

McGUIREWOODS

**‘Til Death (Or Some Other Time)
Do We Part: The Intersection of
Divorce and Estate Planning**

Washington D.C. Estate Planning Council

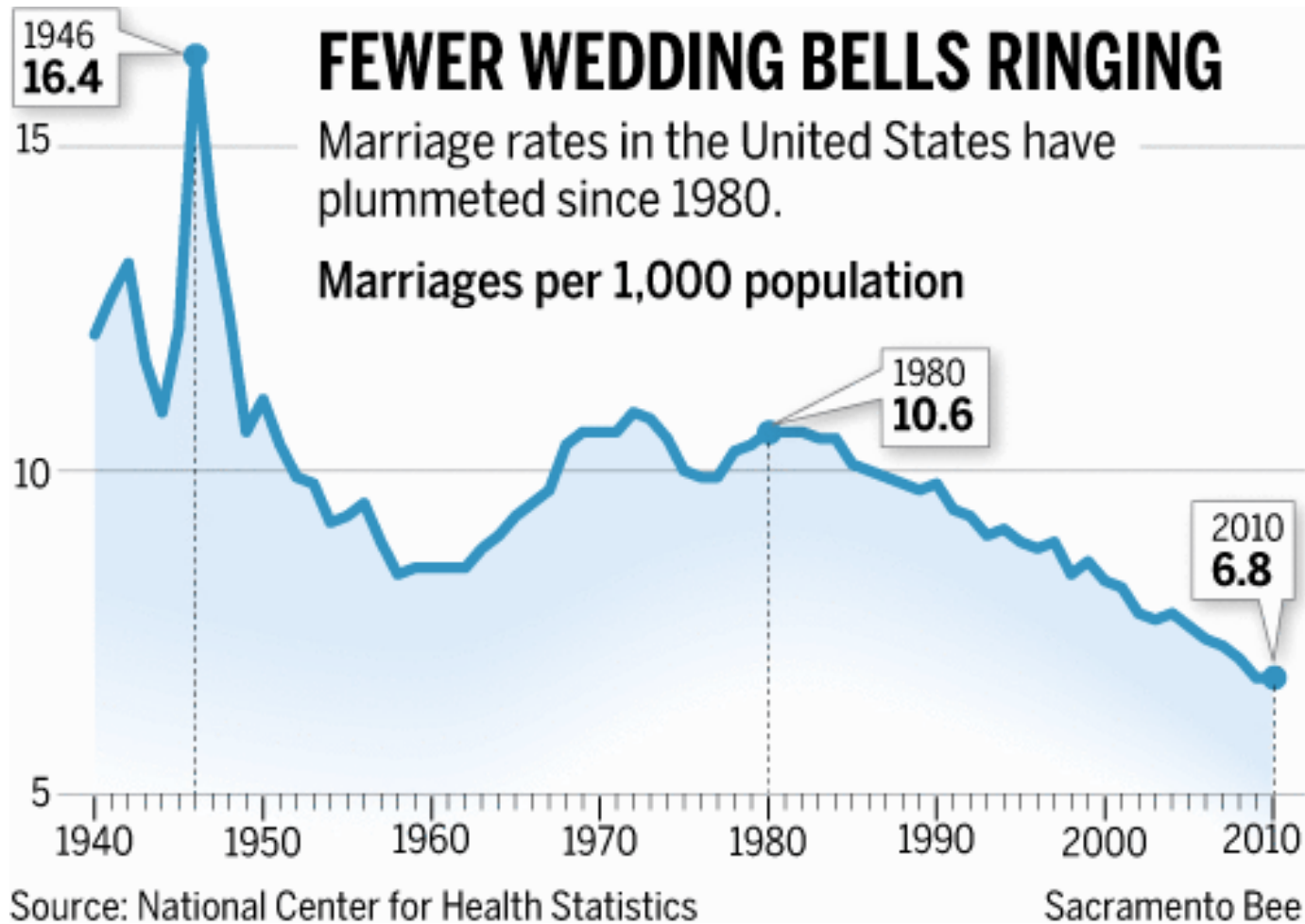
October 18, 2018

Washington D.C.

