



# Divorce, Pensions and Retirement Benefits

Number: 1

Paul Commerford - President - LawDATA, Inc.

December 2002

---

---

## Retirement Plans

### Introduction:

For over 17 years I have lived and breathed the issues surrounding the inclusion of marital property retirement assets in dissolution cases. I have given numerous State Bar CLE sessions and written articles dealing with the distribution of those assets. Many other knowledgeable professionals have been doing the same during this time period. Still this area of divorce related equitable, or community property, distributions continue to be considered a "minefield" by even the most senior and capable divorce attorneys. My monthly contributions will be an attempt to provide a better roadmap for traversing that "minefield". The subjects discussed will tend to be targeted more to practical practice tips rather than to midnight law school esoterica. Also, if you have any questions, or suggestions for future newsletters, or for a personal reply, do not hesitate to e-mail me at [paul@lawdatainc.com](mailto:paul@lawdatainc.com).

As most of you are aware retirement asset distributions can be made using an immediate offset or payout or they can be deferred using a Domestic Relations Order. As to how the pension is viewed and treated can be very different under those two scenarios. The topics in these articles will be directed at one method or the other each month so as not to confuse. We will use some case law or legislation as a jumping off spot but as this newsletter is national in scope we will not spend a lot of time analyzing cases or laws that don't apply to you. Before we mandate the rule about mixing distribution methodologies I thought we should start with the very basics. As an introduction, this month we will discuss the two different types of retirement assets; defined contribution plans and defined benefit plans. Most attorneys are familiar with these terms but are a little hazy about their specific meanings and how distribution of each is effected.

---

---

### Tip of the Month:

**You cannot direct the plan to pay your fee with a QDRO.**

Your fee cannot be paid directly to you with QDRO proceeds. Many attorneys have looked to a QDRO as the answer to the age old dilemma facing practitioners - how to insure payment in a dissolution case where you represent the sympathetic, but basically broke, non-participant spouse. ERISA bars liens against, and assignment of, all ERISA governed retirement assets. The only exceptions are spelled out in the Retirement Equity Act of 1984 (REACT). This is the congressional bill that exempted former spouses and dependent children from the anti-assignment rules and created the Qualified Domestic Relations Order.

Nowhere in the act is the divorce attorney exclusion noted. A plan would be subject to fines and other penalties if it paid retirement funds to other than the named included parties.

---

---

# RETIREMENT PLANS

## Types of Plans:

**DEFINED BENEFIT PLANS** - When the word "pension" is used what is usually meant is an entitlement under a "defined benefit" plan. A U.S. Civil Service pension, a military pension, a phone company pension, most trade union pensions, larger industrial employers (I.B.M, G.M., General Electric) etc.; are all providers of "defined benefit" plans. In most cases the employee makes no contribution to the accrual of his benefit or, if he does, the contribution (i.e. U.S. Civil Service, many state run public employee pensions) has no relationship to the value of his or her projected pension. In other words the employee does not in fact pay for the pension. Rather it is a form of deferred compensation that the employer obligates itself to provide to all employees as a condition of employment.

The benefit to be received is determined by a formula such as final salary x years of service x 1.6% equals annual pension payable to the retiree. There are no individual accounts in the name of the employee. The pension is funded by the company paying into a general account that is invested at a rate of return targeted to fund its future outstanding pension liabilities. The amount needed to accomplish this is determined on an actuarial basis for all employees as a group. Unless the present value of the employee's vested pension, at the time he retires, is less than \$5,000.00, there are no provisions for a lump sum settlement. All defined benefit pension payments are made on a monthly basis over the life of the participant.

Under current federal ERISA regulations most employees have a vested right to receive their accrued benefit when they reach retirement age once they have five years of service. Even if they leave their jobs at a very young age, for any reason whatsoever, they will still have the right to this pension. They will be "vested". This "vesting" period was reduced from ten years to five years in January 1, 1989.

There are other forms of "vesting" but "cliff" or five year "vesting" is the most common and the one with which you will normally be dealing. Military plans differ from the norm in that there is no "vesting". A participant either serves his 20 years and is entitled to a pension or leaves prior to that time and is entitled to nothing. Many public sector plans (and some Unions) still have ten year vesting. In most states it does not matter whether the pension is "vested" or not for it to be considered a marital asset and subject to distribution. In cases involving very short employment (2 or 3 years) it would be appropriate to reduce the present value of the pension for the possibility of termination before vesting. The appropriate reduction is subject to negotiation but a reduction of 20% for each year of non-vesting for a plan with five year vesting is a standard reduction formula that has been applied in a number of cases of which I am aware.

