

# DIVIDING RETIREMENT BENEFITS IN DIVORCE

THOMAS J. DALEY, KOONSFULLER, P.C. – PLANO, TEXAS JUNE 13, 2024

## I. INTRODUCTION

### A. IMPORTANCE OF RETIREMENT BENEFITS IN DIVORCE

Retirement benefits are often one of the largest assets in a marriage, comparable to or even exceeding the value of the marital home. These benefits can significantly impact the financial stability of both parties post-divorce. Understanding how to correctly divide these assets ensures that both parties can maintain a reasonable standard of living. Neglecting the proper division of retirement benefits can lead to significant financial loss for the non-employee spouse.

### B. OVERVIEW OF APPLICABLE LAWS

The division of retirement benefits in divorce is governed by various federal and state laws, with ERISA being a key federal statute that sets out the rules for private sector retirement plans. State laws, such as those in Texas, also play a crucial role, especially for state-specific retirement systems like the Teacher Retirement System (TRS) and the Texas Municipal Retirement System (TMRS). Understanding these legal frameworks is essential for ensuring the division complies with all relevant legal requirements and protections.

## II. UNDERSTANDING DIFFERENT TYPES OF RETIREMENT PLANS

### A. DEFINED BENEFIT PLANS

#### 1. CHARACTERISTICS

Defined benefit plans promise a specific monthly benefit at retirement, which is often calculated based on salary and years of service. These plans are typically employer-funded, meaning the employer bears the investment risk. The benefits are usually paid as a lifetime annuity, providing a steady income stream for the retiree.

#### 2. DIVISION METHODS

The division of defined benefit plans often requires a court order, such as a QDRO, which specifies how the benefits will be divided. The time-rule formula is commonly used to apportion the benefits between the employee and non-employee spouse, taking into account the duration of the marriage and the time the employee participated in the plan. Special considerations may be needed for early retirement subsidies and cost-of-living adjustments, which can affect the value of the benefits.

## B. DEFINED CONTRIBUTION PLANS

### 1. CHARACTERISTICS

Defined contribution plans, such as 401(k)s, rely on contributions from the employee, and often the employer, to individual accounts. The value of the benefit at retirement depends on the contributions made and the investment performance of the account. Unlike defined benefit plans, there is no guaranteed payout, and the employee bears the investment risk.

### 2. DIVISION METHODS

Dividing defined contribution plans typically involves transferring a portion of the account balance to a new account for the non-employee spouse. It is important to consider any outstanding loans against the account, as these can complicate the division. The QDRO must clearly specify the division details, including how gains and losses will be allocated from the valuation date to the distribution date.

## C. HYBRID PLANS

### 1. CHARACTERISTICS

Hybrid plans combine features of both defined benefit and defined contribution plans, offering elements such as guaranteed contributions with investment risk borne by the employee. Examples include cash balance plans and target benefit plans, which provide a more predictable benefit than pure defined contribution plans but less certainty than traditional pensions.

### 2. DIVISION METHODS

The division of hybrid plans requires careful consideration of both the defined benefit and defined contribution aspects. The plan's specific rules must be reviewed to determine how benefits can be divided. In some cases, multiple QDROs may be needed if the plan maintains separate accounts for different types of benefits.

## III. LEGAL FRAMEWORK AND ORDERS FOR DIVISION

### A. QUALIFIED DOMESTIC RELATIONS ORDER (QDRO)

#### 1. DEFINITION AND PURPOSE

A QDRO is a legal order that allows for the division of retirement plan benefits in compliance with ERISA's anti-alienation rules. It enables a non-employee spouse to receive a share of the retirement benefits directly from the plan, which is crucial for ensuring the benefits are divided fairly and in accordance with the law. The QDRO must meet specific criteria set out by ERISA and the IRS to be valid.

#### 2. DRAFTING A QDRO

Drafting a QDRO requires detailed knowledge of the retirement plan's rules and the ability to accurately capture the division terms in legal language. It is crucial to avoid broad, unspecific language that can lead to

disputes or disqualification of the order. A well-drafted QDRO will address all necessary components of the benefits, including survivor benefits and any potential adjustments for early retirement or cost of living.

## B. STATE GOVERNMENTAL PLANS

### 1. TEXAS-SPECIFIC PLANS

Texas has several state-specific retirement plans, including TRS and TMRS, which are governed by state law rather than ERISA. Each of these plans has unique rules for dividing benefits in a divorce, and it is often required to use specific model orders provided by the plan administrators. Understanding these rules is essential for ensuring the division is legally compliant and effective.

### 2. DIVISION METHODS

Division of state plans in Texas requires careful adherence to the specific statutory requirements and the use of approved model orders. These orders must be meticulously drafted to include all necessary provisions and to exclude any irrelevant choices. Failure to comply with these requirements can result in significant delays or the rejection of the division order.

