Qualified Domestic Relations Orders

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I. Introduction

Exception to Anti-Alienation Requirements

Both the Internal Revenue Code ("Code") and the Employee Retirement Income Security Act of 1974 ("ERISA") impose anti-alienation provisions on covered plans designed to prevent both participants and their creditors from reaching assets of covered plans. [IRC Section 401(a)(13); ERISA Section 206(d)]

The Qualified Domestic Relations Order ("QDRO") rules, enacted as part of the Retirement Equity Act ("REA"), provide an exception to the anti-alienation requirements of both the Code and ERISA.

Because the QDRO rules only apply to plans subject to the vesting requirements of the Code, without the application of IRC Section 411(e)(2) or plans subject to ERISA, as applicable, these rules do not apply to Individual Retirement Accounts unless part of an otherwise covered ERISA plan. This means that generally an order need not qualify as a QDRO in order to provide for the division of an IRA. Further, these rules do not apply to government plans or to church plans that have not elected to be covered by "ERISA". [Treas. Reg. Section 1.401(a)-13(a)]

Special rules for Governmental and Nonelecting Church Plans

However, distributions from governmental plans or from church plans are treated as made pursuant to a QDRO if made pursuant to a domestic relations order which creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant under the plan. [IRC §414(p)(11)]

Preemption

ERISA generally preempts all state laws insofar as they relate to employee benefit plans covered by title I of ERISA. [ERISA Section 514(a)] However, in order not to interfere with the ability of spouses to obtain marital property, alimony or child support, Section 514(b)(7) provides an exception for QDROs. As such, to the extent that an order constitutes a QDRO, the plan not only is not prohibited from making payment in accordance with the order, but is required to do so. [ERISA Section 206(d)(3)(A)]
II. Special Fiduciary Exculpatory Provision

ERISA provides that if a plan fiduciary acts in accordance with its fiduciary responsibility provisions in:

(a) treating a domestic relations order as being (or not being) a qualified domestic relations order, or

(b) taking action in accordance with Section 206(d)(3)(H) (i.e., the 18 month segregation rule), then

the plan’s obligation to the participant and each alternate payee is discharged to the extent of any payment made pursuant to ERISA. [ERISA Section 206(d)(3)(I)] See, for example, the court’s analysis in Blue v. UAL Corporation, 160 F. 3d 383 (7th Cir. 1998).

Query, however, to what extent the Internal Revenue Service will be willing to give the plan relief from any violation of the anti-alienation qualification requirement if the plan makes payment in accordance with an order subsequently determined to not constitute a QDRO?

III. What is a QDRO

A. Basic Definition

A QDRO means a domestic relations order which creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant under a plan, and which sets forth certain minimum specifications required under the statute and avoids violating other requirements similarly identified in the statute. [IRC Section 414(p)(1)(A)]

Thus, in order to constitute a QDRO, an order must first qualify as a domestic relations order.

B. Domestic Relations Order

A domestic relations order is any 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 of a spouse, former spouse, child, or other dependent of a participant and which is made pursuant to a state domestic relations law, including a community property law. [IRC §414(p)(1)(B)]

Note that in one Private Letter Ruling, the IRS concluded that an assignment of a participant’s account under a QDRO to secure the participant’s non-retirement plan obligations to a former spouse was permitted under the Code’s QDRO provisions. The ruling concludes that the order can constitute a QDRO if it otherwise satisfies the requirements. [Private Letter Ruling 200252093, 12/26/2002]
The facts involved the drafting of two separate QDROs applicable with respect to the same plan. The first QDRO, a typical order, assigned a portion of the participant’s account in the plan to the alternate payee and allowed the alternate payee to take a distribution of the amount and to roll it over to an IRA. The remaining portion of the participant’s account not part of this assignment remained the participant’s sole property. However, the parties proposed to draft a second QDRO which would provide for a security interest in the participant’s unassigned portion to secure the payment of other non-retirement plan obligations pursuant to the divorce.

The ruling request represented that the parties would seek to enter, as the QDRO required by the Martial Settlement Agreement, an order, which incorporated inter alia the terms of the security interest. The parties represented that the order would be (1) a domestic relations order which assigned to an alternate payee a right to receive a portion of a participant's plan benefit, and (2) an order which meets the terms of paragraphs (2) and (3) of Code section 414(p).

The ruling concludes that the security interest would constitute an assignment which would be incorporated in a QDRO. Because it would be an assignment of a right pursuant to a QDRO, it would be an assignment that is permitted under Code Section 401(a)(13)(B). Accordingly, the ruling concludes that the creation of the security interest will be an assignment permitted pursuant to Code Section 401(a)(13)(B).

Note, however, plans should take care in accepting and certifying similar orders based solely upon the issuance of this Private Letter Ruling which, by its nature, is not binding on those to whom it was not issued.

Moreover, at least one court has reached a contrary concluding holding that a security interest on a participant’s Section 401(k) account purporting to secure the participant’s obligations pursuant to a divorce but outside of the plan do not give rise to a QDRO as no benefit is involved.

Specifically, in Winters v. Kutrip, 2002 WL 31122808 (3rd Cir. 2002), the Consent Decree issued pursuant to the couple’s divorce ordered the participant to pay to his former spouse approximately $150,000 which was to be secured by the participant’s interest in various retirement plans including his employer’s Section 401(k) plan. The plan never recognized the security interest and when the participant died with a new spouse, paid the spouse the benefit pursuant to the beneficiary designation on file. In upholding the lower court’s decision that the Consent Decree could not rise to the level of a QDRO, the Court of Appeals first notes that ERISA has an anti-alienation provision which, with one narrow exception, precludes the assignment of a participant's interest in a covered plan. That narrow exception is a QDRO. In the absence of a QDRO, a plan violates ERISA if it transfers funds to anyone other than the participant or his designated beneficiary. The court notes that one of the requirements that must be satisfied in order that a domestic relations order may constitute a QDRO is that the order must specify: