Issues in Dividing Retirement Plans
Beyond the Basics

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This article is an adaptation of the authors' presentation at the 2016 LCBA Family Law Seminar in Nashville, Tennessee. It is intended to provide practical assistance to divorce practitioners dealing with retirement plans when they draft or negotiate a Marital Settlement Agreement in a divorce case, even when the attorneys do not intend to prepare the Qualified Domestic Relations Orders or other documents to divide the retirement plans to implement the agreement themselves.

THE FIRST STEP – DON'T OVERLOOK RETIREMENT PLANS

For many couples, the largest asset they possess will be retirement plans acquired during the marriage. The first precaution is to make sure to provide for the division of all retirement plans.

Most older Fortune 500 companies have both defined-benefit "pension" plans and defined-contribution "401k" plans. Newer or smaller companies are trying to get away from pension plans and have just 401k plans. If you have a case involving an Abbott employee, you know they have both.

All Illinois public sector employees have a defined-benefit pension, which can be divided by a Qualified Illinois Domestic Relations Order. They might also have a defined-contribution 457 plan, like a 401k Plan. You can usually find if there is a defined-contribution plan by looking for the deduction on their pay stubs. In most cases such plans can be divided by a QDRO.

All federal government employees will have a defined-benefit pension plan (FERS or CSRS). They might also have a defined-contribution Thrift Savings Plan. Both plans can be divided by court orders similar to a QDRO.

Military personnel will have a pension, but to receive the pension benefit they generally have to serve 20 years active duty. Military personnel might contribute to a Thrift

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Savings Plan (TSP). If a service member goes from military to federal civilian employment, he or she might have two TSPs.

Some trade union workers have multiple pensions and a 401k plan. They may have a local and an international pension. This is common with union electricians and bricklayers. Union plans are consolidating and changing administrators, so it can get confusing. Members may legitimately overlook a plan.

Don't forget previous employers. Don't write off bankrupt employers—a pension may be taken over by the Pension Benefit Guarantee Corporation, or another corporation may have assumed responsibility for the pension.

Non-qualified executive plans: ERISA has maximum income limits for "qualified" plans. The IRS 2016 annual compensation limit for a qualified retirement plan is $265,000. Depending on the type of plan, annual benefit or contribution limits vary. Executives and highly compensated employees may have supplemental plans that are not qualified under ERISA. These plans do not have to accept a QDRO. Because QDROs are a convenience for the plan participant, some companies will honor a QDRO or will do so for some employees. If the plan will not honor a QDRO, you have to look at entering an order that the participant make direct payments to the alternate payee, or set-off other assets.

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PROTECT YOURSELF AND YOUR CLIENT

The Second District Appellate Court has given us a "Get out of Jail Free" card. It is the case of In r*e Marriage of Hall*.[1] In that case, the appellate court reversed the trial court for denying a motion to reform the judgment to divide a retirement plan the parties had overlooked. The appellate court said that the language of the judgment made it clear that the parties intended to divide all retirement assets. You should include a statement in the Marital Settlement Agreement that "It is the parties' intent to equally divide the marital portion of all retirement plans," if that is indeed what you do intend.

THE SECOND STEP – HOW MUCH IS "MARITAL?"

When dividing a defined-contribution retirement plan (401K) where a portion was acquired before the marriage, it is often difficult to determine what part is marital and what part is non-marital. This is not an issue with a defined-benefit pension plan because it can be divided by a coverture formula.

The 2016 revision to the IMDMA clarifies the burden of proof in §503(b)(2). The statute creates a presumption that all retirement plans participated in during the marriage are marital. That presumption can be overcome by "clear and convincing evidence." This heavy burden of proof should eliminate a lot of contests. The new statutory provision codifies a trend that was developing in the case law.

It may be difficult or impossible for plan participants to prove the value of their plan at the time of marriage. Plan participants may not have saved their statements. The Plan Administrator may not have records going back years because the plan changed financial managers. If you represent the plan participant, advise your clients to go through their old records or talk to their employer or Plan Administrator to try to document the history of their investment in the plan.

A participant can also argue that he or she should receive any appreciation in value of the non-marital portion that occurred during the marriage. Today, however, the participant probably would have to hire an actuary or similar expert to be able to trace the change in value of each asset in the plan over the course of the marriage.

