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Focus on . . . Qualified Domestic Relations Orders

By DAVID A. PRATT

When is a domestic relations order a qualified domestic relations order? What factual information must a qualified domestic relations order specify? What other requirements must be satisfied? What are the rights of the alternate payee? How may payments be made? This article is a comprehensive examination of the definitions and procedures concerning this complex aspect of pension law.

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As originally enacted in 1974, ERISA Section 206(d)(1) required each pension plan to provide that plan benefits could not be assigned or alienated. Code Section 401(a)(13) imposes a similar requirement on qualified plans. The question thus arose as to whether state court domestic relations orders (DROs), providing for the division of pension benefits on divorce, were preempted by ERISA. The federal courts generally held that there was an implied exception to ERISA preemption for DROs. [See, e.g., Cartledge v Miller, 457 F Supp 1146 (SDNY 1978); Stone v Stone, 450 F Supp 919 (ND Cal. 1978), *affd* 632 F2d 740 (9th Cir, 1980); AT&T v Merry, 592 F2d 118 (2d Cir, 1979)]. In addition, IRS ruled that the anti-alienation rules did not preclude enforcement of state law DROs in certain circumstances. [Rev Rul 80-27, 1980-1 CB 85] However, some cases held that ERISA did preempt such orders. [See, e.g., General Motors Corp v Townsend, 468 F Supp 466 (ED Mich 1976)]

This was an unsatisfactory situation, but it was not until the enactment of the Retirement Equity Act (REA) [PL 98-397] in 1984 that Congress enacted an exception to the anti-assignment and preemption rules for qualified domestic relations orders (QDROs). [ERISA §§ 206(d)(3), 514(b)(7); IRC § 414(p)] Under these REA changes, a pension plan *must* provide for the payment of benefits in accordance with the applicable requirements of any QDRO. [ERISA § 206(d)(3)(A)]

The amendments to ERISA and the Code are generally effective for DROs entered on or after January 1, 1985. [REA 303(d)] If the DRO was entered before January 1, 1985, the plan administrator (1) must treat the order as a QDRO if the administrator was paying benefits pursuant to the order on January 1, 1985, and (2) may, at its option, if the administrator was not then paying benefits pursuant to the order treat the order as a QDRO, even if it does not meet the normal requirements for a QDRO. [REA 303(d)(1), (2)] The REA legislative history also indicates that the alternate payee may have a pre-1985 order amended to satisfy the requirements for a QDRO.

Although REA was enacted in 1984, neither IRS nor the DOL has issued regulations. However, the DOL has issued an explanatory booklet, "QDROs: The Division of Pensions Through Qualified Domestic Relations Orders" (available at http://www.dol.gov/dol/pwba). In addition, the IRS has issued Notice 97-11 [1997-1 CB 379] containing sample language for QDROs. The Notice is included as Appendix C to the DOL booklet. The PBGC also

has special rules that apply to QDROs affecting terminating defined benefit plans, published in "Divorce Orders and PBGC." [PBGC Publication 1005 (Sept 1996), available from http://www.pbgc.gov]

WHAT IS A QDRO?

The basic requirements for a valid QDRO, under ERISA and the Code, are as follows. [ERISA § 206(d)(3)(B); IRC § 414(p)(1)]. First, the order must be a DRO, namely, a judgment, decree, or order (including approval of a property settlement agreement). A property settlement agreement between the parties is not sufficient; the agreement must be approved by or incorporated in an order of a court or agency of competent jurisdiction. [see Notice 97-11, Appendix, Part I] Although a DRO is usually issued by a court, it may be issued by any state agency or instrumentality with the authority to issue judgments, decrees, or orders, or to approve property settlement agreements, pursuant to state domestic relations law. [DOL Booklet, Q&A I-3] In addition, the order must (1) relate to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of a participant; (2) be made pursuant to a state domestic relations law, including a community property law; and (3) create or recognize the existence of an alternate payee's right to, or assign to an alternate payee the right to, receive all or any portion of the participant's benefits under a plan.

The alternate payee must be the participant's spouse, former spouse, child, or dependent. [ERISA § 206(d)(3)(K); IRC § 414(p)(8)] According to the Joint Committee on Taxation, a QDRO may, under some circumstances, order payment to an agent of the alternate payee. [Joint Committee on Taxation, 99th Cong, 2d Sess, Explanation of Technical Corrections to the Tax Reform Act of 1984 and Other Recent Tax Legislation, 222, Comm Print 1187] Thus, it appears that payment could be made to a guardian or custodian or to a state welfare agency as agent for the alternate payee.

A QDRO that provides for child support or recognizes marital property rights need not be issued as part of a divorce proceeding, provided that it is issued pursuant to a state domestic relations law. [DOL Booklet, Q&A 1-8]

In Advisory Opinion 90-46A, the plan participant and his wife resided in a community property state. The wife died, and her estate obtained an order, in a probate proceeding, directing the plan to divide and segregate her community property interest in the participant's benefits. The DOL opined that the order was not a QDRO because the order was not made pursuant to a domestic relations law and thus was not enforceable against the plan. [See Gavin L. Phillips, Annotation, What Constitutes Order Made Pursuant to State Domestic Relations Law For Purposes of QDRO Exception to Antialienation Provisions of ERISA, 79 ALR 4th 1081 (1991)]

The DOL will not issue an advisory opinion on whether a DRO is a QDRO, because it is an inherently factual issue. [DOL Booklet, Q & A 1-14]

STATUS OF THE ALTERNATE PAYEE

Any alternate payee is considered a beneficiary under the plan [ERISA § 206(d)(3)(J)] and must have the same rights as any other beneficiary. Those rights may arise under the law or under the particular terms of that plan. Thus, for instance, the plan may (but need not) allow a beneficiary to direct investments or to borrow from the plan.

The most vexing question, in practice, is whether the alternate payee has the right to designate a beneficiary of any plan benefits assigned to the alternate payee that have not yet been paid at the time of the alternate payee's death.

The QDRO can clearly provide for a contingent alternate payee, who must be a permissible alternate payee (a child or dependent) of the participant and could not be, for instance, a subsequent spouse of the alternate payee or a child of the alternate payee by another marriage.

