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## Beyond the Bar

Distribution of Retirement Plan Benefits - Part 1

by [Joel R. Brandes](#)

**[Editor's Note: Readers are extremely fortunate to be able to share in the years of matrimonial and family law experience which Joel Brandes brings to Beyond the Bar. His recent three-part article on matrimonial agreements (February-April, 2001, BTB)..., was a learning experience for both the novice and the experienced practitioner. Equally as important, this first installment of another comprehensive three-part article, on Retirement Benefits, should be downloaded, digested and kept at hand in any negotiations, to protect your client's best interests. The information imparted is his interpretation of existing law, and is not to be considered as either his legal advice, or that of West Group.]**

Although the settlement of most matrimonial actions involves the equitable distribution of either or both spouses' retirement plan benefits, the law relating to them is confusing to most attorneys. Because benefits may be paid in different forms, with great variations, it is important to understand each type and how it can be distributed upon a divorce or dissolution.

Probably the most recognized retirement plan is the 401(k). A 401(k) plan is a retirement and savings plan that allows an employee to invest pretax contributions from a certain portion of gross wages. Many employers match the employee's contributions. The contributions and their earnings accumulate tax-free until withdrawn. The contributions are invested, generally, in investments of the employee's choice. The employer's contributions and the growth on those contributions does not fully vest unless the employee achieves a certain duration of service with the employer.<sup>1</sup>

A 403(b) plan is a tax-deferred retirement plan for employees of public educational systems and certain tax-exempt organizations, funded primarily with employee contributions (through deferred compensation) and the employer's matching contributions. The contributions accumulate earnings on a tax-deferred basis, so that neither the contributions nor the earnings are taxed until distributed to the employee. This plan is also known as a tax-sheltered annuity or tax-deferred annuity.<sup>2</sup>

A simplified employee pension plan (SEP) is an individual retirement account or annuity funded by employee contributions and by discretionary contributions from the employer. A simplified employee pension plan operates much like a 401(k) plan, in that employee contributions can be made by deferred compensation and the employer can also contribute. This plan is attractive to small employers because it is much easier to administer than a 401(k) plan and gives the employer complete discretion on whether to make an annual contribution.<sup>3</sup>

A Keogh plan is a tax-deferred retirement program developed for the self-employed. This plan is also known as a H.R. 10 plan, after the House of Representatives bill that established the plan. It is also termed self-employed retirement plan.<sup>4</sup>

An individual retirement account (IRA) is a savings or brokerage account allowing a person to contribute up to a specified amount of earned income each year (\$2,000 under current law). The contributions, along with any interest earned in the account, are not taxed until the money is withdrawn after a participant reaches 59 ½ years of age (or before then, if a 10% penalty is paid).<sup>5</sup>

A Roth IRA is an IRA in which contributions are nondeductible when they are made. No further taxes are assessed on the contributions (or accrued interest) when the money is withdrawn (if all applicable rules are followed).<sup>6</sup>

Pension plans are governed primarily by federal law. Most pension plans are governed by the Employees Retirement Income Security Act (ERISA)<sup>7</sup>, which applies to private, employer sponsored plans and limits the time, manner and method of the distribution of the plan benefits. Government, civil service, military and railroad plans are not governed by ERISA.

Both the newly admitted attorney and the seasoned attorney must become familiar with the provisions of the Employees Retirement Income Security Act (ERISA) in order to make the division of these assets upon divorce or dissolution as stress-free and malpractice-free as possible.

If you've handled just one divorce case, doubtless you know that all or part of your client's interest in a retirement plan may be divided, without any tax consequences to the transferor, by a transfer to a spouse or a child which is authorized by a Qualified Domestic Order (QDRO). But are you familiar with all of the nuances of the law which are called for in the preparation of the Domestic Relations Order to assure it will be qualified by the plan administrator? Do you know what types of retirement benefit plans there are and the common approaches to dividing them? Do you know how to prevent a violation of the "anti-alienation rule?" (What's that?)<sup>8</sup> Do you know what happens to your client, the participant in the plan, if the transfer is made in violation of these rules? More, importantly, do you know that you may not be able to enforce the contractual or court ordered right of your client (the "alternate payee") to receive a share of her/his spouse's benefits if he or she (the "participant") dies or retires before the QDRO becomes effective? You **must** know the answers to these questions if you want to avoid sleepless nights!

