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DIVISION OF NON-QUALIFIED RETIREMENT BENEFITS IN DIVORCE

Qualified Retirement Plans. The majority of retirement plans are “qualified” retirement plans. Favorable tax treatment applies to qualified retirement plans that satisfy the qualification requirements of Internal Revenue Code Section 401. The thrust of most of the qualification requirements is to assure that plans cover a fair cross section of all employees and do not discriminate unfairly in favor of highly compensated employees. The principal tax advantages of a qualified plan are (1) the tax deduction available immediately to the plan sponsor for contributions made to the plan by the plan sponsor and (2) the deferral of taxation on earnings of the retirement fund and benefits until benefits are actually paid. Qualified retirement plans are generally subject to division by QDRO.

Non-Qualified Retirement Plans. Many employers (especially larger, more profitable firms) have “non-qualified” retirement plans in addition to qualified retirement plans. Non-qualified plans cover only a select group of executive or highly compensated employees and usually provide benefits in excess of the maximum benefits that may be provided by qualified retirement plans. These plans are typically referred to as “excess benefit plans” or “top hat plans.” Non-qualified plans are generally not subject to the QDRO rules of the Retirement Equity Act of 1984.

Division of Non-Qualified Retirement Plans. Although most non-qualified plans will not accept or honor QDROs, non-qualified plan benefits can still be assigned. Some non-qualified plans will accept and honor a plain “domestic relations order” (a domestic relations order other than a QDRO) that may assign retirement benefits but cannot usually grant alternate payees certain other rights that are permitted under QDROs (such as the right to begin benefits before the participant has retired or the right to be treated as the participant’s surviving spouse). The majority of non-qualified plans will not honor any DRO. However, orders can still be prepared requiring the participant to pay directly all awarded benefits that the plan will not pay.

Do Not Overlook Non-Qualified Plans. Because non-qualified plans are less numerous, cover fewer participants and are not generally subject to the same disclosure requirements as qualified plans, these plans may be less visible and can easily be overlooked. To avoid constructive receipt that would trigger immediate taxability to participants, most non-qualified plans are unfunded and non-qualified benefits are theoretically subject to a substantial risk of forfeiture. The risk of forfeiture may be the requirement to work to a specified retirement age before benefits are paid, non-compete requirements, the need to provide certain consulting services after retirement, the risk of the plan sponsor becoming bankrupt or abandoning the non-qualified plan or other similar risks or requirements. Because of these risks and the uncertainty of qualifying for and receiving benefits,

participants frequently try to minimize the importance of non-qualified plans by saying that they may never receive any non-qualified benefits. However, in the majority of cases, participants ultimately do receive their non-qualified benefits that may be substantial in amount. A properly prepared DRO can subject the benefits awarded to the alternate payee to the same risks as the benefits retained by the participant. Thus, there is no need to ignore non-qualified plans and, in fact, failure to discover and reflect non-qualified benefits in divorce settlement may expose a practitioner to malpractice claims.

Other Issues. Because assigned non-qualified benefits must frequently be paid by the participant rather than by the plan, the parties may be forced to deal with and rely on each other more than is desirable. Generally, non-qualified benefits are taxable to the participant rather than the alternate payee. Therefore, assigned non-qualified benefits usually must be reduced for anticipated taxes.

Anti-Circumvention Provision. An anti-circumvention provision is a provision intended to prevent or nullify any action taken by a participant to prevent, decrease or limit any benefits intended to be paid to the alternate payee. There is a much greater need for a strong anti-circumvention provision in a DRO dividing a non-qualified plan than in a QDRO dividing a qualified plan. This is so because (1) the usual governmental regulation of qualified plans is lacking in the case of non-qualified plans, (2) plan decisions are frequently made by other executives or other highly compensated employees (a group to which the participant belongs), (3) the participant may have a much more direct role and latitude in carrying out or influencing the actual assignment of benefits, and (4) the benefit amounts involved may be so substantial that the incentive for devious action is increased. Participants who intend no devious actions should have no reason to object to the inclusion of an anti-circumvention provision. The inclusion of an appropriate anti-circumvention provision in a DRO dividing non-qualified benefits is so vital to the alternate payee that failure to include such a provision may expose a practitioner to malpractice claims.

QDRO Professionals drafts DROs for non-qualified plans. We depart from our usual fee structure, however, because individual plans can vary considerably and it is quite difficult to obtain information about non-qualified plan rules. Accordingly, please contact us if you encounter a non-qualified plan and would like assistance with its division.

This article is not a substitute for legal advice. If you need legal advice, please contact Jon Mallin at 248.865.4700 or by e-mail at INFO@QDRO.PRO.