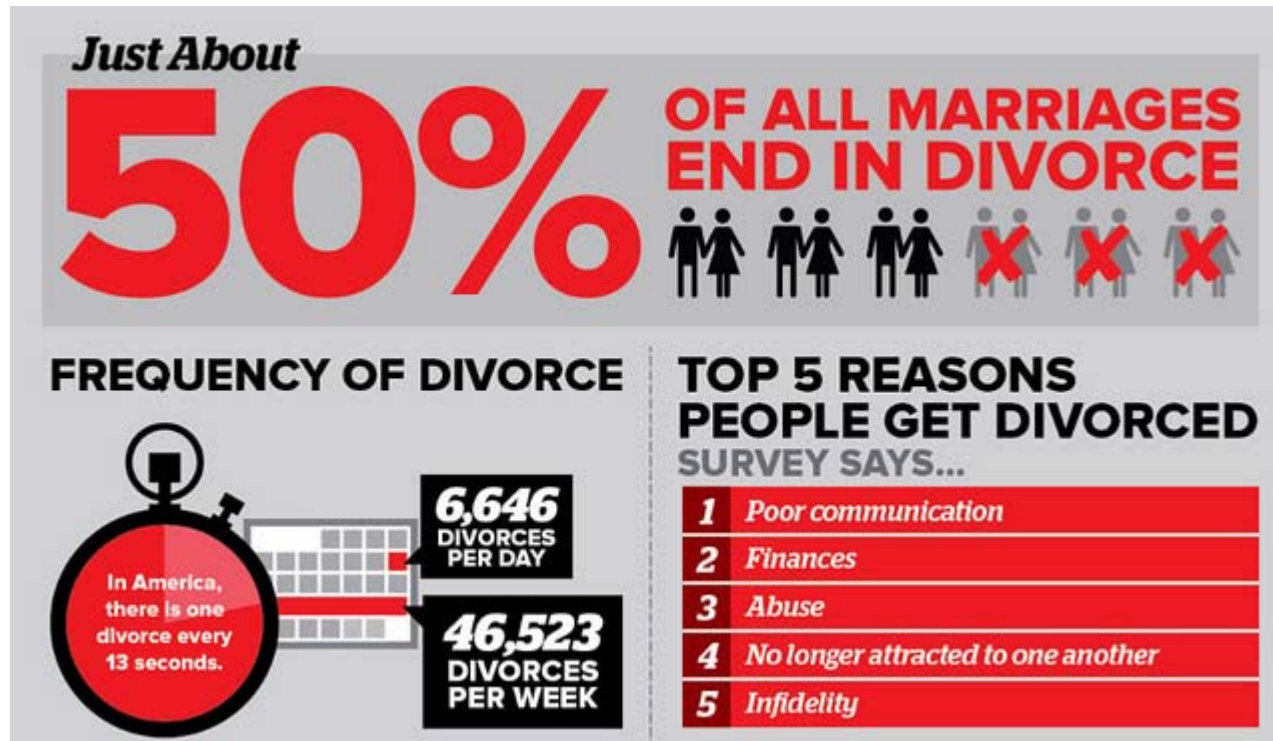
Bill Sanderson

Robert Wynne

'Til Death Do We Part



'Til Death Do We Part



'Til Death Do We Part

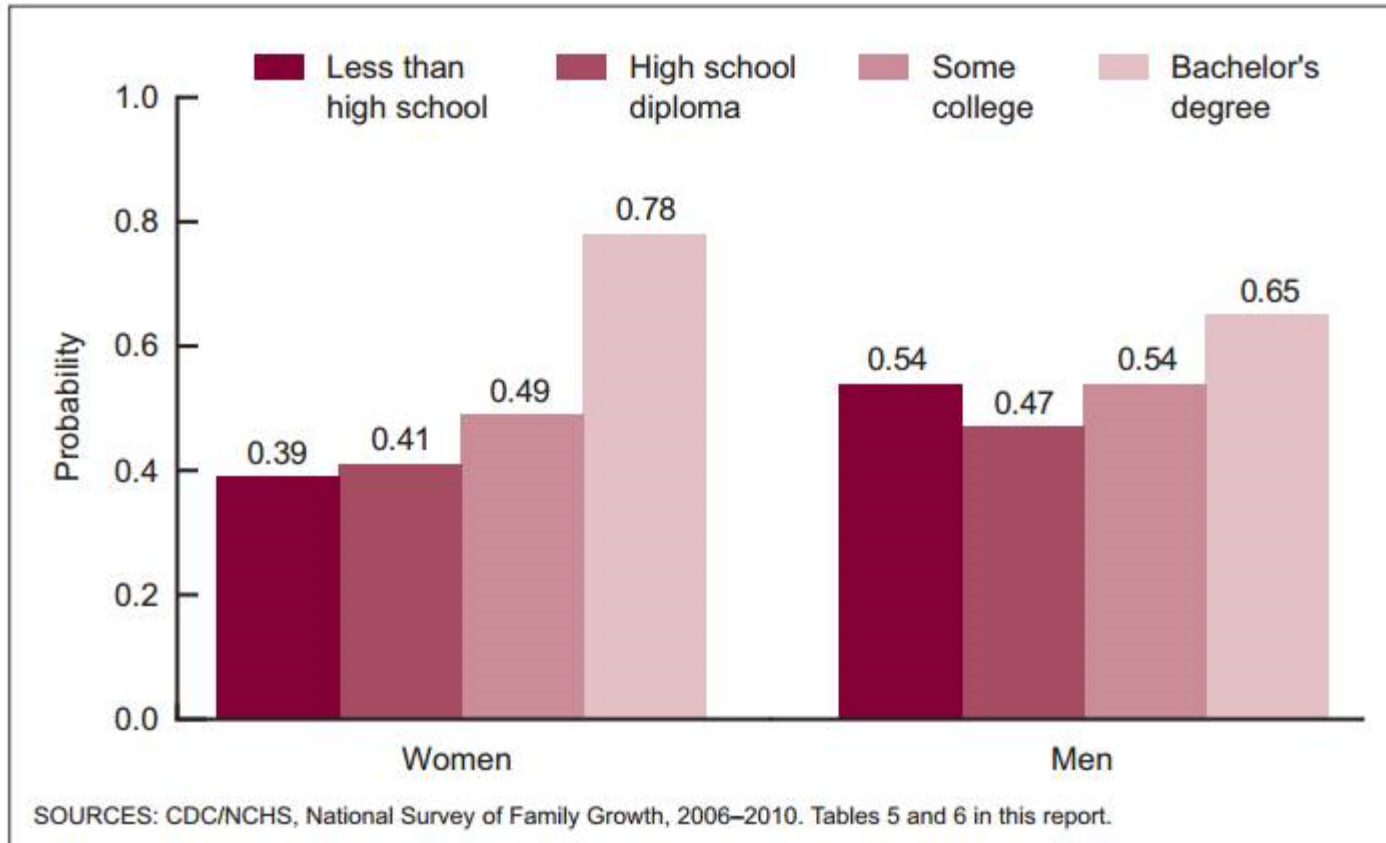
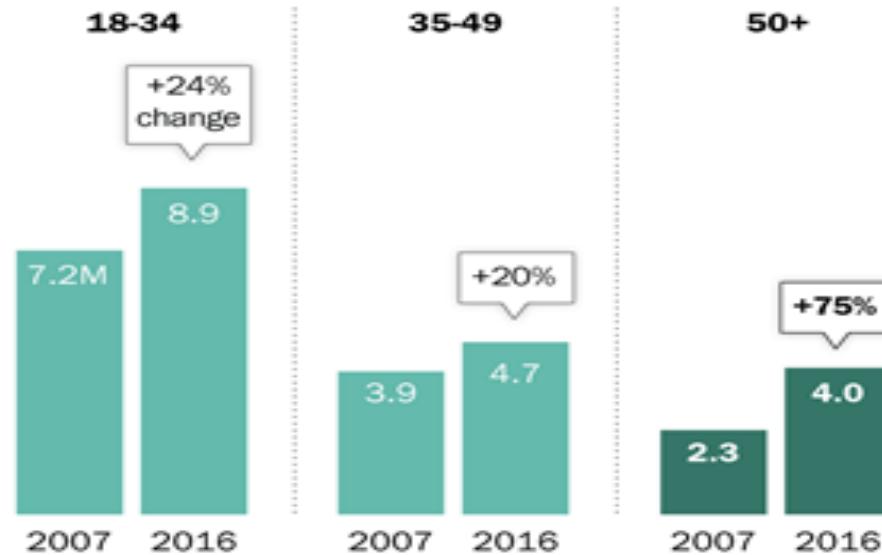


Figure 5. Probability that a first marriage will remain intact (without disruption) for 20 years among women and men 22–44 years of age by education: United States, 2006–2010

'Til Death Do We Part

Since 2007, the number of cohabiting adults ages 50 and older has risen 75%



Source: U.S. Census Bureau Table AD-3 and Pew Research Center analysis of 2007 and 2016 Current Population Survey, Annual Social and Economic Supplements (IPUMS).