If the plan allows other beneficiaries to name their own beneficiaries, then the alternate payee should also have the right to do so, unless the QDRO specifically provides otherwise, and the beneficiary named by the alternate payee need not be a permissible alternate payee of the participant. This should be the result, even if the QDRO is silent on this issue.

If the plan does not allow other beneficiaries to name their own beneficiaries, then, as a matter of principle, the alternate payee should not have this right. What happens if the alternate payee dies before receiving all of the benefits to which he or she is entitled under the QDRO? If the QDRO is silent, there appear to be two alternatives: either payment is made to the alternate payee's estate (which appears to be the more common practice) or the benefit reverts to the participant. If the QDRO provides for a contingent alternate payee, the benefit would simply be paid to that person.

If the original alternate payee is the participant's spouse or former spouse, the tax treatment of pay-

ments to a successor alternate payee is not clear, particularly if the participant is still alive.

These uncertainties suggest two important considerations. First, wherever possible, the alternate payee should receive full payment as soon as possible, to minimize the risk of his or her dying before receiving all of the benefits. Second, and particularly in situations where full and immediate payment is not possible (such as a defined benefit plan that does not allow lump sums), it is essential to plan and to provide in the QDRO for the possibility of the alternate payee's death. Because of these difficulties and the practical problems involved in dealing with alternate payees (who often suspect that the plan administrator is in league with the participant and want their money now), it may be advantageous to amend the plan to allow an immediate lump-sum distribution to an alternate payee, even if a lump sum would not be available to the participant.

FACTUAL INFORMATION

In addition to satisfying the above requirements, a QDRO must clearly specify certain types of factual information. [ERISA § 206(d)(3)(C); IRC § 414(p)(2)]

1. The QDRO must clearly specify the name and last known mailing address of the participant and each alternate payee covered by the order. If the alternate payee is a minor or incompetent, the QDRO should also include the name and address of the alternate payee's legal representative, such as a guardian. [Notice, 97-11, Appendix, Part I.A]
2. The QDRO must clearly specify the amount or percentage of the participant's benefits to be paid by the plan to each such alternate payee, or the manner in which that amount or percentage is to be determined.
3. The QDRO must clearly specify the number of payments, or the period, to which the order applies. For instance, payments to the alternate payee might cease at the age of majority in the case of a child, or on remarriage if the alternate payee is the participant's former spouse.
4. The QDRO must clearly specify each plan to which the order applies. If the plau(s) can be identified from the order, the fact that the order does not use the plan's precise name is immaterial.

The statutory language suggests that compliance with these information requirements is essential to QDRO status. However, this is subject to several exceptions. First, if the DRO omits factual information that is readily obtainable by the plan administrator, the plan administrator should supplement the order rather than rejecting it. [DOL Booklet, Q&A 2-9; Sen Rep 98-575, 98th Cong, 2d Sess, p 20] Second, if the order is ambiguous, the plan administrator should attempt to resolve the ambiguity rather than simply rejecting the order. Third, some courts have held that QDRO drafters should not be held to a high standard of precision. In *Metropolitan Life Insurance Co. v. Wheaton* [42 F 3d 1080 (7th Cir 1994)], the court held that the order was a QDRO, though it did not include the alternate payee's address, or name the plan or specify the percentage division between them. "It is asking too much of domestic relations lawyers and judges to expect them to dot every i and cross every t in formulating divorce decrees that have ERISA implications."

NEGATIVE REQUIREMENTS

As well as satisfying the positive requirements listed above, a QDRO must also satisfy three negative requirements. [ERISA § 206(d)(3)(D), (E); IRC § 414(p)(3)]

First, the order may not require the plan to provide increased benefits, determined on the basis of actuarial value. Second, the order may not require payment to an alternate payee of benefits that are already required to be paid to another alternate payee under another QDRO. Finally, the order may not require a plan to provide any type or form of benefit or any option not otherwise provided under the plan. Thus, for instance, a QDRO may not direct the plan to make a lump-sum distribution to the alternate payee if the plan does not provide for lump-sum distributions. Again, however, this rule is not as absolute as it seems at first glance, and it will not be violated merely because the order requires, in the case of a payment *before* the participant has separated from service, that the plan pay benefits to an alternate payee on or after the date on which the participant attains (or would have attained) the earliest retirement age, as defined below. [ERISA § 206(d)(3)(E)(i)(I); IRC § 414(p)(4)(A)(i)]

The amount of the payment must be determined as if the participant had retired on the date on which payment is to begin under the order, taking into account *only* the present value of benefits actually accrued, and not taking into account the present value of any employer subsidy for early retirement. In determining present value, the plan must use the interest rate specified in the plan or, if none is specified, 5 percent. According to the legislative history of REA:

> When payments are made to an alternate payee before the participant retires, the payments are computed by taking into account only benefits actually accrued and not taking into account any employer subsidy for early retirement.... If an alternate payee begins to receive benefits under the order and the participant subsequently retires with subsidized early retirement benefits, the order may specify that the amount payable to the alternate payee is to be recalculated so that the alternate payee also receives a share of the subsidized benefit to which the participant is entitled. [Sen Rep 98-575, 98th Cong, 2d Sess, p 21]

In *In re Marriage of Oddino* [939 P 2d 1266, 16 Cal 4th 67 (Cal 1997], the wife wanted to receive unreduced benefits under an early retirement subsidy before her husband actually retired. The plan administrator determined that benefits to the wife under the QDRO must be actuarially reduced. The actuarial reduction was about 57 percent. The California Supreme Court held that if the actuarial value of an early retirement benefit exceeds the actuarial value of the plan's normal retirement benefit, the early retirement benefit is subsidized and thus may not be paid pursuant to a QDRO, prior to the participant's retirement.

