DIVISION OF BENEFITS IN MARRIAGE DISSOLUTION

Mary M. Potter
Jeffrey R. Glovan
Cox Smith Matthews Incorporated
112 E. Pecan Street, Suite 1800
San Antonio, Texas 78205

State Bar of Texas
EMPLOYEE BENEFITS LAW 2008
Thursday, May 1, 2008
Dallas

CHAPTER 7

TABLE OF CONTENTS

Page

I. RETIREMENT PLANS; QUALIFIED DOMESTIC RELATIONS ORDERS AND DOMESTIC RELATIONS ORDERS
A. Introduction to QDROs ... 1
1. General Rule Against Anti-Alienation of Benefits ... 1
2. Some Basic Definitions ... 1
3. Requirement to Maintain Written QDRO Procedures ... 1
4. Receipt of a DRO and Separate Accounting ... 2
5. Tax Treatment ... 3
B. QDROs of Defined Benefit Plans vs. Defined Contribution Plans ... 3
1. Defined Benefit Plans ... 3
2. Defined Contribution Plans ... 3
C. Separate Interest Approach vs. Shared Interest Approach ... 3
1. Separate Interest Approach ... 3
2. Shared Interest Approach ... 5
D. Common QDRO Problems and Pitfalls ... 5
1. Valuation Dates of Plan; Specified Date of Calculation ... 5
2. Tracing Issues ... 6
3. Awards of a Specific Dollar Amounts ... 6
4. Failure to Correctly Name the Plan ... 6
5. Failure to Consider Potential Future Vesting ... 6
6. Plan Loans ... 6
7. QDRO Provisions that Conflict with or Fail to Conform to Plan ... 6
8. Rollover Accounts, Accounts from Other Employers, and After-Tax Contributions ... 7
9. “Cashouts” of Small Amounts ... 7
10. Division of Specific Assets ... 7
11. Rights of Alternate Payees ... 7
12. Subsequent Benefit Increases; Early Retirement Subsidies ... 7
13. Language in the QDRO with No Legal Effect ... 8
E. Charging The Participant or Alternate Payee ... 8
F. 403(b) Plans, 457(b) Plans, Governmental and Church Plans ... 8
1. Plans of Tax-Exempt Organizations ... 8
2. Plans of Governments and Non-Electing Churches ... 9
G. QDRO Issues for Nonqualified Deferred Compensation Plans ... 10
1. Nonqualified Plans and QDROs ... 10
2. Tax Treatment of Nonqualified Deferred Compensation Plan QDROs ... 11
3. Code Section 409A and Regulations ... 11
H. Benefits Not Subject to Division by a QDRO ... 12
1. Nonqualified Stock Options and Nonqualified Deferred Compensation ... 12
2. Incentive Stock Options and Employee Stock Purchase Plans ... 12
3. Archer MSAs ... 12
I. Application of QDROs to Welfare Benefit Plans ... 13
J. Model QDRO Forms and Other Resources ... 14

II. GROUP HEALTH PLANS; QUALIFIED MEDICAL CHILD SUPPORT ORDERS
A. Introduction to QMCSOs ... 14
1. ERISA Section 609; Basic Definitions ... 14
2. Employers Subject to QMCSOs ... 15
3. Requirement to Maintain QMCSO Policies and Procedures ... 15
4. National Medical Child Support Notice ... 16
5. Texas Law Pertaining to QMCSOs ... 16
B. Common QMCSO Problems ... 17
1. Plans with More than One Level of Benefits ... 17

2. Plans that Require Dependents to Have the Same Coverage as the Participant 17
3. Multiple Alternate Recipients 17
4. Preexisting Condition Exclusions 17
5. Employees Not Enrolled in the Plan and Waiting Periods 18
6. Effective Date of Enrollment 18
7. Plans Offering No Dependent Coverage 18
8. Health FSA and Cafeteria Plan Issues 18
9. Payment of Benefits or Reimbursements 19
10. Wage Withholding Limitations 19
C. COBRA 19
D. HIPAA Privacy Rule 19
E. Model Forms 20

APPENDIX A SAMPLE QDRO PROCEDURES (DEFINED CONTRIBUTION PLAN)

APPENDIX B MODEL QDRO FORMS (DEFINED CONTRIBUTION PLAN, PARTICIPANTS IN PAY STATUS)

APPENDIX C MODEL QDRO (DEFINED CONTRIBUTION PLAN, PARTICIPANTS NOT IN PAY STATUS)

