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Avoiding Client Dissatisfaction Related to the Qualified Domestic Relations Order Process
by Matthew L. Lundy

When it comes to client satisfaction, an attorney cannot control the outcome of a case, but has control over the expectations they set for their clients. Family law attorneys can apply these principles to managing their client's expectations when dealing with the retirement account division process, otherwise known as the qualified domestic relations order or QDRO (*i.e.*, the QDRO process). When not managed correctly, unrealistic client expectations often lead otherwise satisfied clients to being dissatisfied—sometimes long after the case is thought to be over. With a proper explanation to a client, combined with the effective execution and completion of the QDRO process, client dissatisfaction rarely occurs. This article addresses some of the common mistakes made by family law attorneys when setting client expectations related to the QDRO process, and offers recommendations on how to avoid those mistakes.

Timing of Completing a QDRO or Similar Order

By far the most common mistake family lawyers make when it comes to setting client expectations related to the QDRO process is assuming that the QDRO process comes with some kind of guarantee regarding timing. This is to say, when a client asks how long it will take to get their share of retirement from the other party's account, a lawyer must be mindful of 29 U.S.C. § 1056(d)(3)(G)(i)(II), which provides, in pertinent part:

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within a reasonable period after receipt of such order, the plan administrator shall determine whether such order is a qualified domestic relations order and notify the participant and each alternate payee of such determination.

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As a practical matter, this means that the plan administrator has no precise time limit as to how long they can take to review and administer an order. While certain timetables may be safely assumed, generally, promising a client that the QDRO process will be quick can lead to unrealistic expectations and dissatisfaction. If an attorney is not familiar with a particular plan (keep in mind there are over 100,000 plans nationwide, and the number is growing) and its qualification process, it is best to avoid estimating anything shorter than several months from the time the QDRO is prepared.

Timing of Entry of a QDRO or Similar Order

The appropriate time in a case to have a QDRO entered is simultaneously with a final divorce decree, if not earlier. In the event a final decree is entered and a QDRO has not yet been completed, a participant could die, retire, and/or engage in wrongdoing that may cause irreparable harm to the payee spouse (who may be the practitioner's client).

For example, imagine that an alternate payee has been granted 50 percent of a participant's Bank of America defined benefit pension plan, plus survivor benefits. A final decree is entered, but no QDRO has been entered. The participant spouse leaves the courthouse, and makes an irrevocable election to receive his or her benefits immediately as a single life annuity, thereby foreclosing the possibility of the alternate payee spouse ever getting his or her survivor benefits. Now imagine that instead of retiring, the participant spouse dies while walking out of the courthouse. Their retirement plan then goes to their estate, to which the payee spouse no longer has an entitlement. Whose fault is this? Who will the alternate payee blame?

Which Plans Require QDROs?

Not all retirement plans require QDROs. For example, individual retirement accounts (IRAs) do not necessitate the use of a QDRO to effectuate division of the accounts, since they are established by an individual and not an employer. I.R.C. § 414(p)(1)(B) (along with ERISA 29 U.S.C. § 1056 (d)(3)) defines what a QDRO is, and what plans QDROs apply to).

It is important to note that there are not any laws that prevent IRAs from requiring that a QDRO or QDRO-like order be prepared so the IRA custodian is directed to effectuate a transfer. In fact, many IRA and annuity custodians demand that they be directed by QDRO to effectuate any transfers to a former spouse as a part of a domestic relations case. Thus, unless a lawyer is absolutely certain that a particular IRA does not require a QDRO, he or she should reserve their right to obtain one in the future.

Note that government retirement plans are exempt from the Employee Retirement Income Security Act (ERISA), but many around the country have QDRO-like orders that go by different names, including but not limited to, COAP (court order acceptance for processing) or DRO (domestic relations order) or PADRO (plan-approved domestic relations order). Each of these plans, like IRAs and most ERISA-based accounts, have unique rules that one must be acquainted with to properly divide them. Thus, if an attorney is not acquainted with the processes established by a particular plan, it is best to avoid making assumptions that one plan is similar to another.