EARLIEST RETIREMENT AGE

The earliest retirement age is *not* the earliest retirement age specified in the plan; rather, it is the earlier of (1) the date on which the participant is entitled to a distribution under the plan or (2) the *later* of the participant's 50th birthday or the earliest date on which the participant could begin receiving benefits if he or she separated from service. [ERISA § 206(d)(3)(E)(ii); IRC § 414(p)(4)(B)]

The DOL Booklet includes the following examples. [Q&A 3-10]

> **Example 1.** The pension plan is a defined contribution plan that permits a participant to make withdrawals only when he or she reaches age 59½ or terminates employment. The earliest retirement age for a QDRO under this plan is the *earlier* of (1) when the participant actually terminates employment or reaches age 59½ or (2) the later of the date the participant reaches age 50 or the date the participant could receive the account balance if the participant terminated employment. Since the participant could terminate employment at any time and thereby be able to receive the account balance under the plan's terms, the later of the two dates described in (2) above is age 50. The "earliest retirement age" formula for this plan can be simplified to: the earlier of (1) reaching age 59½ or terminating employment or (2) age 50. Since age 50 is earlier than age 59½, the earliest retirement age for this plan will be the earlier of age 50 or the date the participant actually terminates employment.

> **Example 2.** The pension plan is a defined benefit plan that permits retirement benefits to be paid beginning when the participant reaches age 65 and terminates employment. It does not permit earlier payments. The earliest retirement age for this plan is the *earlier* of (1) the date on which the participant actually reaches age 65 and terminates employment or (2) the later of age 50 or the date on which the participant reaches age 65 (whether or not he or she terminates employment). Because age 65 is later than age 50, the second part of the formula can be simplified to read "age 65" so that the formula is as follows: the earliest retirement age is the earlier of (1) the date on which the participant reaches age 65 and actually terminates or (2) the date the participant reaches age 65. Under this plan, therefore, the earliest retirement age will be the date on which the participant reaches age 65.

According to the IRS and the legislative history of REA and the Tax Reform Act of 1986 (TRA '86), a plan may (but is not required to) allow payments to begin to an alternate payee before the earliest retirement age, if the QDRO so provides, even if a distribution to the participant would not be permissible at that time. [Notice 97-11, Appendix, Part I.D.1.b.; Treas Reg § 1.401(a)-13(g)(3); Sen Rep 98-575, 98th Cong, 2d Sess, pp. 21-22 (REA); H Rep 99-841, 99th Cong, 2d Sess, II-858 (1986) (TRA 86)]

> **Example 3.** A pension plan permits lump-sum distributions but does not allow any distributions to a participant before termination of employment. However, the plan provides that an immediate distribution may be made to an alternate payee under a QDRO, if the QDRO so provides, even if the

participant has not yet attained his or her earliest retirement age. A distribution to an alternate payee under this provision would not jeopardize the qualification of the plan. By contrast, the IRS has ruled that an eligible deferred compensation plan described in Code Section 457 may not make distributions, pursuant to a QDRO, prior to the earliest date on which distributions are permissible under Code Section 457(d)(1)(A). [Ltr Rul 9145010]

If the plan did not provide for an immediate distribution to an alternate payee, then a DRO that required an immediate distribution to the alternate payee in these circumstances would not be a QDRO. Thus, a divorce decree that required 50 percent of the former husband's pension to be paid to the former wife as soon as administratively possible, before the participant's earliest retirement age, was not a QDRO. [Stott v Bunge Corp, 800 F Supp 567 (ED Tenn 1992)]

It is not clear whether an alternate payee's eligibility to receive hardship or disability benefits depends on whether the participant or the alternate payee satisfies the requirements for hardship or disability benefits. If the QDRO provides for shared payments (the alternate payee receives a dollar amount or percentage of each payment made to the participant), then it seems clear that the participant must satisfy the requirements. If, however, the QDRO creates a separate interest for the alternate payee, the correct answer is not clear.

CAN PAYMENTS BE MADE FOR THE ALTERNATE PAYEE'S LIFE?

The payment to an alternate payee under a QDRO may be made in any form in which benefits may be paid under the plan to the participant, except that a QDRO may not require payment of a joint and survivor annuity to the alternate payee and his or her subsequent spouse.

Accordingly, the DOL takes the position that "an order may substitute the alternate payee's life for the life of the participant to the extent that the form of payment is based on the duration of an individual's life." [DOL Booklet, Q&A 3-8]

Example 4. A QDRO provides that an alternate payee is to receive monthly payments for her life under a defined benefit plan, beginning at the participant's earliest retirement age (age 55), that are actuarially equivalent to 50 percent of the participant's accrued benefit payable at normal retirement age (65). The accrued benefit, payable at age 65, is $1,000 per month. The alternate payee will be age 58 at the participant's earliest retirement age. Under the plan's unisex actuarial assumptions, the annuity purchase rate, for each $1 of monthly benefit, is $120 at age 65, $200 at age 58, and $240 at age 55.

The QDRO provides that the alternate payee may elect to receive either an annuity payable for the participant's life or an annuity payable for the alternate payee's life. The normal form of benefit under the plan is a single life annuity, and the plan does not provide for benefits payable over the life of a beneficiary, except for the required QJSA and QPSA benefits. According to the DOL, this is a valid QDRO. The monthly amount payable under each option would be as follows:

Annuity for Participant's Life:
50% × $1,000 × $120 ÷ $240 = $250

Annuity for Alternate Payee's Life:
50% × $1,000 × $120 ÷ $200 = $300

MINIMUM DISTRIBUTION RULES

The form of payment to the alternate payee must comply with the minimum distribution rules. A former spouse to whom benefits are payable under a QDRO will be treated as a spouse (and as a surviving spouse) for purposes of Code Section 401(a)(9). [Prop Reg § 1.401(a)9)-1, Q&A H-4(a)] Distribution over the joint lives of the alternate payee and a designated beneficiary (other than the participant) will not satisfy Code Section 401(a)(9). [Prop Reg § 1.401(a)(9)-1, Q&A H-4(b)]

SECTION 415 LIMITATIONS

In determining compliance with the Section 415 limitations on contributions and benefits, the benefits payable to the participant and the benefits payable to all alternate payees of that participant are aggregated. [Notice 87-21, 1987-1 CB 458, Q&A 20] Thus, a plan participant may not use a series of divorces as a

technique for receiving increased benefits under the plan.