APPENDIX D MODEL QMCSO

APPENDIX E QUALIFIED MEDICAL CHILD SUPPORT ORDER PROCEDURE

Employee Benefits Issues in Marital Dissolution

Mary M. Potter
Jeffrey R. Glovan

I. RETIREMENT PLANS; QUALIFIED DOMESTIC RELATIONS ORDERS AND DOMESTIC RELATIONS ORDERS

A. Introduction to QDROs

1. General Rule Against Anti-Alienation of Benefits

As a condition to qualification under Section 401(a) of the Internal Revenue Code ("Code"), a trust forming part of a stock bonus, pension, or profit-sharing plan must provide that benefits provided under the plan may not be assigned or alienated. Code § 401(a)(13). Furthermore, Section 206(d)(1) of the Employee Retirement Income Security Act of 1974 ("ERISA") demands that all pension plans provide that plan benefits may not be alienated. However, these anti-alienation provisions do not apply to assignment of pension benefits or recognition of separate rights to benefits under an order that meets specific legal requirements that make it "qualified," that is, a "qualified domestic relations order" or "QDRO." Code § 401(a)(13)(B); ERISA § 206(d)(3). Affected Plans must also pay benefits in accordance with the terms of a QDRO. ERISA § 206(d)(3)(A).

2. Some Basic Definitions

The limited exception to anti-alienation and assignment of benefits is set forth in Code Section 414(p) and ERISA Section 206(d)(3). A QDRO is 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. Code Section 414(p)(1)(A)(i); ERISA Section 206(d)(3)(B)(i)(I). Moreover, a QDRO must clearly specify (i) the name and the last known mailing address (if any) of the participant and the name and mailing address of each alternate payee covered by the order; (ii) 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 such amount or percentage is to be determined; (iii) the number of payments or period to which such order applies; and (iv) each plan to which such order applies. Code Section 414(p)(2); ERISA Section 206(d)(3)(C). Finally, a QDRO cannot contain any provision that requires the plan (i) to provide any type or form of benefit, or any option, not otherwise provided under the plan; (ii) to provide increased benefits (determined on the basis of actuarial value); and (iii) pay benefits to an alternate payee which are required to be paid to another alternate payee under another order previously determined to be a QDRO. Code Section 414(p)(3); ERISA Section 206(d)(3)(D).

Likewise, "domestic relations order" is defined broadly to mean any judgment, decree, or order (including approval of a property settlement agreement) which relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of a participant, and that is made pursuant to a State domestic relations law (including a community property law). Code Section 414(p)(1)(B); ERISA Section 206(d)(3)(C)

An "alternate payee" is any spouse, former spouse, child or other dependent of a participant who is recognized by a DRO as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant. Code Section 414(p)(8); ERISA Section 206(d)(3)(K). An alternate payee is considered to be a beneficiary under the plan for all purposes of ERISA. ERISA § 203(d)(3)(J).

At first glance, the process of qualifying a court order as a QDRO might seem to be a straightforward matter. However, the relatively straightforward language in the Code and ERISA is deceptively simple; QDRO practice is fraught with numerous traps pitfalls that even the most diligent and seasoned practitioner is apt to fall prey to. A practitioner's best tools to negotiate the QDRO quagmire include proficiency in the applicable Code and ERISA provisions, and a strong familiarity with the plan in question. Common QDRO problems and pitfalls are discussed below in Section I.D.

3. Requirement to Maintain Written QDRO Procedures

Both the Code and ERISA require a plan to establish reasonable procedures for determining whether domestic relations orders are QDROs and for administering distributions under QDROs. ERISA § 206(d)(3)(G)(ii); IRC § 414(p)(6)(B). The Code does not elaborate on the meaning of "reasonable," but ERISA imposes additional requirements not found in the Code. ERISA Section 206(d)(3)(G)(ii)(I) specifically requires the plan's QDRO procedures to be in writing. Furthermore, the procedures must provide that each person specified in the DRO as entitled to benefits under the plan will receive notice of the plan's QDRO procedures, and that alternate payees must be allowed to designate a representative for receipt of copies of notices sent to the alternate payee with respect to the DRO. ERISA § 206(d)(3)(G)(ii)(II)-(III). In addition to the foregoing

statutory requirements for plan procedures, the Department of Labor takes the position 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." Department of Labor, "The Division of Pensions Through Qualified Domestic Relations Orders," 2-5 ("DOL QDRO Manual," available at http://www.dol.gov/ebsa/publications/qdros.html). Thus, in designing QDRO procedures, practitioners and plan administrators may want to review this DOL publication, which suggests that a plan's QDRO procedures should include explanations regarding several facets of the plan's QDRO determination process.

4. Receipt of a DRO and Separate Accounting

When a plan receives a DRO, the plan administrator must "promptly" notify the affected participant and each alternate payee named in the DRO that the plan has received the DRO. ERISA § 206(d)(3)(G)(i); IRC § 414(p)(6)(A). At the same time, the plan administrator must provide the foregoing persons a copy of the plan's QDRO procedures at the address included in the domestic relations order. *Id*. The plan administrator then has a reasonable period of time to determine whether the DRO is a QDRO, and then must promptly notify the participant and each alternate payee of the determination. *Id*. Exactly what constitutes a reasonable determination period is not specified in the QDRO statutes. The DOL advises that "reasonableness" will turn on the specific facts and circumstances of the case at hand, and that observance of the plan's QDRO procedures should ensure timely determinations. DOL QDRO Manual, 2-10.