PEW RESEARCH CENTER

Source: Renee Stepler, Number of U.S. adults cohabiting with a partner continues to rise, especially among those 50 and older (<http://www.pewresearch.org/fact-tank/2017/04/06/number-of-u-s-adults-cohabiting-with-a-partner-continues-to-rise-especially-among-those-50-and-older/>)

'Til Death Do We Part

| All Individual Income Tax Returns Reporting <u>Alimony Paid</u> | | |
|---|-------------------|--------------|
| Adjusted Gross Income | Number of Returns | % of Returns |
| All Returns | 586,253 | 100% |
| Under \$50,000 AGI | 143,708 | 25% |
| \$50,000 < \$75,000 | 76,276 | 13% |
| \$75,000 < \$100,000 | 80,380 | 14% |
| \$100,000 < \$200,000 | 164,127 | 28% |
| \$200,000 < \$500,000 | 90,094 | 15% |
| Over \$500,000 | 31,667 | 5% |

Source: IRS Statistics of Income Division; Table 1.4. All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2016 (Filing Year 2017)

'Til Death Do We Part

| All Individual Income Tax Returns Reporting <u>Alimony Received</u> | | |
|---|-------------------|--------------|
| Adjusted Gross Income | Number of Returns | % of Returns |
| All Returns | 415,515 | 100% |
| Under \$50,000 AGI | 231,281 | 56% |
| \$50,000 < \$75,000 | 91,784 | 22% |
| \$75,000 < \$100,000 | 36,565 | 9% |
| \$100,000 < \$200,000 | 43,935 | 11% |
| \$200,000 < \$500,000* | 11,949* | 3%* |
| Over \$500,000* | * | * |

* Data combined by IRS to avoid disclosure of information for specific taxpayers.

Source: IRS Statistics of Income Division; Table 1.4. All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2016 (Filing Year 2017)

'Til Death Do We Part

| All Individual Income Tax Returns Reporting <u>Alimony Paid</u> | | |
|---|-------------------|--------------|
| Adjusted Gross Income | Number of Returns | % of Returns |
| All Returns | 586,253 | 100% |
| Under \$50,000 AGI | 143,708 | 25% |
| \$50,000 < \$75,000 | 76,276 | 13% |
| \$75,000 < \$100,000 | 80,380 | 14% |
| \$100,000 < \$200,000 | 164,127 | 28% |
| \$200,000 < \$500,000 | 90,094 | 15% |
| Over \$500,000 | 31,667 | 5% |

Source: IRS Statistics of Income Division; Table 1.4. All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2016 (Filing Year 2017)

'Til Death Do We Part

| All Individual Income Tax Returns Reporting <u>Gambling Earnings</u> | | |
|--|-------------------|--------------|
| Adjusted Gross Income | Number of Returns | % of Returns |
| All Returns | 1,974,960 | 100% |
| Under \$50,000 AGI | 778,991 | 39% |
| \$50,000 < \$75,000 | 345,763 | 18% |
| \$75,000 < \$100,000 | 268,807 | 14% |
| \$100,000 < \$200,000 | 410,080 | 21% |
| \$200,000 < \$500,000 | 135,760 | 7% |
| Over \$500,000 | 35,561 | 2% |

Source: IRS Statistics of Income Division; Table 1.4. All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2016 (Filing Year 2017)

'Til Death Do We Part: The Intersection of Divorce and Estate Planning

- Effect of Divorce on Estate Planning
 - In DC, we have:
 - D.C. Code § 18-109
 - *Estate of Liles*, 435 A.2d 379 (D.C. App. 1981)
 - *Estate of Reap v. Malloy*, 727 A.2d 326 (D.C.App. 1999)
 - In Virginia, they have:
 - Code of Virginia § 64.2-412
 - In Maryland, they have:
 - MD Code, Estates and Trusts, §4-105 (4)
- But don't forget the importance of premarital agreements...

‘Til Death Do We Part: Beneficiary Designations at the Intersection of Divorce and Estate Planning

Bolle v. Hume, 619 A.2d. 1192 (D.C. App. 1993).

***UBS Financial Services Inc. v. Children*, No. 1:12cv74, July 15, 2013, U.S. District Court.** Blank IRA Beneficiary Designation Leads to Lawsuit.

***Maretta v. Hillman*, 133 S. Ct. 1943 (2013).** Revocation of Benefits Incident to Divorce. The U.S. Supreme Court confirmed that Virginia law granting third parties the right to recover FEGLI benefits from a former spouse is preempted by federal law.