To facilitate the understanding of the distribution of retirement plan benefits one must untangle the anti-alienation rule and understand the importance of the federal "preemption doctrine."

The anti-alienation rule was enacted to protect the employee from his own financial improvidence in dealing with third parties. It was intended to assure that the employee and his beneficiaries would reap the ultimate benefits due on retirement.<sup>9</sup> ERISA's anti-alienation rule<sup>10</sup> requires all pension, profit-sharing or stock bonus plans of which the pension trust is a part, to provide that the plan benefits may not be anticipated, assigned or alienated, or be subject to attachment, garnishment, levy, execution or other legal or equitable process.<sup>11</sup> "Assignment" or

"alienation" includes any arrangement providing for the payment to the employer of plan benefits which would otherwise be due the participant under the plan. It also includes any direct or indirect arrangement, whether revocable or irrevocable, whereby a party acquires from a participant or beneficiary an enforceable right or interest against the plan in, or to, all or any part of a benefit payment which is, or may become payable to the participant or beneficiary.<sup>12</sup>

The anti-alienation rule does not apply to a transfer of a participant's benefits to a spouse, former spouse, child or dependent, pursuant to a "qualified domestic relations order."<sup>13</sup>

So, in order to transfer an interest in a pension trust to a spouse without violating the anti-alienation rule, there must be a QDRO.

Major problems may occur for a recipient spouse (and his/her counsel) if the participant dies or retires before the QDRO becomes effective. Counsel should consider holding entry of the divorce or dissolution judgment in abeyance pending the qualification of the domestic relations order by the plan administrator. If the participant makes the decision to retire he is usually offered several payment options by the plan administrator. If he elects a higher paying life-only annuity payment, rather than a joint and survivor annuity, he receives the payments for the rest of his life. Once he dies all of the payments end.

If the participant dies, before the QDRO is approved, having elected a life-only annuity payment prior to marriage, your client may receive nothing because the deceased participant's election of a form of pension under an ERISA plan is irrevocable. If the participant retires and receives payments before the QDRO becomes effective your client may not receive her share of those payments because plan administrators are not required to make retroactive payments. Therefore, if your intention is to share the payments, the QDRO must be approved before the participant retires.

Most of the benefits provided by qualified retirement plans are "retirement benefits" paid during the participant's life, and "survivor benefits" that are paid to beneficiaries after the participant's death. Usually, a spouse can assign all or a portion of each of these types of benefits to an alternate payee.

## **TYPES OF RETIREMENT PLANS**

There are two basic types of qualified retirement plans. One is a "defined benefit plan." The other is a "defined contribution plan."

A "defined benefit plan" pays each participant a specific benefit at retirement. It is usually based on a formula that takes into account the number of years the participant has been employed and the participant's compensation. The basic retirement benefits are usually periodic payments for the participant's life beginning at the plan's normal retirement age. This is known as an "annuity." The plan may also provide that benefits may be paid in other forms, such as a lump sum payment.<sup>14</sup>

A "defined contribution plan" provides an individual account for each participant. The benefits are based solely on the amount contributed to the account, and any income, expenses, gains and losses, as well as any forfeitures of accounts of other participants which may be allocated to the participant's account. A profit-sharing plan, a "401(k)" plan, an employee stock ownership plan ("ESOP") and a money purchase pension plan are defined contribution plans. These plans usually permit retirement benefits to be paid in the form of a lump sum payment of the participant's entire account balance.