While the qualified status of a DRO is being determined (regardless of the party making that determination), ERISA and the Code require the plan administrator to separately account for the amounts (referred to as "segregated amounts") that would be payable to the alternate payee under the DRO during such period as if the DRO were already a QDRO. ERISA § 206(d)(3)(H)(i), 404(a); Code § 414(p)(7)(A). During this determination period, the plan administrator must take steps to ensure that the segregated amounts are not distributed to the participant or any other person. DOL QDRO Manual, 2-11, 2-12.

The plan administrator's duty to separately account for and to preserve the segregated amounts is limited to a period of 18 months. ERISA § 206(d)(3)(H)(v); Code § 414(p)(7)(E). This "18-month period" does not begin until the first date that the DRO would require payment to the alternate payee. *Id*. The DOL points out that the 18-month period cannot begin before the plan receives a DRO. DOL QDRO Manual, 2-11. Rather, to ensure the availability of a full determination period, the "18-month period" will begin on the first date on which a payment would be required to be made under DRO following receipt by the plan. *Id*. Note, however, that in practice some plan administrators place a hold on a participant's account to delay the payment of benefits if they become aware that the plan may receive a DRO with respect to that participant. This practice was specifically authorized in the Conference Committee Report to the Tax Reform Act of 1986, which stated 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."

If the plan administrator determines that a DRO is a QDRO within the 18-month period, the plan administrator then pays the segregated amounts to the alternate payee in accordance with the terms of the QDRO. ERISA § 206(d)(3)(H)(ii); Code § 414(p)(7)(B). If a DRO is determined not to be a QDRO, or if the issue is not yet resolved, within the 18-month period, then the plan administrator must pay the segregated amounts to the person or persons who would have been entitled to such amounts as if the DRO did not exist (usually the participant). ERISA § 206(d)(3)(H)(iii); Code § 414(p)(7)(C). If the DRO is determined to be a QDRO after the expiration of the 18-month period, the DRO applies only prospectively. ERISA § 206(d)(3)(H)(iv); Code § 414(p)(7)(D). Thus, the alternate payee would be entitled only to amounts payable under the DRO after the time of the subsequent determination.

Note that if the plan administrator determines that a DRO is qualified before benefits are payable to the alternate payee, the plan administrator has a continuing duty to account for and to protect the alternate payee's interest in the plan in the same manner the plan administrator is obliged to account for and to protect the interests of the plan's participants. DOL QDRO Manual, 2-12. The plan administrator is also obligated to pay benefits in accordance with the QDRO when benefits become payable to the alternate payee. *Id*.

When a plan administrator rejects a DRO as unqualified, the plan administrator may face requests for distribution of benefits from the participant (which ordinarily the plan administrator would be obligated to pay) that conflict with the plan administrator's duty to preserve assets that may be distributable to the alternate payee. To reduce the likelihood of such

conflicts, the plan's QDRO procedures may provide for placing a "hold" on the account. The procedure may also provide for review of draft DROs. Such preliminary review will allow the plan administrator to postpone a final determination regarding a DRO for a limited period, and will allow the parties greater opportunity to correct any deficiencies in a DRO during the 18-month period.

5. Tax Treatment

If a distribution or payment is made from a qualified plan to an alternate payee pursuant to a QDRO, and the alternate payee is the participant's spouse or former spouse, the alternate payee's portion is taxable to the spouse or former spouse as the "distributee." Code §§ 402(a); 402(e)(1)(A). The spouse or former spouse alternate payee may also roll over amounts so paid as provided in Code Section 402(c). Code §402(e)(1)(B). However, a distribution to the participant's dependent child as alternate payee under a QDRO is includible in the gross income of the participant, and a nonspouse alternate payee may not treat the distribution as a rollover. Notice 89-25, Q&A 3l Q&A 4.

B. QDROs of Defined Benefit Plans vs. Defined Contribution Plans

One of the most significant factors that practitioners must consider when drafting a QDRO is the type of plan to which the QDRO will apply. Without an understanding of the type of plan at issue, the drafter can anticipate much greater difficulty in qualifying a DRO because a DRO cannot be a QDRO unless its assignment of rights or division of benefits complies with the terms of the plan. The type of plan will affect the types of benefits available for assignment, and will influence how the parties choose to assign the benefits. There are two basic types of qualified plans to which QDROs apply: defined benefit plans and defined contribution plans.

