



IDENTIFYING THE MARITAL PORTION OF A DEFINED CONTRIBUTION PLAN

Introduction:

The most common retirement asset today is the Defined Contribution Plan. In most cases, you can easily place a value on these assets. But there are situations where the parties will not be satisfied with identifying the marital property using a simple carve out based on a time line coverture calculation (months married while in the plan up to the marital property cut-off date ÷ total months of plan participation up to the marital property cut-off date). In the very volatile investment climate of the past 10 years the parties may think that only by analyzing the actual dollar growth during the marital period will it be possible to accurately value each share. In some cases that will be true but whether this approach is practical or not depends on a number of other factors.

Tip of the Month:

The biggest retirement asset mistakes an attorney can make when negotiating and writing settlement agreements and Qualified Domestic Relations Orders when he or she represents the non-participant Spouse:

1. Failing to clearly identify how the portion of the pension awarded to the non-participant spouse (dates and/or formulae are necessary. Supplemented early retirement benefits and post retirement enhancements (COLA, etc.) are plan components and should be dealt with in the settlement agreement.
 2. Not clearly stating how, or whether, the pre and post retirement survivor annuities are to be awarded to the alternate payee.
 3. Failing to fully identify all the marital property retirement assets. Often vested benefits from prior employment, reserve military pensions and additional defined contribution plans (ESOP, deferred compensation plans, etc.) are overlooked. Do not rely on the participant for the retirement data! ([See attached release form](#))
 4. Not assuming responsibility for the preparation of the QDRO in the settlement agreement. Even worse than the participant's attorney preparing the QDRO, when you represent the non-participant, is the scenario in which both attorneys prepare their own versions of the QDRO. This invites a never-ending nightmare with litigation almost a certainty. Who is responsible for preparation of the order should be in the settlement agreement.
 5. Not filing the QDRO concurrent with the settlement agreement at the issuance of the final decree. Your client (and you) are at risk if the plan participant should die, retire or leave employment prior to the receipt of the order by the Plan Administrator.
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IDENTIFYING THE MARITAL PORTION OF A DEFINED CONTRIBUTION PLAN

If you have been reading these newsletters, you should now have a pretty good idea of what a defined contribution plan is all about. It can most easily be equated to a tax-deferred savings account. While the concept is not hard to grasp determining, what portion of the account is marital property can be.

If the plan participant joined the plan after the date of the marriage (often a different date than the date of employment), it is relatively easy to assign a value to the marital property component. In that scenario, each party to the divorce would be entitled to one half of the account balance on the marital property accrual cut-off date. The non-participant spouse would also be entitled to all interest, dividends, gains or losses that are attributable to his or her portion between the marital property cut-off date and the date the funds are actually distributed to them. Unless there are substantial other marital assets to offset the non-participant's share, defined contribution plan funds are usually distributed with a Qualified Domestic Relations Order.

This is a tax-free transfer to the participant and if a trustee-to-trustee transfer is made to another tax deferred retirement account (IRA, etc.); it is also tax free to the non-participant. Upon receipt and approval of a Qualified Domestic Relations Order, most plans will pay out the non-participant spouse's share immediately. If he or she elects to receive the money directly (no transfer to an IRA or other tax deferred retirement account) then the amount received must be added to their income in the year of receipt and all taxes incurred must be paid. The plan will automatically withhold 20% of the proceeds and pay it to the IRS in the name of the payee. In the case of direct payment to the non-participant spouse, the 10% early withdrawal penalty due on receipt of certain lump sum retirement accounts before age 59½ would be waived. This is an exception written into the federal tax laws specifically to facilitate marital breakup property distributions.

The difficulty in identifying the marital portion of a defined contribution account arises when the participant is already in the plan when he or she marries. Most states treat the funds in the account on the date of marriage, plus all passive earnings on that portion of the account, as the separate property of the participant. There are two ways that the value of the separate property on the marital property cut-off date can be identified for distribution purposes - the easy way and the hard way.

The easiest way to apportion the account value at the time of the marital breakup is to do a time value coverage calculation. If a participant began contributing to the plan on January 1, 1985, got married on January 1, 1990 and the marriage broke up on January 1, 2004, then the coverage calculation would be applied by simply dividing the fourteen years that the parties were married by the nineteen years the participant was in the plan and identifying the marital portion as 73.6842% of the account balance on the marital property cut-off date. The non-participant spouse would be entitled to one half of that or 36.8421% of the account on that date plus any post appraisal date earnings or losses on his or her portion. If the earnings and growth of the plan had been fairly consistent throughout the duration of plan participation, this method would result in a distribution that would often be deemed equitable by all parties. Comparing the outcome of this method with others always results in differences but how significant they are depends on a lot of factors.