## C. FEDERAL PLANS

### 1. FEDERAL EMPLOYEE RETIREMENT SYSTEM (FERS)

The division of federal retirement plans, such as FERS, is governed by specific federal regulations, and a QDRO is not applicable. Instead, a Court Order Acceptable for Processing (COAP) is used to divide these benefits. It is essential to follow the detailed guidelines provided by the federal plan to ensure the order is accepted and the benefits are divided correctly.

### 2. MILITARY RETIREMENT

Military retirement benefits have unique rules for division, including the requirement that the benefits can only be divided if they are not classified as disability pay. A Court Order Dividing Military Retirement is used instead of a QDRO, and it must comply with federal regulations to be enforceable. Understanding these differences is critical for the successful division of military retirement benefits.

## IV. TAX IMPLICATIONS

### A. TAXATION OF DIVIDED BENEFITS

#### 1. TAX TREATMENT OF DISTRIBUTIONS

Retirement plan distributions are generally subject to federal income tax, and dividing these benefits in a divorce can have significant tax implications. The non-employee spouse, as the alternate payee, will be responsible for paying taxes on any distributions they receive. However, QDROs allow for the transfer of retirement benefits without incurring the usual early withdrawal penalties, provided the funds are rolled over into a qualified plan.

---

## 2. IMPACT ON ALTERNATE PAYEE

The non-employee spouse must be aware of their tax liability when receiving retirement benefits as part of a divorce settlement. It is important to consider whether to take a lump sum distribution, which will be taxed immediately, or to defer taxes by rolling over the benefits into an individual retirement account (IRA). Careful planning can help minimize the tax impact and maximize the financial benefits of the division.

## B. STRATEGIC CONSIDERATIONS

---

### 1. LUMP SUM VS. ANNUITY

Deciding between a lump sum payout and an annuity can have significant tax and financial planning implications. A lump sum may provide immediate funds but will be subject to full taxation in the year it is received. An annuity provides a steady income stream and spreads out the tax burden over time, potentially reducing the overall tax impact.

### 2. EARLY RETIREMENT OPTIONS

Early retirement options can affect the value of retirement benefits and their division in a divorce. Plans that offer early retirement subsidies can provide significant financial advantages, but it is crucial to include provisions in the QDRO to ensure the non-employee spouse receives a fair share of these benefits. Understanding the plan's rules for early retirement and any applicable penalties or adjustments is essential for effective planning.

## V. PRACTICAL CONSIDERATIONS IN DIVISION

---

### A. INFORMATION GATHERING

---

#### 1. IMPORTANCE OF COMPREHENSIVE DATA

Gathering complete and accurate information about all retirement benefits is essential for a fair and effective division. This includes obtaining benefit statements, plan descriptions, and any relevant employment contracts. The employee spouse should provide releases to allow direct access to information from the employer or plan administrator, ensuring that all potential benefits are identified and valued correctly.

#### 2. EMPLOYEE CONSENT AND RELEASES

Securing the employee spouse's consent to obtain information about their retirement benefits is a critical step in the process. This can be included as part of temporary orders or initial discovery requests. Without this consent, the non-employee spouse may lose access to important information that could affect their rights to the benefits, making it difficult to achieve a fair division.

### B. AVOIDING COMMON PITFALLS

---

#### 1. FREEZING BENEFITS

Freezing retirement benefits during the divorce process can prevent the employee spouse from taking actions that could negatively affect the non-employee spouse's share of the benefits. Sending a freeze letter to the

plan administrator is a protective measure that can safeguard the benefits from changes or withdrawals. However, if the administrator does not agree to freeze the benefits, the attorney is protected from malpractice claims related to any adverse actions taken by the employee spouse.

---

## 2. ADDRESSING NON-QUALIFIED PLANS

Non-qualified plans, such as deferred compensation plans, may not be subject to the same rules as qualified plans under ERISA. It is essential to review the plan's contract to determine if the benefits are transferable and whether a domestic relations order (DRO) can be used to effectuate the division. If the benefits are not transferable, the divorce decree may need to include detailed constructive trust language to ensure the non-employee spouse receives their share.

## C. WORKING WITH PLAN ADMINISTRATORS

---

### 1. BUILDING EFFECTIVE RELATIONSHIPS

Developing a positive working relationship with the plan administrator is crucial for the successful division of retirement benefits. Understanding the administrator's requirements and preferences can help ensure that the division order is accepted and processed smoothly. Regular communication and a collaborative approach can also help address any issues that arise during the division process.

---

### 2. ADDRESSING ADMINISTRATOR REQUIREMENTS

Plan administrators may have specific requirements for the format and content of division orders. It is important to review the plan's rules and model orders to ensure that all necessary provisions are included and that the order complies with the plan's guidelines. Advocating for the inclusion of language that protects the client's interests, even if it differs from the administrator's preferences, can be crucial for securing the non-employee spouse's rights to the benefits.