1. Defined Benefit Plans

A "defined benefit plan" promises to pay each participant a specific benefit at retirement that is generally paid in the form of an annuity (e.g., periodic payments for the participant's life beginning at the plan's normal retirement age). The basic retirement benefits are usually based on a formula that takes into account the number of years a participant has worked for the employer and the participant's salary. This regular benefit may increase over time, before and/or after benefit commencement, due to factors such as salary increases, grants of additional service credit with the employer, or plan amendments. Defined benefit plans may also provide other forms of benefit, such as a lump sum distribution, joint and survivor annuities, or "term certain" payments for a period of years.

2. Defined Contribution Plans

Unlike defined benefit plans, "defined contribution plans" are retirement plans that provide for an individual account for each participant. Importantly, defined contribution plans do not provide a specific benefit to a participant. Rather, the participant's benefits under the plan are based solely on the amount contributed to the participant's account, which is adjusted over time by income, expenses, gains, and losses to the account. Examples of defined contribution plans include profit sharing plans (including the popular "401(k)" plan), employee stock ownership plans ("ESOPs"), and money purchase pension plans. Defined contribution plans commonly permit retirement benefits to be paid in the form of a lump sum payment (although annuities or other benefit forms may also be allowed).

C. Separate Interest Approach vs. Shared Interest Approach

There are two common (and mutually exclusive) approaches to dividing retirement benefits in a QDRO. The first approach awards a wholly separate interest in the participant's retirement benefits to the alternate payee. This is sometimes referred to as the "separate interest" or "separate payment" method. In contrast, the "shared interest" or "shared payment" method merely allows the alternate payee to share in the payment of the participant's retirement benefits. When deciding which approach to use, practitioners must consider a number of factors, such as whether the participant has begun to receive benefits from the plan, whether the plan is a defined benefit plan or defined contribution plan, and the manner in which the parties have agreed to divide the participant's retirement benefits. Neither approach is required by federal law, and the task of drafting the DRO falls to the parties based upon the way they decide will best achieve the purposes for which the plan benefits are being divided. Practitioners may wish to refer to Chapter 3 of the DOL QDRO Manual, selected portions of the Pension Benefit Guaranty Corporation's booklet "Qualified Domestic Relations Orders & PBGC" (available at http://www.pbgc.gov/docs/QDRO.pdf), and Notice 97-11 for guidance on these benefit division methods. Much of what is presented below has been culled from these sources.

1. Separate Interest Approach

A separate interest QDRO divides the participant's benefits into two separate parts: one for the participant and one for the alternate payee. This variety of QDRO divides the participant's entire retirement benefit (as opposed to dividing the stream

of payments) into two separate portions. The thrust of a separate interest QDRO is to give the alternate payee a separate right to receive a portion of the retirement benefit to be paid at a time and in a form different from that chosen by the participant. The precise division of the benefit may be an amount or percentage that the parties select. Furthermore, a separate interest QDRO may provide that the alternate payee can determine the form in which his or her benefits are paid and when benefit payments commence.

An alternate payee under a separate interest QDRO will generally enjoy the advantage of exercising control over the timing and form of his or her benefit payments (subject to the terms of the plan and as discussed in more detail below). This means that the alternate payee could start his or her payments before the participant (subject to certain restrictions), and receive annuity benefits (if available under the plan) over his or her lifetime rather than the participant's lifetime. If offered by the plan, the alternate payee could also choose a life and term certain annuity or a term certain annuity that may provide limited benefits to the alternate payee's beneficiary. Finally, the alternate payee could receive surviving spouse benefits under the participant's remaining separate interest if the separate interest method is used, although not all plans permit this. However, most plans require that a separate interest QDRO may be used only if the participant's benefit payments have not started when the DRO is submitted to the plan administrator for qualification because the participant's form of benefit has already been selected. In other words, if a participant is in "pay status," the parties are limited to dividing the form of benefit previously chosen, and therefore must use a shared interest QDRO. Nevertheless, some plans, especially governmental plans, do permit the parties to restructure benefits already in pay status into a separate interest award.

Practitioners should take into account a number of issues if benefits are to be divided by a separate interest QDRO depending on the type of plan at issue.

a. Defined Benefit Plan Considerations

Separate interest QDROs dividing benefits under a defined benefit plan must consider whether the plan offers subsidies, and whether future increases in benefits are available under the plan. Defined benefit plans may pay benefits in a variety of forms, and at different times. These time and form differentials can be significant because benefits paid at certain times or in certain forms may have a greater actuarial value than "basic" retirement benefits payable at normal retirement age. To illustrate, defined benefit plans commonly allow a participant to begin receiving benefits from the plan at an "early retirement date." Some plans actuarially reduce the amount of an early-retiring participant's benefit to account for the longer period for which benefits are likely to be paid. However, some plans will not reduce the benefit at all; this is referred to as "subsidized" early retirement benefit. The plan may only partially reduce the benefit at early retirement, in which case the benefit would be "partially subsidized." Participants are usually not entitled to a subsidy unless they have met special eligibility requirements. Eligibility for these benefit increases will often entail working for the employer for a minimum number of years, attaining a certain age, or some combination of the two. For example, a plan with a "Rule of 85" might grant additional benefits if the participant has attained at least age 55, and the participant's years of service for the employer plus the participant's age equal at least 85.