THE THIRD STEP – SURVIVORSHIP ISSUES

When dividing a traditional pension plan, protect your client by being alert to survivorship issues in case the participant should die before the alternate payee. In most cases, pensions will only be paid out in the form of monthly payments once the participant reaches "minimum retirement age" and retires. Fortunately, defined-contribution 401K-type plans can usually be divided immediately, so that survivorship is not normally an issue.

A survivor benefit is different than a death benefit. A death benefit is generally a predetermined lump sum payment upon a plan member's death.

A survivor benefit is a monthly payment to an alternate payee that is paid upon the death of the plan member. Survivor benefits can be paid in addition to death benefits. There are two types of survivor bene-

1 404 Ill. App. 3d 160 (2d Dist. 2010).

fits: a qualified pre-retirement survivor benefit, and a qualified post-retirement survivor benefit. A qualified pre-retirement survivor annuity may be paid when the member dies before retiring. If you represent the alternate payee and the member dies before retiring and you did not obtain a qualified pre-retirement survivor annuity, your client may lose his or her benefits, because a pension is never paid.

A post-retirement survivor benefit may be paid if a member dies after retiring. A post-retirement survivor benefit is also not a pension; it is paid in lieu of the pension. The pension stops upon the death of the member. When a member dies, his or her pension payments die too. But provision can be made for post-retirement survivor benefits to be paid for the life of the surviving spouse.

For many private industry pension plans governed by ERISA—for example Abbott or Allstate—survivorship issues can be avoided by entering a "separate interest" QDRO because the plan "severs" the alternate payee's interest from the participant's interest. However, other company plans only "separate" the alternate payee's interest when the benefit commences. That approach assures the alternate payee receives benefits for the rest of his or her life once the benefit commences. It does not, however, protect the alternate payee's benefits if the participant dies before the alternate payee commences receiving benefits. Therefore, the QDRO should still require pre-retirement survivor benefits be maintained under a "separate interest." A "separate interest" is not available for military pensions, federal government pensions, or pensions governed by the Illinois Pension Code. It is therefore important to advise your client what, if any, benefits may be available to them as a survivor, and to make provision for those benefits.

The Illinois Pension Code governs teachers, police, fire, and municipal workers, and states that a QILDRO shall not apply to, or affect, the payment of any survivor's benefits, disability benefit, life insurance benefit or health benefit.[2] The pension code does not allow a QILDRO to provide survivor benefits. It does provide a death benefit, but remember that a death benefit is different from a survivor benefit.

For example, say a member retires after 30 years under the Illinois Municipal Retirement Plan. On the member's statement of benefits as of the date of retirement, the death benefit is listed at $250,000 (employee contributions). The former spouse is granted 50% of the benefit in the judgment for dissolution of marriage. The former spouse is under the belief that upon the member's death, they will receive 50% or $125,000 as the death benefit. But this is not always the case. The employee's contributions are used to pay the member's monthly benefit. If the member's monthly retirement benefit is $5,000, then after 4 years and 2 months of receiving retirement benefits, the employee's contributions are depleted. At that point the state takes over paying the monthly benefit and it will pay only a $3,000 death benefit. The former spouse will now be entitled to 50% of $3,000, or $1,500. The former spouse receives no survivor benefit and not much of a death benefit.

If your client is eligible for a share of a military pension, you should ask that the service member be required to maintain a Survivor Benefit Payment ("SBP"), which continues payments to the ex-spouse if the service member dies. If there is an ex-spouse and a current spouse, the government will not divide the SBP between spouses. Only one spouse or former spouse can receive the benefit. This is significant to a service member who plans on remarrying and would like the new spouse to receive the survivor benefits. It is also significant to a former spouse who wants or needs survivor benefits. The military will not enforce a SBP unless the survivor benefit is granted in a court order. Generally, the court order is the judgment for dissolution. Even if a survivor benefit is granted in a court order, a former spouse may still lose the survivor benefit unless an election for survivor benefit is filed within one year of the Order granting SBP. Either the service member or the former spouse of the service member can make the election. If a former spouse remarries before the age of 55, the SBP ceases. However, if the subsequent marriage ends in death or divorce, the SBP is reinstated.

For federal employees such as postal workers or air traffic controllers participating in the Civil Service Retirement System ("CSRS") or Federal Employees Retirement System ("FERS"), survivor benefits can be divided between former spouses or between a current spouse and former spouse like in private plans. Like the military former spouse, however, if a former spouse remarries before the age of 55, then that former spouse loses his or her survivor benefits under CERS or FERS. Again, if the subsequent marriage ends in death or divorce, SBP is reinstated.