If the earnings and growth during the marital period had been extremely erratic and one party or the other, or the judge or mediator insists on apportioning the asset based on the actual passive growth on the participant's separate property share, then you are faced with a difficult, often expensive, and sometimes impossible, task. The account must be

analyzed in detail to determine the value of the participant's separate property with the goal of identifying the specific worth of that portion of the account on the marital property cut-off date and then bring it up to its actual value on a date close to the date a report of this analysis is prepared.

This report will require the services of a third party consultant who will analyze the growth, usually on a quarterly basis, throughout the marital period to ascertain the passive growth of the non-marital portion of the account. The consultant's starting point is the value of the account on the date of the marriage. As many plans have options wherein the participant can allocate their funds to different investment vehicles, and optionally change them at will, this can be a very difficult and time-consuming exercise. Also, as mergers and acquisitions have not been uncommon during the past 25 years, just getting the necessary information from the employer can sometimes be impossible.

To perform the kind of analysis that will satisfy all concerned it is necessary to have all the quarterly investment reports provided to the participant during the marital period available. If you are talking about a fourteen-year marriage, unless the participant saved every quarterly statement, getting the necessary information will usually be impossible. If some statements have been retained you can get close as long as two consecutive statements are not missing. But if two or more consecutive statements are missing, you force the analyst to move from science to art and the results can easily be challenged.

More often than not, retirement plan managers will not provide duplicate statements that have already been provided once to the participant. They, rightly, cite the uncompensated expense of digging up old records. This is a particular problem if the period in question is lengthy and the company has changed ownership or investment plan managers a couple of times. If that is the situation then the parties will either have to use the coverture method or come to agreement as far as a settlement figure. In the absence of evidence, it is doubtful that the cost of litigating the issue before a judge will produce a satisfactory result. In all likelihood the judge will fall back on the coverture method as the only way to come to equity.

You should explain this to your client and hope that reason prevails. While it is true there was spectacular growth during the mid-nineties there has also been spectacular losses since 2000. It really tends to even things out and makes the coverture methodology still a viable approach, in some instances, to valuing defined contribution plans.

[Model Property Settlement Language](#)

Download our settlement language form and let the experts at LawDATA, Inc. [draft model property settlement language](#) (<http://www.lawdatainc.com/SetLanForm.pdf>) that deals specifically with the pension plan to which the order is addressed and the facts of your case.

Mr. Commerford has been active in the valuation of pensions and the preparation of Domestic Relations Orders for his attorney clients since the founding of LawDATA, Inc. in 1984. He has presented Continuing Legal Education programs, dealing with the valuation and distribution of retirement assets incident to divorce cases, for State Bar Associations throughout the country and written many articles on the subject for legal publications.

For any questions or ideas for upcoming articles you can reach Paul Commerford at paul@lawdatainc.com.

RETIREMENT ASSET RELEASE FORM

I, _____, do hereby instruct a representative of
(Plan Participant - printed)

(Name – address – phone # of benefits provider)

to cooperate fully with _____
(Name of attorney - address - phone #)

_____ or his/her designee and answer any and all questions relating to my pension plan or any other retirement or deferred income plans in which I participate. I also request that you furnish this individual a current plan booklet and a current accrued benefits statement, and a statement as of _____,
(Marital Property Cut-off Date)

of all of my accrued retirement benefits including any defined contribution and defined benefit plans in which I am a participant. The defined benefit plan statements should detail the accrued vested benefit payable to me on my normal retirement date along with a statement of projected pension benefits, including supplemental benefits, if any, payable to me on the earliest date that I may receive them on an actuarially unreduced basis (based on my current income) assuming continued employment to that date. If my benefit is contingent upon my classification or job level or contribution level please so state and advise what that may be. Also, please provide a statement showing my service computation date (first day of employment), dates of all breaks in service (if any), my current salary and my annual salary for the past five years, the legal names of the plans in which I participate and their addresses and the name, address and telephone number of the person to be contacted if additional information is needed. I authorize that person to answer all questions incident to this request. The defined contribution Plan statements should show my current plan balances as well as my account balances on

_____ and on _____.
(Marital Property Cut-off Date) (Date of Marriage)

Signature of Plan Participant

Today's Date

Date of Birth

Social Security #

Witness # 1 - Signature

Witness # 2 - Signature

Witness # 1 - PSrinted

Witness # 2 - Printed