(1) Benefit Increases After Entry of a QDRO

A participant's basic retirement benefits under a defined benefit plan may increase due to circumstances that occur after a QDRO has been entered. Events that would cause such an increase include post-divorce increases in salary, crediting of additional years of service, or amendments to the plan's provisions. Examples of such amendments include a cost of living adjustment, or an increase in a benefit payment equal to $100 per month multiplied by the participant's years of service to $105 per month multiplied by years of service. The treatment of such benefit increases should be considered when drafting a QDRO.

(2) QDRO Drafting Issues

To adequately address a subsidy or benefit increase, a QDRO (whether separate or shared interest) must specify the amount or percentage of the subsidy or benefit increase, if any, that the alternate payee will receive should the participant become entitled to either such benefit. The plan's QDRO procedures can act as a safety net in a case where a DRO is silent by providing that all such benefits will be divided pro rata.

b. Defined Contribution Plan Considerations

Often in a defined contribution plan, the participant's account will be invested in more than one investment fund. If the plan provides for participant-directed investments, the separate interest QDRO should address how the alternate payee's interest will be invested.

(1) Alternate Payee Fails to Act

In particular, the QDRO should state how the alternate payee's interest will be invested in the

absence of direction by the alternate payee. If the QDRO is silent on this count, the plan administrator will have to decide how to invest the alternate payee's share, which potentially subjects the plan administrator to fiduciary liability with respect to those investment decisions. A QDRO (or the plan's QDRO procedures) may provide that the alternate payee's awarded interest will be invested in the plan's default investment vehicle if the alternate payee fails to act.

(2) Subsequent Contributions

Furthermore, a participant's account balance in a defined contribution plan may increase after the QDRO has been entered as future contributions or plan forfeitures are allocated to the participant's account. If the parties desire to assign all or a portion of such future allocations to the alternate payee, the separate interest QDRO should state the manner in which these allocations will be divided. In Texas, the parties will not ordinarily divide future plan contributions (which would be separate property) between the participant and the alternate payee except in the case of certain delayed contributions attributable to the time in which the participant and alternate payee were married.

2. Shared Interest Approach

A shared interest QDRO simply splits the benefit payments from the plan between the participant and the alternate payee. Shared interest QDROs may be used regardless of whether the participant has started payments. This variety of QDRO provides that the alternate payee will commence receiving benefit payments at the onset of the participant's payments, or at the time the DRO is accepted as a QDRO, if the participant has already begun to receive benefits from the plan. Note that only shared interest QDROs may be used if a participant is already receiving benefits from the plan when the QDRO is entered. While use of this variety of QDRO obviates many of issues that arise with separate interest QDROs, shared interest QDROs are not without their disadvantages.

a. Limits on Timing of Payments to Alternate Payee

A necessary result of using a shared interest QDRO is that the alternate payee cannot start receiving benefits before the participant starts receiving benefits. Furthermore, payment of benefits to the alternate payee will stop when the benefit option chosen by the participant terminates. However, a shared interest QDRO may also assign a right to survivor benefits or other plan benefits to the alternate payee. The alternate payee under a shared interest QDRO would also be unable to exercise investment control over the alternate payee's awarded interest in a defined contribution plan.

b. Period to Which the QDRO Applies

All QDROs must specify when the alternate payee's right to share the payments begins and ends, but this issue is quite important for shared interest QDROs. (Separate interest QDROs usually satisfy this requirement by providing the alternate payee the right to elect the time and form of benefit). In the absence of such a directive, the DRO would fail to qualify as a QDRO. In spite of the particularity demanded by the QDRO statutes when using a shared interest QDRO, the parties are afforded some flexibility not available with a separate interest QDRO. For example, the QDRO might state that payments to the alternate payee will end when the alternate payee remarries. If payments end upon the occurrence of a specific event, the QDRO should require the alternate payee or the participant to provide notice and reasonable substantiation to the plan that the event has occurred.

D. Common QDRO Problems and Pitfalls

The QDRO statutes assume that the plan administrator will be making the determination as to whether a DRO is qualified. A plan administrator, of course, is a plan fiduciary. The plan administrator may seek the advice of another service provider, such as the plan's counsel, for assistance in making the determination. No custodian of funds, however, should ever honor a domestic relations order without having it subjected to full review under the QDRO statutes and plan provisions in order to determine whether the DRO is indeed qualified. The payment of benefits under a nonqualified order may subject the payor to liability to the plan participant, persons claiming under the participant, or other alternate payees.