***Van Den Broek v. Tang*, No. CL 2013-12884, Mar. 5, 2014, Fairfax Circuit Court.** Decedent’s Federal Benefits Pass to Ex-Wife, Not Surviving Spouse. In a case involving federal benefits under a Thrift Savings Plan (“TSP”), the Fairfax Circuit Court has concluded that federal law preempts the terms of a property settlement agreement in a divorce.

ERISA Plan Documents Rule

- ERISA requires every plan to specify the basis on which benefit payments are made, including payments due upon a participant's death
- Plan fiduciaries (e.g., plan administrator, trustees, etc.) have a fiduciary duty to follow plan documents, including terms governing beneficiary designations
- Plans frequently allow participants to designate beneficiaries and contain default provisions in cases where there are no designations or surviving beneficiaries
- Due to spousal protection requirements in ERISA and the Code, plans generally require spouses of married participants to be the beneficiary (unless properly waived)
- Divorcing couples need to update beneficiary designations for all ERISA plans to reflect their intentions and avoid unintended consequences

Kennedy v. Plan Administrators for DuPont Savings and Investment Plan

- Participant died, leaving \$400k in DuPont Plan
- Participant's wife was designated as beneficiary
- Couple divorced pursuant to a decree providing a divestment of all rights to benefits in any retirement plan
- Participant never changed beneficiary designation
- Ex-wife and participant's daughter (on behalf of estate) both filed claims. Plan administrator paid ex-wife (the designated beneficiary), then the daughter sued the plan to recover the benefits
- Supreme Court: waiver ineffective; plan document and beneficiary designation control, both of which required the plan administrator to pay the ex-wife
- Post-*Kennedy*, waivers generally available only if plan allows them
- Note: The IRS has approved a disclaimer of an interest in a qualified plan when the disclaimer satisfies rules under Code Section 2518

ERISA Preemption

- ERISA generally preempts state laws that “relate to” employee benefit plans
- Although areas of traditional state regulation like family law have benefitted from a presumption against preemption, that presumption can be overcome if the state law conflicts with ERISA or sufficiently relates to ERISA plans

Egelhoff v. Egelhoff

- U.S. Supreme Court considered a state law that, in the event of a participant's divorce, automatically revoked any beneficiary designation in favor of a participant's former spouse (former spouse is deemed to have pre-deceased the participant)
- This type of law attempted to correct the issue in *Kennedy* – participant neglects to change beneficiary designation post-divorce
- Supreme Court: ERISA preempted this state law and similar state laws to the extent that they purport to apply to 401(k) and other ERISA plans
- Post-*Egelhoff*, plans will need to pay death benefits consistent with plan docs (written beneficiary designation or plan's default rules) regardless of whether the designated beneficiary is a participant's former spouse

Bottom Line

- Assume ERISA Plan Documents and Preemption Rules will apply over any inconsistency in any divorce decrees, settlements, judgments and/or orders and regardless of party intent
- Regularly encourage updates to beneficiary designations and understanding of consequences for the failure to keep designations current
- Review plan documents and summary plan descriptions to understand provisions governing QDROs, beneficiary designations, revocation rules and/or waivers

Tax-Qualified Retirement Plan Issues in Divorce

- Providing support payments and/or dividing marital property through Qualified Domestic Relations Orders (QDROs)
- Avoiding unintended consequences with beneficiary designations

QDROs

Background

- Major portion of individual wealth is developed through the accumulation of assets in employer-sponsored, tax-qualified retirement plans
- Generally, ERISA and the Code prohibit assignment/alienation of benefits
- QDRO rules are the exclusive means of enforcing marital and community property rights under qualified plans
- Unless a domestic relations order is determined by a plan to be “qualified” under the QDRO rules, those assets may be lost for an ex-spouse
- Pre-nuptial agreements, post-marital agreements, divorce decrees, dissolution orders and settlement agreements are all items that are not QDROS
 - However, these documents can become QDROs (or become part of a QDRO) if they meet certain requirements and are accepted by the plan administrator as “qualified”

What is a QDRO?

- Domestic relations order (DRO)
- That creates or recognizes the existence of an “alternate payee’s” right to receive, or assigns to an AP the right to receive, all or a portion of the benefits payable with respect to a participant under a plan
- That contains certain required information
- The doesn’t contain certain impermissible provisions

What is a DRO?