## VI. CASE LAW AND PRECEDENTS

### A. KEY TEXAS CASES

---

#### 1. SHANKS V. TREADWAY

In *Shanks v. Treadway*, 110 S.W.3d 444 (Tex.2003), the Texas Supreme Court addressed the issue of broadly worded division orders that failed to specify the community and separate property interests. The court held that the language used resulted in the division of the entire benefit, not just the community portion. This case highlights the importance of using precise and specific language in division orders to avoid unintended consequences and ensure a fair division of retirement benefits.

---

#### 2. REISS V. REISS

*Reiss v. Reiss*, 118 S.W.3d 489 (Tex.2003) further clarified the need for clear and specific language in division orders. The Texas Supreme Court ruled that a general provision stating that the non-employee spouse was entitled to a portion of the retirement benefits was insufficient to divide the community property interest. This case underscores the importance of detailed and accurate drafting to ensure that the division order reflects the parties' intent and complies with legal requirements.

## B. IMPACT OF CASE LAW ON PRACTICE

### 1. ENSURING ACCURATE AND SPECIFIC ORDERS

Case law, such as *Shanks and Reiss*, emphasizes the importance of drafting accurate and specific division orders. Attorneys must carefully review and draft orders to ensure they comply with the plan's rules and clearly outline the division of community and separate property interests. Failure to do so can lead to costly litigation and the need for clarification or amendment of the order.

### 2. LEARNING FROM CASE LAW PRECEDENTS

Understanding and applying the lessons from key case law precedents is crucial for successful practice in dividing retirement benefits. Attorneys should stay informed about relevant cases and use them to guide their drafting and negotiation strategies. By learning from these precedents, attorneys can avoid common pitfalls and ensure their clients' rights are protected.

## VII. DRAFTING AND IMPLEMENTING EFFECTIVE ORDERS

### A. CHECKLISTS AND OFFICE PROCEDURES

#### 1. INITIAL CASE ASSESSMENT

The initial case assessment should include a thorough review of all retirement benefits and related documents. Using a comprehensive checklist can help ensure that no details are overlooked and that all necessary information is gathered early in the process. This assessment sets the foundation for drafting effective division orders and achieving a fair division of benefits.

#### 2. DRAFTING PHASE

During the drafting phase, it is essential to ensure that the division order is complete, accurate, and tailored to the specific retirement plan. This includes addressing all components of the benefits, such as survivor benefits, cost-of-living adjustments, and any potential loans or distributions. Detailed and precise drafting can prevent disputes and ensure the order is accepted by the plan administrator.

### B. COMMON AREAS OF FAILURE

#### 1. MISUNDERSTANDING PLAN RULES

A common area of failure in dividing retirement benefits is misunderstanding or misapplying the plan's rules. Each plan has its own specific requirements, and failing to comply with these can result in the rejection of the division order. Attorneys must thoroughly review the plan's rules and model orders to ensure that the division order is drafted correctly and meets all necessary criteria.

#### 2. FAILING TO SECURE APPROVAL

Another frequent issue is failing to secure approval of the division order from the plan administrator. This can occur if the order does not comply with the plan's requirements or if it includes provisions that are not allowed.

by the plan. Ensuring that the order is reviewed and approved by the plan administrator is crucial for the successful division of benefits and to avoid the need for future amendments or litigation.

## C. ADDRESSING POST-DIVORCE ISSUES

### 1. ENFORCEMENT AND AMENDMENTS

After the divorce, issues may arise with the enforcement or amendment of the division order. If the order is not properly enforced, the non-employee spouse may not receive their entitled benefits. It is important to have procedures in place to address these issues and to seek amendments or clarifications if necessary to protect the client's interests.

### 2. ONGOING LEGAL SUPPORT

Providing ongoing legal support to clients can help address any post-divorce issues related to the division of retirement benefits. This includes assisting with the enforcement of the division order, responding to changes in the plan's rules, and ensuring that the client continues to receive their benefits as intended. Ongoing support is essential for maintaining the client's financial security and ensuring compliance with the division order.

## VIII. CONCLUSION

### A. SUMMARY OF KEY POINTS

Dividing retirement benefits in divorce involves understanding the different types of plans, legal frameworks, and practical considerations. It is crucial to gather comprehensive information, draft precise division orders, and work closely with plan administrators to ensure compliance and protect clients' interests. By following these steps, attorneys can help ensure a fair and effective division of retirement benefits.

### B. FINAL TIPS AND RECOMMENDATIONS

Stay informed about changes in laws and regulations related to retirement benefits and divorce. Use detailed checklists and office procedures to ensure that no steps are missed in the division process. Build strong relationships with plan administrators and advocate for your clients to secure their entitled benefits. Finally, always use clear and specific language in division orders to avoid future disputes and litigation.

**THANK YOU** to Charla Fuller of KoonsFuller, P.C. for her years of research carefully curated into her rich paper that could be the basis of an entire semester-long class in law school: Division of Employee Retirement Benefits presented Aug 4, 2021 at Advanced Family Law. Her research and writing form the basis of this presentation.