1. Valuation Dates of Plan; Specified Date of Calculation

DROs frequently attempt to award a percentage of the participant's account balance as of the date of divorce, and possibly a pro rata share of earnings carried forward from that date to date of distribution without determining what the plan's valuation dates are. However, plans may be valued annually, every business day of the year, or at some other interval. In this regard, defined contribution plans will tend to pose more problems than defined benefit plans, where the calculation of benefits is largely built into the plan. A DRO which does not specify the method of calculating the alternate payee's award, including the date of calculation, may not qualify under the plan at issue.

Another challenge facing plan administrators is when a DRO is issued several years after the participant and the alternate payee divorced that

attempts to award the alternate payee a portion of the participant's benefit as of the date of divorce. To make such an award, the plan administrator would have to trace the value of the participant's account or benefit back to that date, taking into account subsequent additions and earnings. As a practical matter, this may be an incredible administrative burden, and some plans will refuse to honor such a DRO.

2. Tracing Issues

A defined contribution DRO that is submitted years after the date of division imposes a tracing burden that some third party administrators will not address. For example, a DRO may simply provide that 50% of the contributions made during the marriage, plus earnings thereon, be awarded. In a 401(k) plan especially, this amount may be difficult to determine.

3. Awards of a Specific Dollar Amounts

A DRO that awards a specific dollar amount to the alternate payee presents special problems because the value of the participant's account will fluctuate over time. Such a DRO should not be approved unless the DRO adequately addresses the possibility that the participant's account or payments might be less than the amount awarded. For example, the DRO could provide that the alternate payee is awarded "the lesser of $X or the entire vested account of the participant as of the date of division," or could require the participant to make up any deficiency out of his or her own pocket.

4. Failure to Correctly Name the Plan

Code Section 414(p)(2)(D) and ERISA Section 206(d)(3)(C)(4) plainly state that a DRO is not a QDRO unless the DRO clearly specifies "each plan to which such order applies." Nevertheless, DROs all too frequently fail to satisfy this straightforward requirement. Note that neither the Code nor ERISA requires that the DRO provide the *exact* name of the plan. Therefore, where the plan administrator can determine with reasonable certainty the plan to which the DRO is to apply, the plan administrator should approve the DRO and supplement the DRO with appropriate identifying information. DOL QDRO Manual, 2-9. Only in cases where the plan administrator is unable to determine which plan the DRO is intended to apply, and such information is not easily obtainable (e.g., through communication with the parties or their counsel), should the plan administrator reject the DRO. In such a case, the plan administrator should also provide the submitting party with the correct plan name.

5. Failure to Consider Potential Future Vesting

Because the QDRO statutes do not mention vesting, most DROs do not address the interaction of vesting, the intended amount of the award, and the timing of the alternate payee's distribution. A fiduciary reviewing a DRO which applies to a partially vested or unvested benefit should make sure that the vesting issue is adequately addressed before accepting the DRO as qualified. It is the best practice for a plan administrator to require that the DRO explicitly provide that only vested amounts are awarded by the DRO.

6. Plan Loans

Some plans permit participant loans from the plan that are secured by the participant's account. Plans that allow loans must determine whether loans outstanding as of a DRO's stated date are to be considered part of the participant's plan account balance for purposes of an award in a QDRO. Furthermore, a plan administrator that approves a DRO awarding an interest to an alternate payee in a participant's account that is subject to a loan may face considerable administrative hassle if the participant refuses to repay the loan. In such a case, the alternate payee has a worthless asset. The plan administrator arguably must pursue the participant in an effort to collect on the loan to make the alternate payee whole. This is in contrast to a normal default on a plan loan, which is simply treated as a taxable or deemed distribution from the plan. The administrator is thus placed in the uncomfortable position of possible litigation with a plan participant. Although the threat of treating the loan default as a deemed distribution might prompt repayment of the loan, the best practice is for the plan administrator to reject DROs that attempt to award accounts with loans to the alternate payee. Treatment of plan loans should be addressed in the plan's QDRO procedures. See the model QDRO procedure in Appendix A for an example of how a plan might address these issues.

7. QDRO Provisions that Conflict with or Fail to Conform to Plan

Code Section 414(p)(3)(A) and ERISA Section 206(d)(3)(D)(i) state that a DRO is not a QDRO if the DRO requires the plan to provide a type or form of benefit, or any option, not otherwise allowed under the plan. As pointed out above, if a plan paid amounts pursuant to an unqualified DRO, the payor may be liable to the participant, other alternate payees, or persons claiming under them. Obviously, a plan administrator could not approve a DRO that awarded an annuity to an alternate payee where no such benefit was offered under the plan.

8. Rollover Accounts, Accounts from Other Employers, and After-Tax Contributions

It is common for plans to allow participants to roll over their accounts from the plan of a previous employer. In addition, when an employer merges with or is purchased by another employer, the plan accounts from the merged or purchased employer will be transferred into the plan of the acquiring entity. Finally, some plans allow participants to contribute a portion of their after-tax earnings to the plan (or allowed such contributions in the past). In the case of any of the foregoing, the receiving plan must generally hold such transferred amounts in separate accounts for the participants. In a marital dissolution, the parties can divide these separate accounts in any fashion they choose, and their agreement should be reflected in the DRO. If the DRO fails to specify how these accounts are to be divided, the plan administrator should seek clarification from the parties' counsel. However, detailed QDRO procedures can avoid this issue. For example, the QDRO procedures could provide that, in the absence of direction in the DRO, the plan administrator will divide these special accounts on a pro-rata basis.