IF THE ORDER IS NOT A QDRO

A pension plan is neither required nor permitted to follow the terms of a DRO that is not a QDRO. The exception from the anti-alienation rules does not apply to orders that are not QDROs. Thus, if an order is not a DRO, or if it is a DRO but not a QDRO, the general anti-alienation rule applies, and the plan may not make payments, under the order, to a person other than the participant. [ERISA § 206(d)(3)(A)]

PLANS TO WHICH THE QDRO RULES APPLY

The Section 401(a)(13) anti-alienation rule and the Section 414(p) exception for QDROs apply to retirement plans subject to the vesting rules of Code Section 411. The rules do not apply to governmental plans or nonelecting church plans. [IRC § 411(e)(1); Treas Reg § 1.401(a)-13(a)] The QDRO rules do apply to Section 403(b) arrangements. [IRC § 414(p)(9)]

The ERISA Section 206(d) anti-alienation rule generally applies to pension plans, as defined in Code Section 3(2), inclnding nonqualified plans and Section 403(b) arrangements. Governmental plans, nonelecting church plans, and unfunded excess benefit plans are exempted by Code Section 4(b). Further, the rule does not apply to unfunded deferred compensation plans maintained primarily for management or highly compensated employees (top-hat plans), IRAs, or fnnded excess benefit plans, as defined in Code Section 3(36). [ERISA § 201]

According to the legislative history of REA, a QDRO remains qualified with respect to a successor plan of the same employer or a plan of a successor employer, within the meaning of Code Section 414(a). [Sen Rep 98-575, 98th Cong, 2d Sess, p 20]

RULES FOR IRAS

If any type of IRA (including a SEP, SIMPLE IRA, or Roth IRA) is to be divided tax free in connection with a divorce, the rules of Code Section 408(d)(6) must be followed rather than the QDRO rules. Under Code Section 408(d)(6), the transfer of an interest in an IRA to the IRA owner's spouse or former spouse will be tax free only if the transfer is made under a divorce decree, a decree of separate maintenance, or a written instrument incident to such a decree. [IRC § 71(b)(2)(A)] Thereafter, the amount transferred is treated as maintained for the benefit of the spouse.

Code Section 408(d)(6) does not provide for a tax-free transfer to anyone other than the IRA owner's spouse or former spouse, such as a child.

There is no provision allowing a withdrawal from one spouse's IRA to be tax free if it is rolled over to the other spouse's IRA. Therefore, it is prudent to be very conservative when transferring an interest in an IRA. [See, e.g., Rodoni v Commissioner, 105 TC 3]

STATUS OF FORMER SPOUSE

It is also important, in drafting a QDRO, to address the possibility that the participant will die before the alternate payee has received all benefits otherwise payable to him or her under the QDRO. If the QDRO is silent, the alternate payee will generally not be entitled to receive any survivor benefit from the plan.

To the extent provided in the QDRO, the former spouse of the participant (but no other alternate payee) will be treated as the participant's surviving spouse, and any spouse of the participant will not be treated as a spouse, for purposes of the QJSA and QPSA rules. [ERISA § 206(d)(3)(F); IRC § 414(p)(5)] To the extent that the order does so provide, then not only will some or all of the survivor's benefits be payable to the former spouse, but any required spousal consent relating to that portion of the benefit (such as a consent to a nonannuity form of benefit or consent to a plan loan to be secured by such benefits) must be obtained from the former spouse rather than the current spouse. [DOL Booklet, Q&A 3-5] If a QDRO provides for snrvivor benefits, the QDRO supersedes any prior waiver of such benefits by the alternate payee. [IRC § 414(p)(5); ERISA § 206(d)(3)(F)]

It is also prudent to spell out in the QDRO the precise extent of the alternate payee's right to survivor benefits. Defining the survivor benefits by reference to, or as being the same as, the alternate payee's share of the benefits payable during the participant's life may result in ambiguity and litigation. For example, in *Davenport v. Office of Personnel Management* [62 F3d 1384 (Fed Cir, 1995)], D's former husband died before beginning to receive his pension. Had he retired on the date of his death, D would have received 39 percent of her ex-husband's pension, and he and his new wife would have received 61 percent. The court held that D was entitled to 78 percent, not 39 percent (as OPM had determined), of the survivor annuity. "OPM's interpretation of the QDRO in this case would result in a precipitons drop in Patricia's income from almost one-half of Richard's annuity to a survivor annnity of only about half that amount. We can discern no hint that the parties intended to make

Patricia's rights turn so dramatically on whether Richard was retired or dead."

PLAN PROCEDURES FOR QDROS

If a plan receives a DRO, the plan administrator must promptly notify the participant and each alternate payee of receipt of the order and the plan's procedures for determining the qualified status of DROs.

Within a reasonable time after receipt of the order, the plan administrator must determine whether the order is a QDRO and notify the participant and each alternate payee of its determination. [ERISA § 206(d)(3)(G)(i); IRC § 414(p)(6)(A)] The 18-month period during which the plan administrator must preserve segregated amounts is not the measure of a reasonable time, and "in most cases would be an unreasonably long period of time to take to review an order." [DOL Booklet, Q&A 2-12] The checklist in Table 1 is designed to assist a plan administrator who has received a domestic relations order in determining whether the order is a QDRO. Depending on the complexity of the plan, the language of the order, and the amount at stake, it may be appropriate for the plan administrator to seek advice. An error could be costly to the plan.

If the plan administrator determines that the DRO is *not* qualified, the notice should include the reasons for the rejection. The notice should also be written in a manner that can be understood by the parties. [DOL Booklet, Q&A 2-14]

According to the DOL, a plan administrator may provide model QDROs but may not condition its determination of QDRO status on the use of a particular form. [DOL Booklet, Q&A 2-7] In addition, plan administrators must "take steps to avoid unnecessary and excessive administrative burdens and costs to the plan." [DOL Booklet, p 11]

Each plan must establish reasonable procedures for determining the qualified status of DROs and for administering distributions under QDROs. These procedures

1. Must be in writing;
2. Must provide for the notification of each person specified in a DRO as entitled to benefit payments under the plan, at the address in the order, of the procedures, promptly upon receipt of the order; and
3. Must permit an alternate payee to designate a representative for receipt of copies of notices that are sent to the alternate payee with respect to a DRO. [ERISA § 206(d)(3)(G)(ii); IRC § 414(p)(6)(B)]