- To be recognized as a QDRO, an order must first be a DRO, which is:
 - A judgment, decree, or order (including the approval of a property settlement)
 - That is made pursuant to state domestic relations law (including community property law) and
 - That relates to the provision of child support, alimony payments, or marital property rights for the benefit of a spouse, former spouse, child, or other dependent of a participant
- A state authority (usually a court) must actually issue the judgment, decree or order (or formally approve a property settlement agreement)
- No requirement for divorcing couple to sign the DRO
- Not necessary to bring the plan into state court or made a party to a domestic relations proceeding

DROs Must Have

- Name and last known mailing address of the participant and each AP
- Name of each plan to which the order applies
- Dollar amount or percentage (or method of determining the amount or percentage) of the benefit to be paid to the AP
- The number of payments or time period to which the order applies

DROs Must Not Require a Plan to . . .

- Provide an AP or participant with any type or form of benefit, or any option, not otherwise permitted under the plan
- Provide for increased benefits (determined on the basis of actuarial value)
- Pay benefits to an AP that are required to be paid to another AP under another order previously determined to be a QDRO
- Pay benefits to an AP in the form of a QJSA for the lives of the AP and his or her subsequent spouse

Other Things You Should Know

- QDROs can be part of the divorce decree or property settlement agreement, or issued as a separate order
- If an AP is a minor or legally incompetent, QDRO can provide for payment to someone with legal responsibility for the AP (e.g., guardian or party acting *in loco parentis* in the case of a child, or trustee as agent for the AP)
- QDROs can assign rights to benefits under more than one plan of the same or different employers (so long as each plan and the assignment of benefit rights under each plan are clearly specified)
- Although every QDRO must contain certain provisions, the specific content of the rest of the order will depend on the type of plan, the nature of the participant's benefits, the purposes behind issuing the order, and the intent of the drafting parties

Issues to Consider When Drafting QDROs

- Why are benefits being divided?
 - To provide support payments (temporary or permanent) to the AP?
 - To divide marital property in the course of dissolving a marriage?
- What drafting approach facilitates these goals?
 - “Shared payment” approach (i.e., splitting the benefit to give AP part of each payment) often used in support orders when participant has already begun receiving a stream of payments from the plan (e.g., life annuity)
 - “Separate interest” approach (i.e., dividing the benefit into two separate portions with the intent of giving the AP a separate right to receive a portion to be paid at a time and in a form different from that chosen by the participant) often used to divide a benefit as part of the marital property upon divorce

Issues to Consider When Drafting QDROs

- What kind of plan is involved?
 - Important because an order cannot be a QDRO unless its assignment of rights or division of benefits complies with the terms of the plan
 - Note: ERISA provides participants and beneficiaries statutory right to receive plan docs upon 30 days' written request to plan administrator
- Should AP receive a right to any survivor benefits under the Plan?
 - Generally, if a participant divorces spouse prior to his or her “annuity starting date,” the divorced spouse loses all rights to the plan’s survivor benefits (e.g., QJSA/QPSA rights, death benefits, etc.). However, to the extent a QDRO requires that a former spouse be treated as the participant’s surviving spouse for all or part of the survivor benefits payable after the participant's death, any subsequent spouse of the participant cannot be treated as the participant’s surviving spouse

Issues to Consider When Drafting QDROs

- For orders relating to DC plans, parties should consider addressing the possibility of contingencies occurring that may affect the account balance (and AP's share) during the determination period
 - Specify source of AP's share when account is invested in multiple investments
 - Allocation of income/loss attributable to participant's account
 - Outstanding plan loans
- If shared interest approach is used, what happens to AP's benefit if the participant dies?
- Does the plan have a model QDRO? Will they review and pre-approve a draft?

The Plan's Perspective

- Plan administrator is the person/entity responsible for determining the qualified-status of a DRO
- Plan administrators are subject to ERISA fiduciary requirements – must discharge their duties prudently and solely in interest of participants and beneficiaries
- Plans are required to establish reasonable procedures to determine QDRO status and to administer distributions pursuant to QDROs
- Plan administrators required to provide notice of receipt of DROs and furnish copies of the plan's QDRO procedures
- During determination process, plans must separately account for the amounts that would be payable to an AP under the terms of the DRO during such period if the order had been determined to be qualified
- Plan's frequently prepare model QDROs for parties to use or will review draft orders before being formalized

Questions

www.mcguirewoods.com