Tax Consequences

Generally, the distributee of a payment from a retirement plan is going to be taxed on the distribution.[1] Thus, when a QDRO or similar order is administered, and direct payment is made from a retirement plan to an alternate payee, the participant will not experience any tax consequences but an alternate payee will.

When dealing with a defined contribution plan, there are generally two tax consequences and one exception to each of those consequences that a family lawyer needs to know about. First, any distribution made to a party from a defined contribution will be subject to regular income tax, unless the payment is made from a Roth IRA or 401(k).[2] Second, any distribution made from a defined contribution plan prior to age 59 ½ will be subject to a 10 percent penalty. A limited exception to the 10 percent penalty exists when a distribution is made pursuant to a QDRO. To be clear, when an ERISA-based qualified defined contribution plan is divided pursuant to a QDRO, the payee spouse has the option of taking a distribution rather than a rollover that will be subject to regular income tax, but not subject to the 10 percent penalty, even if the payee is younger than 59 ½.[3] This does not include government plans.

This becomes a useful rule if a client has consented to a QDRO during a case to pay fees or temporary support, since both parties can potentially benefit from this 10 percent penalty exemption.

Valuation Dates and Passive Gains and Losses

When parties execute a settlement agreement, they often fail to specify a valuation date. Under New Jersey law, the cut-off date for marital assets is the date of marriage. However, parties may agree to use virtually any date of their choosing, as long as it is allowable under a particular retirement plan. When parties' use ambiguous settlement agreement language, such as stating a dollar amount or percentage without specifying a valuation date, the potential for unnecessary litigation is created. This is particularly true when the market is volatile, or there has been a long divorce case and a pension has changed in value throughout the case.

The same issue arises when parties and their attorneys fail to specify whether or not passive gains/losses apply to an award from a defined contribution plan. Parties often wait months or years to have their QDROs or similar orders drafted and administered, and accounts will likely wildly fluctuate in value during that time. Therefore, if a dollar amount is specified in a settlement agreement, and that dollar amount represents a certain percentage of an account as of an intended date, that amount when actually distributed may represent significantly more or less of the account, which may, in turn, lead to a dissatisfied client and/or litigation.

Survivor Benefits

There is no more important, nor more misunderstood ancillary economic benefit related to retirement accounts than survivor benefits. Again, it is critical that the family law practitioner *specify* whether or not the payee spouse will receive all or a portion of any pre- or post-retirement survivor benefits, or they may be lost completely. Otherwise, there may be grounds for litigation or, worse yet, a payee spouse may completely lose the benefit of being awarded a portion of the pension. Note that most survivor benefits come at a cost, in the form of a reduction to the monthly pension annuity, and that although they are generally only associated with defined benefit plans, they can also come into play with annuitized defined contribution plans.

Federal and Military Age 55 Rule

In representing the payee spouse of a member of the military or a federal civilian employee who is entitled to a pension, it is critical to advise the client that if he or she remarries prior to age 55, he or she is not entitled to survivor benefits.[4] Advising a client of this is not only important for the purpose of setting client expectations, but also in order to give the client the opportunity to make informed decisions about which assets they actually want as part of their divorce, and to properly plan for their future.

Conclusion

When encountering retirement plans in family law cases, special attention is *always* required. No two plans are the same, and many of the most common plans are governed by totally different sets of laws. However, with proper discovery, and close attention to detail, the proper division of a retirement plan can be relatively simple.

Matthew L. Lundy *practices in Cherry Hill.*

Endnotes

1. *See* I.R.C. § 72(a)(1).
2. *See* I.R.C. § 408A(d).
3. *See* I.R.C. § 72(t).
4. *See* 10. U.S.C. § 1450(b); 5 C.F.R. § 831.644(b).