The DOL takes the view that a plan's QDRO procedures should be designed to ensure that QDRO determinations are made in a timely, efficient, and cost-effective manner, consistent with the administrator's fiduciary duties under ERISA. [DOL Booklet, Q & A 2-5]

ACTIONS BEFORE RECEIPT OF A DRO

In *Schoonmaker v. Employee Savings Plan of Amoco Corporation* [987 F 2d 410 (7th Cir 1993)], the plan followed the unwritten procedure of placing a hold upon the account of a participant with respect to whom a QDRO was anticipated. S tried to sell Amoco stock and reinvest in a money market fund, but he was prevented from doing so by the hold, and his account suffered substantial losses as a result of the stock market decline in October 1987. S claimed the right to be made whole. The plan denied his claim, and he sued. The district court granted summary judgment to the defendants. The appeals court reversed, holding that this practice substantially modified the plan's written procedures and that it was a violation of ERISA to adopt the practice without complying with ERISA's amendment provisions. "Here, the interpretation embodied in the Plan's informal hold policy contradicts the Plan's written procedures and thus is prohibited." S was held entitled to recover his losses from the plan.

In this case, the plan's procedure would apparently have been permissible if it had been reflected in the plan's written QDRO procedures. According to the legislative history of TRA '86,

> The committee intends that the plan administrator may delay payment of benefits for a reasonable period of time if the plan administrator receives notice that a domestic relations order is being sought. For example, a participant in a profit-sharing plan which is exempt from the survivor benefit rules requests a lump sum distribution from the plan. Before the distribution is made, the plan administrator receives notice that the participant's spouse is seeking a domestic relations order. The plan administrator may delay payment of benefits. [TRA '86, HR Conf Rep No 841, 99th Cong, 2d Sess, II-858 (1986)]

According to the TRA '86 legislative history, a plan administrator served with a restraining order, which does not qualify as a QDRO, to delay benefit

Table 1. DOMESTIC RELATIONS ORDER CHECKLIST

Unless otherwise indicated below, a "No" answer to any of the following questions will require the plan administrator to determine that the document received by the plan is not a QDRO. However, in such a case, it will generally be preferable for the plan administrator to assist the alternate payee's attorney to correct the defect, rather than simply rejecting the proposed order. Also, if the order omits factual information that is readily obtainable by the plan administrator, the plan administrator should supplement the order rather than rejecting it.

Name of Alleged Plan Participant ______________________

Name of Plan to Which Order Is Addressed ______________________

Alternate Payee(s) to Whom Benefits Are Payable under the Order:

______________________ ______________________

Name Relationship to Participant

______________________ ______________________

Name Relationship to Participant

______________________ ______________________

Name Relationship to Participant

(For each question, circle "Yes" or "No," as appropriate)

Yes No 1. The Plan has received an order, namely a judgment, decree, or order (including approval of a property settlement agreement) that relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of the Participant.

Yes No 2. The Participant is a participant in the Plan.

Yes No 3. The order was made by a court or ageney which appears to have jurisdiction to do so under state law.

Yes No 4. The order identifies the state domestic relations or community property law under which it is made.

Yes No 5. The order (1) creates or recognizes the existence of the Alternate Payee's right to receive all or a portion of the Participant's benefits under the Plan or (2) assigns to the Alternate Payee the right to receive all or a portion of the Participant's benefits under the Plan.

Yes No 6. The order clearly specifies the last known mailing address of the Participant.

Yes No 7. The order clearly specifies the last known mailing address of each Alternate Payee covered by the order.

Yes No 8. The order clearly specifies the amount or percentage of the Participant's benefit to be paid by the Plan to each Alternate Payee, or the manner in which that amount or percentage is to be determined.

Yes No 9. The order clearly specifies the number of payments, or the period, to which the order applies.

Yes No 10. The order clearly specifies each plan to which it applies.

Yes No 11. The plan administrator has received evidence that each Alternate Payee has one of the required relationships (spouse, former spouse, child or dependent) to the Participant.

Yes No 12. The type or form of benefit, or option, provided under the order is provided under the Plan.

Yes No 13. The order does not require the Plan to pay a joint and survivor annuity to the Alternate Payee and his or her spouse.

Yes No 14. The order does not require the Plan to pay increased benefits, determined on the basis of actuarial value.

Yes No 15. The order does not require the payment, to an Alternate Payee, of benefits that are required to be paid to another alternate payee under another order previously determined to be a QDRO.

payments, is to comply with the order pending receipt of the DRO. [Sen Rep 99-313, 99th Cong, 2d Sess, 1105; see also Joint Committee on Taxation, 99th Cong, 2d Sess, Explanation of Technical Corrections to the Tax Reform Act of 1984 and Other Recent Tax Legislation, Comm Print 1187, at 224–225] There is no statutory authority to support this statement.

WHILE QUALIFICATION IS BEING DETERMINED

During the period in which the qualified status of the order is being determined (by the plan administrator, a court, or otherwise), the plan administrator must separately account for the amounts (the segregated amounts) that would have been paid to the alternate payee during that period if the order had been determined to be a QDRO. [ERISA § 206(d)(3)(H)(i), IRC § 414(p)(7)(A)]

If the order is determined to be a QDRO within the 18-month period beginning with the date on which the first payment would be required to be made under the QDRO, the plan administrator must pay the segregated amounts, including any interest thereon, to the person(s) entitled to them. If, within that 18-month period, it is determined that the order is not a QDRO, or the qualification issue is not resolved, then the plan administrator must pay the segregated amounts, including any interest thereon, to the person(s) who would have been entitled to them if there had been no order. [ERISA § 206(d)(3)(H)(ii), (iii); IRC § 414(p)(7)(B), (C)]

If the plan administrator determines, after the end of the 18-month period, that an order is a QDRO, the determination will be applied prospectively only. [ERISA § 206(d)(3)(H)(iv), IRC § 414(p)(7)(D)]

Example 5. P is a participant in a defined benefit plan, and she is currently receiving a pension of $1,000, payable on the first day of each calendar month. In connection with P's divorce from her husband, H, the court orders that the plan pay H $400 per month, beginning on January 1, 1999, so that the benefit payable to P from that date forward will be reduced to $600.