You should also be cognizant that survivorship benefits have a cost. Someone will be responsible for paying that cost. Depending upon the plan rules, the employer, the participant, or the alternate payee may pay for pre-retirement survivor benefits. The post-retirement survivor benefits can be allocated to one or both parties depending upon the division of the benefit. For example, with a "separate" interest benefit, such as a private industry plan where the member is not yet retired, the former spouse's share of the benefit is separated and actuarially adjusted for his or her own life so there is no cost to the participant and the former spouse receives a benefit until that person's death. On the other hand, with a "shared" interest benefit, such as a military or federal pension or a private industry pension where the parties do not elect a separate interest, the former spouse receives a share of the participant's benefit. That benefit is not separated. The survivor benefit cost is deducted from the pension payment and then each party receives their respective share. Therefore,

2 40 ILCS 5/1-119(b)(4).

the survivor benefit cost is divided between the parties in same percentage as their interest unless they adjust the division of the benefit to allocate the cost differently.

The final issue with survivor benefits is what happens if a party dies before the court enters the QDRO. Some plan administrators will honor a QDRO entered after the death of the participant, but many will not. Also, some courts have treated the death of the participant as ending a former spouse's right to enter a QDRO dividing retirement benefits. However, a recent Illinois case the Second District Appellate Court reversed the Circuit Court of Lake County and allowed the former spouse to receive pension benefits granted in the dissolution even though the QDRO was not entered before the death of the participant.[3] It is interesting to note in this case that the subsequent spouse may have to pay the benefits.

POTENTIAL PROBLEM – DISABILITY PAYMENTS

Disability payments present another area of concern for parties dividing retirement plans. Disability payments may or may not be divided between the parties when the pension has been divided between the parties in a judgment for dissolution of marriage. Generally, under a private pension plan, you can divide disability payments. The Illinois Pension Code, however, does not allow the division of disability pay for its members. The Code states that a "QILDRO shall not apply to or affect the payment of any survivor's benefits, disability benefit, life insurance benefit or health benefit."[4]

This has had far reaching implications. If a participant is determined to be disabled before he or she retires, he or she can continue receiving disability payments indefinitely and never elect to receive a retirement pension, thus depriving the ex-spouse of the share of the pension awarded in the dissolution of marriage. But in 2015, Illinois case law distinguished disability pay from a disability pension and allowed a disability pension to be divided.[5] Faced with compelling facts, the appellate court affirmed a trial court order that the disabled spouse make direct payment from his disability benefit to his former spouse even though the original judgment only awarded a portion of retirement benefits.

A similar issue frequently occurs with Military Retired Pay. Under the Uniformed Services Former Spouse Protection Act ("USFSPA"), "disposable retired pay" can be divided in a dissolution action. Disability pay is excluded from the definition of "disposable retired pay." There are two different types of disability pay: (1) military disability retired pay, and (2) VA disability compensation. Both are excluded from the USFSPA definition of disposable retired pay and the military will not accept an order providing for direct payment to a former spouse of a portion of the disability pay.[6]

To avoid an unfair result because a retired service member elects to receive disability pay instead of retired pay, many courts have ordered payment from other sources and required a service member who waived a portion of retired pay in order to receive disability pay to reimburse his former spouse from other assets for the value of the share she was deprived of as a result of his actions.[7] It is advisable to address the issue of disability in the dissolution by including language in a martial settlement agreement that requires a member to reimburse a former spouse for any reduction in pension benefits due to receiving future disability.

CONCLUSION

If you follow these steps when negotiating and drafting the Marital Settlement Agreement, you will ensure that your client receives the share of marital assets to which he or she is entitled. Preparing the QDRO will then be the final step to transfer the assets you have secured.

3 *Platt v. Platt*, 2015 IL App (2d) 141174.
4 40 ILCS 5/1-119(b)(4).
5 See *In re Marriage of Benson*, 2015 IL App (4th) 140682.

6 Note that although disability pay cannot be divided as marital property, it can be used to determine maintenance and child support. *Rose v. Rose,* 481 U.S. 619 (1987).
7 In *re Marriage of Nielsen*, 341 Ill. App. 3d 863 (2d Dist. 2003)

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