### **METHODS OF DIVIDING BENEFITS**

The "separate interest" method divides the participant's benefits into two separate parts, one for the participant and one for the alternate payee. The treatment of subsidies provided by a plan, such as early retirement benefits, and the treatment of future increases in benefits due to increases in the participant's compensation, additional years of service, changes in cost of living, or as a result of other plan provisions should be considered when negotiating a property settlement based on the separate interest approach to allocate benefits under a defined benefit plan. A QDRO may transfer to the alternate payee all or part of the participant's basic retirement benefits, and can also address the disposition of any subsidy to which the participant may become entitled after the QDRO has been entered.

If you are dividing an interest in a defined contribution plan under the "separate interest" method, the participant's account may be invested in more than one investment fund. If the plan provides for participant-directed investment of the participant's account, consideration should be given to how the alternate payee's interest will be invested. A participant's account balance may later increase due to the allocation of contributions or forfeitures after the QDRO has been entered. The property settlement should provide that the amounts assigned to the alternate payee will include a portion of such future allocations.

If the parties use the "shared payment" method, under which benefit payments from the plan are split between the participant and the alternate payee, the alternate payee receives payments only when the participant receives payments. You may provide that the alternate payee commences receiving benefit payments when the participant begins receiving payments or at a later stated date, and that the alternate payee will cease to share in the benefit payments at a stated date, or upon a stated event, provided that adequate notice is given to the plan. In splitting the benefit payments, you may give the alternate payee either a percentage or a dollar amount of each of the participant's benefit payments, although, the amount given cannot exceed the amount of each payment to which the participant is entitled under the plan. If a QDRO transfers a percentage of the participant's benefit payments, rather than a dollar amount, then, unless the QDRO provides otherwise, the alternate payee generally will automatically receive a share of any future subsidy or other increase in the participant's benefits.<sup>15</sup>

**(to be continued next month)**

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<sup>1</sup> Black's Law Dictionary (7th Ed., 1999). IRC ([26 USCA § 401\(k\)](#))

<sup>2</sup> Black's Law Dictionary (7th Ed., 1999). IRC ([26 USCA § 403\(b\)](#))

<sup>3</sup> Black's Law Dictionary (7th Ed., 1999). IRC ([26 USCA § 408\(k\)](#))

<sup>4</sup> Black's Law Dictionary (7th Ed., 1999)

<sup>5</sup> Black's Law Dictionary (7th Ed., 1999)

<sup>6</sup> Black's Law Dictionary (7th Ed., 1999)

<sup>7</sup> See [29 USCA §§ 1055-1056](#)

<sup>8</sup> To be discussed.

<sup>9</sup> See American Tel & Tel Co. v Merry, (CA2d Conn) [592 F2d 118](#)

<sup>10</sup> See [29 USCA § 1056\(d\)](#); IRC Section 401(a)(13).

<sup>11</sup> Id.; IRC Section 401(a)(13); Reg Section 1.40(a)(13).

There is an exception for any voluntary and revocable assignment not to exceed 10% of any benefit payment made by any participant who is receiving benefits under the plan unless the assignment or alienation is made for provisions of defraying plan administration costs.

There is also an exception for enforcement of Family Support orders. Cody v. Riecker, (ED NY) [454 F. Supp 22](#), affd (CA2 NY) [594 F2d 314](#); American Tel & Tel Co. v. Merry, (CA2, Conn) [592 F2d 118](#); Cartledge v Miller (SDNY,1978) [457 F Supp 1148](#);

<sup>12</sup> Reg Section 1.40(c)(1).

<sup>13</sup> [29 USCA § 1056\(d\)\(3\)\(a\)](#); IRC Section 401(a)(13)(B); IRC Section 414(p)(6)(a); IRC Section 404(a)(13)

<sup>14</sup> See generally IRS Notice 97-11, [1997-2 I.R.B. 49](#), [1996 WL 747904 \(I.R.S.\)](#)

<sup>15</sup> See generally, IRS Notice 97-11, [1997-2 I.R.B. 49](#), [1996 WL 747904 \(I.R.S.\)](#)

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