While the plau administrator, A, determines the qualified status of the order, it continues to pay $600 per month to P, but segregates the other $400 per month in a separate interest-bearing account under the plan. Here are three possible scenarios:

1. On April 9, 1999, A determines that the order is a QDRO. A must now pay to H the four monthly payments, totaling $1,600, to which he is entitled, plus the interest earned on the segregated account.
2. On April 9, 1999, A determines that the order is not a QDRO. A must now pay to P the $1,600 withheld from her pension to which she is entitled, plus the interest earned on the segregated account.
3. A does not determine the qualified status of the order until after June 30, 2000, the end of the 18-month period. A must now pay to P the $7,200 withheld from her pension to which she is entitled, plus the interest earned on the segregated account. If A subsequently determines that the order is a QDRO, payments to H will be prospective only. However, depending on the reason for the delay, H may have a claim against A for breach of fiduciary duty in taking so long to reach a decision.

JURISDICTION TO CHALLENGE THE PLAN ADMINISTRATOR'S DECISION

The DOL has expressed its view that jurisdiction to challenge the plan administrator's determination as to the qualified status of a DRO lies exclusively in federal court. [DOL Booklet, Q&A 1-12] However, the Supreme Court of California has held that federal and state courts have concurrent jurisdiction. [Oddino v Oddino, 939 P 2d 1266, 1997]

If, as the court held in *Oddino*, an action concerning a QDRO determination is an ERISA Section 502(a)(1)(B) claim for benefits, then presumably the QDRO determination should be subject to the plan's claims review procedure. If the plan gives the plan administrator discretion, the decision should be reviewed under the deferential "arbitrary and capricious" standard. [Firestone v Bruch, 489 US 101 (1989)]

WHO PAYS THE COSTS OF OBTAINING A QDRO?

According to the DOL, it is impermissible to impose a separate fee or cost on a participant or alternate payee, either directly or by charging his or her plan account, in connection with determining the status of a DRO or administration of a QDRO. [DOL Adv Op 94-32A] Under a defined benefit plan, this effectively

burdens the employer with the cost. Under a defined contribution plan, the cost will be borne either by the employer or by all of the plan participants. Why should one participant's marital troubles result in adverse consequences either to the company or to other plan participants?

The award of attorneys' fees, incurred by both parties in connection with drafting the QDRO, against the plan was held to be preempted by ERISA. [AT&T Management Pension Plan v Tucker, 902 F Supp 1168 (CD Cal 1995)]

EFFECT OF STATE COURT RULINGS

The DOL holds that only federal courts, not state courts or agencies, have jurisdiction to determine whether a DRO is a QDRO. [DOL Booklet, Q&A 1-12] However, some cases have held that it is appropriate for a federal court to defer to a prior state court determination that an order is a QDRO, without independent review of the merits [see, e.g., Board of Trustees of the Laborers Pension Trust Fund v Levingston, 816 F Supp 1496 (ND Cal 1993)]

The plan administrator is not required to review the correctness of a determination by a competent state authority that an individual is a spouse, former spouse, child, dependent, or surviving spouse of the participant. [DOL Adv Op 92-17A]

In *Blue v. UAL Corp.* [1998 US App Lexis 28246 (7th Cir 1998)], the husband alleged that the state court order was not a QDRO. The court held that ERISA does not require, or even permit, a plan to look beneath the surface of an order: "the spectacle of administrators second-guessing state judges' decisions under state law would be repellent . . . far better to let the states' appellate courts take care of legal errors by trial judges . . . plans may mechanically implement orders from state courts."

FIDUCIARY RESPONSIBILITY

If a plan fiduciary acts in accordance with the fiduciary-responsibility provisions of part 4 of Title I of ERISA in determining whether an order is a QDRO, or in making or withholding payments, then the plan's obligation to the participant and each alternate payee is discharged to the extent of the resulting payments. [ERISA § 206(d)(3)(I)]

In *Crosby v. Crosby* [986 F 2d 79, 1993], the Fourth Circuit held that, if a plan mistakenly pays the incorrect beneficiary before notification of a contrary claim, the plan need not pay the benefit again, so long as there is a good-faith basis for the payment. The correct beneficiary must recover the money from the person who was paid incorrectly.

WHO IS THE BENEFICIARY?

A surprising number of cases, affecting both pension plans and welfare plans, involve the following situation. The plan participant names his or her spouse as beneficiary. The parties are later divorced, and the divorce decree (or an agreement incorporated in the decree) includes either a general waiver or a specific waiver by each party of any claim against the other spouse's benefits. The participant then dies without changing the beneficiary designation. Who is the beneficiary? [See Who Is The Payee, Part VIII: Altobelli v IBM and the Other Benefit Waiver Cases, 5 (No. 3) ERISA Litig Rep 14 (August 1996)]

In *Fox Valley & Vicinity Construction Workers Pension Fund v. Brown* [897 F 2d 275 (7th Cir 1990)], the participant, James, named his wife, Laurine, as his beneficiary in 1986. Later that year, they divorced. In their marital property settlement, they agreed that "each waives any interest or claim in and to any retirement, pension, profit sharing and/or annuity plans resulting from the employment of the [other]." James died without having changed the beneficiary designation.

James's mother and Laurine both claimed the plan's death benefit. It was conceded that the property settlement agreement did not satisfy the formal statutory requirements for a QDRO. Laurine argued that, since that was so, the waiver was preempted by the ERISA anti-alienation rule. The majority held against her, holding that "a proper waiver of interest by a nonparticipant in a plan is not preempted by ERISA's anti-alienation" provision. Judge Easterbrook dissented, stating that ERISA Sectiou 206(d)(1) "bars the assignment of 'benefits'—that is payments under the plan—without regard to the identity of the person making that assignment."

In response to the argument that the court's rule would impose significant administrative burdens, the court said, with a breathtaking disregard for the realities of plan administration:

> No such additional burdens will be imposed because, under the ERISA statutory scheme, a plan administrator must investigate the marital history of a participant and determine whether any domestic relations orders exist that could affect the distribution of benefits. This case arose from just such an investigation. Our decision only requires plan administrators to continue their cur-

rent practice of thoroughly investigating the marital status of a participant.

A spousal waiver was also upheld in *Altobelli v. IBM* [77 F 3d 78 (4th Cir 1996)] A and his wife, D, were divorced in 1985. D was the beneficiary of A's group life insurance and thus was the default beneficiary of his pension benefits. D specifically waived any right to A's pension plans. When A died without changing the beneficiary designation, IBM wanted to pay the benefits to D. The district court held that she was entitled to the life insurance, but awarded the pension benefits to A's estate. Only IBM appealed, arguing that the waiver was invalid. The appeals court affirmed, agreeing with the Seventh Circuit that ERISA Section 206(d)(1) does not apply to a beneficiary's waiver.

Writing for the majority, Judge Ervin said that Congress's allowing QDROs "reveals that, in some situations, it deems the intent of the parties sufficiently important to override the policy of simplified administration." He then said that enforcement of a divorce decree's specific waiver of death benefits "would require no marginal infringement of [congressional] policy beyond the infringement already necessitated by the QDRO provisions, and since ERISA does not directly address the issue," it was appropriate to give effect to the waiver. In dissenting, Judge Wilkinson expressed concern about the disparity between the precise technical requirements for a QDRO and the vagueness of a rule that would require plans to review divorce decrees to determine whether they constituted a waiver of benefits by the nonparticipant spouse.

It seems that a waiver by a nonparticipant spouse should be permissible under ERISA, as is a disclaimer. [See GCM 39858, 1991] However, the court's analogy to QDROs is misplaced because the QDRO rules safeguard plans against unrecorded benefit claims by requiring that an order be submitted to the plan administrator for a determination on its status as a QDRO.

In *Brandon v. Travelers Insurance Company* [18 F 3d 1321 (5th Cir 1994)], H named W as his life insurance beneficiary. They were divorced. The court held that the state law divorce decree was preempted, but held that the beneficiary designation was revoked as a matter of federal common law. [See also Metropolitan Life Ins Co v Steffey, 1997 US App Lexis 30531 (6th Cir 1997); Metropolitan Life Ins Co v Pressley, 82 F 3d 126 (6th Cir 1996), *cert den* 117 S Ct 2431]

The Eighth and Tenth Circuit Courts of Appeals have held that a divorce settlement can waive pension plan benefits, but only if the waiver is specific.

In *Lyman Lumber Co. v. Hill* [877 F 2d 692 (8th Cir 1989)], the court held that a former spouse can waive pension benefits in a divorce settlement if the waiver specifically refers to and modifies the beneficiary interest.

Nada v. Arbeitman [89 F 3d 496 (8th Cir 1996)], involved two ERISA plans. Under one plan, the participant did not change the designated beneficiary to his surviving spouse subsequent to his divorce from his former spouse. Since the property settlement agreement between the former spouse and the participant did not make it clear that the former spouse was to lose her rights in the participant's benefits, the court held that the participant's former spouse (as the designated beneficiary) and his surviving spouse (as surviving spouse) were each entitled to receive half of his benefit. With respect to the second plan, the participant made no beneficiary designation and, therefore, the court held that the surviving spouse received 100 percent of the benefit under that plan.

In *Metropolitan Life Insurance Co. v. Hanslip* [939 F 2d 904 (10th Cir 1991)], the court agreed with the Eighth Circuit and held that the beneficiary designation on file with the plan administrator controls, unless the divorce decree dictates otherwise.

The Second and Sixth Circuit Courts of Appeals have held that the plan administrator need consider only the beneficiary designations on file with the plan, and thus a divorce decree cannot waive pension plan benefits.

In *McMillan v. Parrott* [913 F 2d 310 (6th Cir 1990)], the court held that a divorce settlement cannot effectively waive pension plan benefits because the plan administrator is to consider only the designation on file. [See also Metropolitan Life Ins Co v Pressley, 82 F 3d 126 (6th Cir 1996), *cert den* 117 S Ct 2431]

In *Kushner v. Colgate Palmolive Co.* [7 F 3d 11 (2d Cir 1993)], the court agreed with the reasoning of the Sixth Circuit and held that a divorce settlement cannot effectively waive pension benefits.

In view of the differing results in these cases, and the problems and costs created for the plans, it is clearly good practice to remind plan participants frequently of the importance of keeping beneficiary designations up to date. In addition, if the plan administrator has notice of a participant's divorce or impending divorce, it might be advisable to ask the participant whether the beneficiary designations should be changed.

One possible approach would be to include a reminder with the participants' year-end benefit state-

ments and possibly include, as part of the package, a listing of each participant's current beneficiaries, on record with the plan administrator, for each of the employer's pension and welfare plans. Another approach would be to include language in the plan's definition of the term "beneficiary," to attempt to reduce the number of possible conflicts and perhaps also spell out a procedure for resolving conflicts that is quicker and less expensive than litigation.

GOVERNMENTAL PENSIONS

Plans maintained by federal, state, and local governmental entities are exempt from the anti-alienation rules of ERISA and the Code and thus are not subject to the QDRO rules. Benefits under governmental plans can generally be divided on divorce, but only to the extent and in the manner provided by the governing statute.

The Former Spouses Protection Act [10 USC § 1408], authorizes state courts to treat the pay of military retirees as community property, and creates a QDRO-like mechanism for direct payment of state court awards to a former spouse, in both community property and separate property states. Under some states' laws, disability benefits are not marital property. Even if they are, state court marital property decrees do not reach military disability benefits. [McCarty v McCarty, 453 US 210 (1981)] With regard to federal employees, see also 5 USC Section 8341(h)(1).

The right of a divorced spouse to share in his or her ex-spouse's Social Security or Railroad Retirement benefits is governed by statute. [42 USC §§ 402(b)(1), 402(c)(1), 416(d); 45 USC § 231a(c)(4)]

DROs AFTER DIVORCE

A QDRO may be used to enforce an earlier support order and to collect arrears of alimony or child support. [See, e.g., In re Marriage of Bruns, 535 NW 2d 157 (Iowa App 1995); Baird v Baird, 843 SW 2d 388 (Mo App 1992)]

In *Hopkins v. AT&T Global Information Solutions Co.* [105 F 3d 153 (4th Cir, 1997)], H owed W arrears of alimony. After H's retirement, the state court (1) ordered that W be an alternate payee of pension benefits and (2) directed that she, rather than H's current spouse, be the payee of the surviving spouse benefits. AT&T argued successfully that the second order was not a QDRO, on the basis that the surviving spouse benefit vested in the current spouse on the participant's retirement; thus it was not a benefit payable with respect to a participant and therefore the order was not a QDRO. The court failed to distinguish between a benefit payable *to* a participant and a benefit payable *with respect to* a participant.