9. "Cashouts" of Small Amounts

Many plans provide for the immediate distribution of benefits that are no greater than a small dollar value (usually $5,000 or less). The plan's QDRO procedures should make this clear to avoid surprising an alternate payee who receives a cashout. If a plan maintains model QDROs to assist participants and alternate payees in preparing DROs, the model QDROs should also contain the cashout provisions. Refer to the model QDRO forms in Appendix B for details.

10. Division of Specific Assets

Depending on plan provisions and procedures, participants and alternate payees may be entitled to divide or assign specific assets in a QDRO. Participant direction of specific assets, such as parcels of real estate or stock of closely held corporations, used to be more common in smaller plans (e.g., plans sponsored by doctors). Dividing up specific assets with a QDRO can create headaches, however, where the fair market value of the asset in question is not easily ascertainable. These problems are compounded where the DRO makes an award of a specific dollar amount to the alternate payee (see above). In contrast, QDROs that assign a specific asset irrespective of its value without the requirement that the alternate payee receive a set dollar amount generally pose no additional issues.

11. Rights of Alternate Payees

A person who is an alternate payee under a QDRO is considered a beneficiary under the plan for purposes of ERISA. ERISA §206(d)(3(J). Consequently, an "alternate payee" under a QDRO, including a spouse or a former spouse recognized in the QDRO as having the right to receive plan benefits, has certain rights under qualified plans, including:

- The right to receive summary plan descriptions, summaries of material modifications; the plan's summary annual report, and other disclosures as specified in ERISA;
- The right to designate a beneficiary of the alternate's payee's awarded interest (unless such a designation is made in a DRO);
- In plans with participant directed accounts, the right to direct the investment of the alternate payee's awarded interest under a QDRO;
- The right to make claims for benefits under the plan, and to have claims reviewed under the plan's claims review procedures;
- The right to obtain, upon written request to the Plan Administrator, copies of documents governing the operation of the plan, including insurance contracts (if any), and copies of the latest annual report (Form 5500 series);
- For multiemployer defined benefit plans, the right to receive the plan funding notice.

The best practice to address issues that might arise regarding the rights of an alternate payee is for the plan's QDRO procedures to clearly state the alternate payee's rights. For example, the QDRO procedures should state whether alternate payees are allowed to direct investment of their awarded interests, and what happens in the event they fail to do so. The procedures should also speak to whether loans are available to alternate payees.

12. Subsequent Benefit Increases; Early Retirement Subsidies

As mentioned above at I.C.1.a., QDROs must take into account any subsequent benefit increases to which a participant may be entitled by setting forth how the participant and the alternate payee will share (or even if they will share at all) in such increases. Ideally, the QDRO will address whether the alternate payee will receive all or part of the subsidy or increase. The plan's QDRO procedures should clearly state how a subsidy will be treated in both the case of a Separate Interest Award QDRO and a Shared Interest Award QDRO, especially in cases where the DRO is silent in this regard. In plans it administers, the Pension Benefit Guaranty Corporation will pay the entire subsidy to the participant if the DRO is silent

regarding a retirement subsidy (in a Separate Interest Award QDRO). Qualified Domestic Relations Orders & PBGC, p. 16. Practitioners should develop the plan's QDRO procedures in concert with the plan's actuary to address cases where the participant has begun receiving benefits under the plan. Specific plan policies should be developed in cooperation with the plan's actuary.

13. Language in the QDRO with No Legal Effect

Plan administrators will from time to time encounter a provision in a DRO that has no legally binding effect on a party or the plan administrator, or that is simply irrelevant to the plan in question. For example, a DRO may attempt to control the behavior of the plan administrator even before the DRO is qualified. Such a provision does not violate the Code or ERISA QDRO requirements. Therefore, assuming that the DRO otherwise meets all applicable technical requirements of the Code and ERISA, and does not violate any QDRO prohibitions shown in the plan's QDRO procedure, the plan administrator should ignore the inoperative language and approve the DRO as a QDRO.