Defined benefit plans are valued by determining how much money in a fully funded annuity is needed (lump sum) at the time the employee retires in order to fund the stream of income provided by his projected annual pension benefit for the actuarial balance of his life commencing at the earliest unreduced retirement age. Once this is determined, that amount is reduced to its present value and a coverture calculation is applied to identify what portion of the present value is attributable to the marriage. Distribution of the marital portion of the present value is then accomplished by a negotiated or litigated immediate offset settlement or by the issuance of a Qualified Domestic Relations Order. The Pension Benefit Guaranty Corporation (P.B.G.C., a federal agency established by ERISA in 1974 to guarantee the payment of private pensions to participants) provides the actuarial data used by valuation experts throughout the country. The P.B.G.C. has become the accepted and recommended source of actuarial data. Many jurisdictions have reviewed this issue and concurred.

DEFINED CONTRIBUTION PLANS - a profit sharing plan, an employee stock ownership plan (ESOP), an employee savings plan (401k plan); these are some of the forms defined contribution plans can take. They differ from defined benefit plans in that there is no guarantee as to what their value will be at the time the employee retires. In most cases the company makes contributions to an account in the employee's name by some predetermined formula. This could be accomplished by paying out a portion of the company's profits to employees or by matching a portion of the employee's own contributions to a savings or stock purchase plan.

The employee is always vested in the portion of his account that he has paid for himself and vested in the company-funded portion of the account by a formula similar to the vesting formulas applied to defined benefit plans. In many cases they are simply tax deferred savings accounts. Many larger companies offer participation in defined contribution plans in addition to participation in defined benefit plans. Because of the expense of setting up and maintaining a defined benefit plan, smaller companies often rely on defined contribution plans as the sole means of providing help to employees in planning for retirement.

If the employee leaves employment he does not have to wait until retirement age, in most cases, to receive his vested account balances. Many plans also allow loans against these accounts in the case of financial emergency. Under certain guidelines I.R.S. permits this with no tax liability. It is very easy to understand that these plans are simply tax sheltered deferred compensation/savings plans and that the account balances represent marital assets subject to distribution.

Until the Retirement Equity Act of 1984 established Qualified Domestic Relations Orders, dealing with defined contribution plans was a real problem because often the employee was not in a position to buy out the spouse's interest. While the money was not really available until retirement it was completely under the control of the employee until that time. Ten years after the divorce, he could quit and take the proceeds and the spouse would probably never know it. If he paid the spouse her interest by immediate offset, fairness dictated she would only get a small amount of what was actually available in the account at the time of the divorce because the account balance had to be discounted to represent the loss of usage to the employee until such time as he was eligible to receive the money.

Today, in most cases, defined contribution plan assets are distributed by means of a Qualified Domestic Relations Order. What this means is that the portion of the employee's account that has been determined to be marital property is divided between the parties and a separate account in the non-pension holder's name is established by the plan. Interest and dividends, if any, that accrue to that portion of the plan that has been determined to be the non-pension holder's property are added to the account balance until such time as the proceeds can be paid out. In 1989 the Internal Revenue Service gave plan providers the option of paying out the Alternate Payee's share immediately upon receipt and approval of a Qualified Domestic Relations Order. Most plan providers have amended their by-laws to permit these immediate QDRO distributions. Some smaller companies have not gotten around to making these changes. In any case immediate payment of the account balances due the Alternate Payee is a Plan option and cannot be overridden by a court order. The Qualified Domestic Relations Order on a defined contribution plan is usually the best source for immediate funds for the non-participant spouse. With trustee-to-trustee transfers the taxes can be deferred or if direct payment of the funds is made to the non-participant spouse there is no early withdrawal penalty.

## Conclusion

Immediate offset distribution is the most common method of dealing with defined benefit plans. Many judges encourage this method because in their mind it finalizes the divorce

and removes the court's responsibility for overseeing a deferred distribution. That perception is for the most part wrong because if a domestic relations order is written and accepted by the plan any future action would not be part of the original divorce case unless one of the parties was responsible for fraudulent information. But that would be just as true if there was an immediate offset settlement. If the non-participant spouse has an immediate need for funds and the participant spouse cannot buy out his or her interest with cash, always use a domestic relations order if there is a defined contribution plan in the marital assets.

Just knowing the type of retirement account with which you are dealing can immediately help in planning your settlement strategy.

---

---

### **[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](mailto:paul@lawdatainc.com).

Web: [www.lawdatainc.com](http://www.lawdatainc.com)

©LawDATA, Inc 2002