The Fourth Circuit affirmed. The court also adduced a practical reason for its holding: "Because the disbursement of plan benefits is based on actuarial computations, the plan administrator must know the life expectancy of the person receiving the Surviving Spouse Benefits to determine the participant's monthly Pension Benefits. As a result the plan administrator needs to know on the day the participant retires, to whom the Surviving Spouse Benefit is payable." [105 F 3d 153, 157]

EFFECT OF THE PARTICIPANT'S BANKRUPTCY

If the plan participant is bankrupt, are the alternate payee's rights under a QDRO dischargeable in the bankruptcy? Federal bankruptcy law [11 USC § 523(a)(5)] generally provides that maintenance obligations are not dischargeable.

In *In re Gendreau* [122 F 3d 815 (9th Cir 1997)], H and W divorced in 1992. The court awarded W 50 percent of the pension benefits that H had accrued during the marriage. In January 1993, the court entered a decree intended to be a QDRO. In May 1993, the plan administrator determined that the order was not a QDRO. In November 1993, H filed a chapter 7 bankruptcy petition and sought to discharge W's claim under the QDRO. His motion was denied, and the Ninth Circuit affirmed the denial. The court held that the alternate payee's interest in a pension plan is not a debt of the participant that is dischargeable in the participant's bankruptcy, even if the DRO has not yet been qualified by the plan. See also *In re Reines* [142 F 3d 970 (7th Cir 1998)] and Bnsh v. Taylor. [912 F 2d 989 (8th Cir 1990)]

SHOULD THE PLAN BE A PARTY TO THE MATRIMONIAL ACTION?

The plan generally need not be a party to the action in which the DRO is issued. "Indeed, because state law is generally preempted to the extent that it relates to pension plans, the Department takes the position that pension plans cannot be joined as a party in a domestic relations proceeding pursuant to state law." [DOL Booklet, Q&A 1-2]

However, under the California Family Code, a DRO is not enforceable against a plan unless the plan has been joined as a party to the action for dissolution of the marriage. Accordingly, in California and other states with similar laws, the plan will generally be made a party to the action.

TAX CONSEQUENCES OF QDROS

If the alternate payee is the spouse or former spouse of the participant, the alternate payee is taxable on the benefits received under the QDRO. [IRC § 402(e)(1)]

In determining the taxable portion of installment payments from the plan, regulations are to provide that the investment in the contract is to be allocated, on a pro rata basis between the present value of the payments to the alternate payee and the present value of all other benefits payable with respect to the participant. [IRC § 72(m)(10)]

The special five- or ten-year averaging rules for lump-sum distributions will apply to benefits payable to an alternate payee, if the participant would be entitled to claim such treatment at the time of the distribution.

An alternate payee who is the spouse or former spouse of the participant may roll over any eligible rollover distribution, tax free. [IRC § 402(e)(1)] If the alternate payee receives a distribution of property other than cash, the amount transferred must consist of the property received or the proceeds of sale of the property. [IRC § 402(a)(6)(F)(iii)]

For the purpose of determining whether a lump-sum distribution has been made, the balance to the credit of a participant will not include amounts payable to an alternate payee under a QDRO. [IRC § 402(d)(4)(H)]

If the alternate payee is not the spouse or former spouse of the participant, the participant is taxable on the amounts paid to the alternate payee under the QDRO. The same result occurs if payments are made to a spouse or former spouse under an order that is determined not to be a QDRO. The participant may roll over to an IRA an amount equal to the alternate payee's distribution on which the participant will otherwise be taxable. [IRS Notice 89-25, Q&A 3, 4] If the distribution includes property other than cash, the participant may be unable to satisfy the requirement that the property distributed be rolled over, since the property distributed is now the property of the alternate payee.

Who is taxed if a nonspouse alternate payee receives benefits after the participant's death? Under the general rules relating to income in respect of a decedent, the distribution would be taxed to the recipient when it is actually received. [IRC § 691]

Payments to an alternate payee are not subject to the 10 percent premature distribution penalty tax, regardless of the age of the participant or the alternate payee. [IRC § 72(t)(2)(C)] This exception applies only to distributions from qualified plans and not to distributions from IRAs.

Hawkins v Commissioner [86 F 3d 982 (10th Cir 1996)] involved whether H or W was taxable on a $1 million pension distribution paid to W from H's plan under a marital dissolution decree. W argued that the order was not a QDRO because (1) it did not create, recognize, or assign to her the right to receive plan benefits and (2) it did not clearly specify the facts required by Code Section 414(p)(2). Disagreeing with *Wheaton*, the Tax Court held that "section 414(p)(2) should be accorded its plain meaning, and not interpreted so as to allow the parties to omit the requested information whenever it is convenient or even perhaps logical to do so." The Tax Court held that the decree did not satisfy the statutory definition of a QDRO, and that H was thus taxable on the distribution. The Tenth Circuit reversed, holding that the decree substantially complied with the QDRO requirements, and that this was sufficient.

A state court cannot decide who pays federal income tax with respect to payments made under a QDRO. [Clawson v Commissioner, TCM 1996-446]

If a divorce decree directs that payments be made to the nonparticipant spouse from a nonqualified retirement plan, those payments are nevertheless taxable to the participant spouse, under the assignment of income doctrine. [See, e.g., Ltr Rul 9340032]

CONCLUSION

Correct processing and administration of QDROs is a difficult task. Although the QDRO provisions were enacted in 1984, many important questions have no clear answers, and the numerous court decisions are hard to reconcile. Against this background, it is important that plans have clear and comprehensive QDRO procedures, so that the plan administrator can respond promptly to any order that is received. Also, it is essential for the plan administrator to remember that, wherever its sympathies actually lie, the processing of a QDRO is a fiduciary responsibility, and it must act impartially in its dealings with the participant and the alternate payee.