non-attorney businesses that prepare QDROs, if you really like to live dangerously.

**F. Attorney Fees**

An issue I see frequently is the attempt to collect attorney fees by way of a QDRO in a divorce case (not child support). Attorney fees can't be paid from a retirement account. The purpose of ERISA is to prevent an assignment of a person's retirement account, even on a voluntary basis, to a creditor. All transfers and assignments are prohibited, with an exception for division of property, child support or alimony. An alternate payee may only be a spouse, former spouse, child or other dependent and the assignment must be made by QDRO. An attorney doesn't qualify as an alternate payee. An attorney is simply another creditor.

Some attorneys have the QDRO prepared so that the attorney's address is used for the alternate payee current mailing address, hoping that the check will come to the attorney's office and held until payment

arrangements can be made by the client. Ethical considerations of this action are not discussed here, however, many plans won't accept a c/o address that is an attorney's office.

The amount of the attorney fees can always be added to the amount awarded to the alternate payee, if approved by opposing counsel, with the idea that when the alternate payee receives his/her money from the plan, he/she will pay the attorney fees on a voluntary basis. That may be the best the attorney can hope for. A problem with this approach is that the alternate payee will be taxed on the entire amount of the distribution, so he/she is paying income taxes on that portion that is used to pay attorney fees.

Under Texas law, the award of attorney fees in a child support enforcement is considered part of the child support obligation and may be enforced by any means available to enforce the child support obligation, including contempt (Sect. 157.167, Texas Family Code). However, in the event the arrearage is taken from the obligor's defined contribution plan, the Texas Attorney General's Disbursement Unit has no procedure in place to separate attorney fees from arrearages and make payment to the attorney. Attorney fees must be collected in another manner.

### G. When to Enter the QDRO or Division Order

Section 9.101, Texas Family Code, gives the divorce court continuing, exclusive jurisdiction to enter or amend a QDRO or similar division order. If possible, I recommend entering the QDRO or division order at the same time as the Decree of Divorce. There are a number of reasons I recommend this. First, in preparing the QDRO, a problem with the Decree or agreed division has a better chance of being discovered. For example, say the parties are attempting to award a lump sum dollar amount on a TRS benefit. In drafting the QDRO using the model provided by TRS and reviewing the other source material, it would become clear that a lump sum amount can't be awarded. The parties can then revise the agreement and the Decree before it is entered. Second, although unlikely, there is the possibility that a participant could die before the QDRO is entered. Many plans won't accept a QDRO after the death of the participant.

The longer the wait after the divorce, the more likely there could also be valuation or record issues. I have been hired to prepare a QDRO for a 2009 divorce only to find out there were no records with the current record keeper before 2011. I also routinely run into the problem of a participant terminating employment soon after the divorce and withdrawing all the money from the 401(k) before the QDRO reaches the plan.

There are a few Plans that won't accept a division date that is more than six months prior to the date the Plan receives notice of the division. Unfortunately, the attorney probably won't know about that restriction until the QDRO is prepared and the model states that fact. If it is already more than six months since the division date, there is a real problem. If it hasn't yet been six months, usually a letter to the Plan advising that a QDRO is in the works and providing the division date will avoid the problem.

If the QDRO or division order is presented to the court more than 30 days after the Decree is signed, the Court still has jurisdiction to enter (Sect. 9.101), but since it is outside of the court's plenary power, most counties charge a filing fee. Many courts also require the filing of a Petition to Enter QDRO if past the 30 day period, which just increases the work and fees required to tie up the loose ends.

There is no legal reason that I know of why a QDRO or division order can't be entered prior to divorce, so long as it is part of the division of property, child support or alimony. Since ERISA considers an alternate payee to be either a spouse or former spouse, I see no problem and have prepared QDROs for entry prior to divorce. The Temporary Order, if applicable, should probably reference the issue and be clear as to the intent of the Court and/or parties. I would have the Decree recognize the "early" transfer and the purpose or intent behind that action. Counsel will still have to get the Judge to approve the action and the order, but that doesn't seem to be a large problem in most cases.

### H. Issues for In-Pay Status Participants

As previously mentioned, once a participant begins to receive benefit payments, most plans will not allow a QDRO to make a "separate interest" division and require a "shared interest" division. Another issue that arises for in-pay status participants concerns dividing the benefit pending the plan's approval of the QDRO.

Although most plans process a QDRO within about 90 days, it can take longer. The alternate payee likely is going to want his/her share of the benefit payment immediately after the divorce but prior to direct payment being made to the alternate payee pursuant to the QDRO.

Many Decrees address this issue, making the participant a constructive trustee of the alternate payee and ordering the participant to directly pay the alternate payee his/her share. There can be significant enforcement issues unless the Decree is very specific as the amount and timing of each payment. The Decree should also address how taxes will be handled, since the participant is going to get a 1099R for the entire benefit, even though part was passed along to the alternate payee.

I suggest giving written notice to the plan that a divorce is pending and that it is anticipated that a QDRO will be forthcoming. A number of plans will place a hold on the benefits or account for a certain period, although the plan is not required to do so. I just

prepared a QDRO where the Plan's rules required it to hold back 50% of the benefit payment once the plan received a proposed QDRO or was put on notice that a QDRO was in the works. That is the best scenario and insures that the alternate payee will get his/her portion from the plan once the QDRO is approved.

In cases where the participant receives the entire benefit payment and fails to pay the alternate payee his/her awarded portion, the alternate payee can sue for the benefits that should have been paid, but it only results in a judgment and we all know the problem with collecting judgments in Texas.

There will be occasions where the participant is about to retire or terminate employment and the QDRO is not completed. In such cases, there may be concern that the participant might withdraw all the 401(k) funds or begin benefit payments without turning over that portion awarded to the alternate payee. In such cases, counsel should consider sending an letter to the plan, stating that a QDRO is anticipated shortly and requesting a hold or freeze on the benefits or account, as appropriate. Then, get a certified copy of the Decree to the Plan, just as one would send a QDRO. We all know the Decree probably does not contain the proper language to qualify as a QDRO, but its receipt will likely cause the plan to place a partial hold on benefit payments or freeze an account for a certain time while the QDRO is being entered.

## I. Income Tax and the 10% Early Withdrawal Penalty

Under most circumstances, if there is a withdrawal of funds from a defined contribution plan prior to age 59 ½, a 10% penalty is imposed. There are several hardship exceptions provided. The IRC now also provides an exemption from the 10% penalty when there is a division of property made pursuant to a QDRO, so that is no longer an issue.

If the proceeds from a defined contribution plan are transferred or rolled into an IRA or other qualified plan or account by a direct transfer from the plan to the new IRA or other qualified plan, there is no liability for federal income taxes on the amount transferred at the time of transfer. Of course, in the future when there are withdrawals from the IRA or other plan, there will be tax liability on the withdrawn amount.

If the proceeds are withdrawn by the alternate payee instead of doing a rollover, liability for federal income taxes attaches. Federal tax law provides that if the alternate payee is a spouse or former spouse, then the alternate payee is responsible for payment of income tax. In the event a child or other dependent is the alternate payee, the participant is responsible for payment of the tax.

Unless the plan receives instructions to make a rollover, it will automatically withhold 20% of the anticipated distribution for federal taxes. The appropriate party will claim the distribution on that year's federal tax return as regular income. The amount of total taxable income will determine the actual tax rate, which may be less or more than the 20% used for the withholding. Any person wanting to take an immediate distribution should consult with his/her tax advisor prior to doing so to avoid a nasty surprise on the following April 15.