E. Charging The Participant or Alternate Payee

Plan administrators may incur substantial expenses when determining whether a DRO is a QDRO. The DOL states that, in the context of a defined contribution plan, the plan administrator may assess reasonable expenses attributable to such a determination against the individual account of the participant or beneficiary who is a party to the DRO. DOL QDRO Manual, 2-6; FAB 2003-3. This position is a reversal of the DOL's earlier position taken in Advisory Opinion 94-32A, which disallowed a plan amendment that would assess QDRO determination charges against individual accounts on the basis that charging such fees would impermissibly interfere with the rights of an alternate payee to receive benefits under a QDRO. However, practitioners and plan administrators should note that the plan's summary plan description must include a description of any provisions that may result in the imposition of a fee or charge on a participant or beneficiary, or their individual accounts, if payment of the fee is a condition to the receipt of benefits under the plan. 29 C.F.R. § 2520.102-3(l); FAB 2003-3. Furthermore, the summary plan description must identify the circumstances that may result in offset or reduction of benefits that a participant or beneficiary might otherwise reasonably expect the plan to provide. *Id.*

F. 403(b) Plans, 457(b) Plans, Governmental and Church Plans

1. Plans of Tax-Exempt Organizations

a. 403(b) Plans

Any Code Section 403(b) plan ("403(b) plan") that is subject to ERISA is required to pay benefits in accordance with a QDRO that applies to the plan. ERISA § 206(d)(3)(A). Public schools and tax-exempt organizations are entitled to establish 403(b) plans. Code § 403(b)(1)(A)(i), (ii). These plans may also be established for certain ministers by a church or convention of churches. Code § 403(b)(1)(A)(iii). However, 403(b) plans of governments and churches are not governed by Title I of ERISA, and thus need not comply with a QDRO. ERISA § 4(b)(1), (2). Governmental and church plans are discussed below at Section I.F.2.

Distributions made pursuant to a QDRO from a 403(b) plan are treated in the same manner as distributions from a plan to which Code Section 401(a)(13)(B) applies (i.e., a qualified plan). Code § 414(p)(9); Reg. § 1.403(b)-10(c). Furthermore, a 403(b) plan will not fail to satisfy the 403(b) distribution restrictions merely as a result of a distribution made under a QDRO. Code § 414(p)(10). Consequently, QDRO distributions from 403(b) plans are permitted without regard to whether the employee has terminated employment or experienced another event that would permit a distribution under the 403(b) plan. Reg. § 1.403(b)-10(c). For 403(b) plans subject to ERISA, ERISA Section 206(d)(3) would also not prohibit distributions from a 403(b) plan that are made pursuant to a QDRO. Reg. § 1.403(b)-10(c).

b. 457(b) Eligible Deferred Compensation Plans

QDROs may also be also used to divide benefits upon marital dissolution in an "eligible deferred compensation plan" under Code Section 457(b) ("457(b) plans"). As with 403(b) plans, 457(b) plans governed by ERISA must comply with the applicable requirements of a QDRO. ERISA § 206(d)(3)(A). Some background on 457(b) plans clarifies why QDROs present an issue to these plans.

States, political subdivisions, and agencies and instrumentalities of the foregoing, as well as nongovernmental tax-exempt organizations, are entitled to establish 457(b) plans, which operate in a fashion similar to that of qualified plans. See Code § 457(e)(1); Reg. Section 1.457-2(e). 457(b) plans that are sponsored by governmental employers are not subject to ERISA. ERISA §§ 3(32); 4(b)(1). However, ERISA does apply to any non-governmental 457(b) plan. Amounts deferred under governmental 457(b) plans are includible in gross income only when benefits are paid to the participant. Code Section

457(a)(1)(A). In contrast, employees of tax-exempt organizations (other than state or local governments) must include 457(b) plan benefits in income when the benefits are either paid or otherwise made available to them. Code Section 457(a)(1)(B); Reg. Section 1.457-7(c)(1). 457(b) plans may not make amounts deferred under the plan available to participants or beneficiaries earlier than the year in which the participant attains age 70½, at severance from employment, or in the case of an unforeseeable emergency. Code Section 457(d)(1)(A). 457(b) plans that violate these restrictions or any other requirement of 457(b) are "ineligible" plans, and are subject to Code Section 457(f). Code Section 457(f)(1). Amounts deferred under an ineligible plan are included in income in the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation. Code Section 457(f)(1)(A).

A 457(b) plan, however, does not become an ineligible plan subject to Code Section 457(f) solely because its administrator or sponsor complies with a QDRO as defined in section 414(p), including an order requiring the distribution of the benefits of a participant to an alternate payee in advance of the general rules for eligible plan distributions under §1.457-6. Reg. § 1.457-10(c); Private Letter Ruling 9145010. Furthermore, if a distribution or payment is made from an eligible plan to an alternate payee pursuant to a QDRO, rules "similar to the rules of section 402(e)(1)(A)" apply to the distribution or payment. Reg. § 1.457-10(c)(1). As discussed at Section I.A.5. above, this means that if the alternate payee is the participant's spouse or former spouse, the alternate payee's portion is taxable to the spouse or former spouse. Code §§ 402(e)(1)(A); Reg. § 1.457-10(c)(1). A distribution to the participant's dependent child as alternate payee under the QDRO is taxable to the participant. Notice 89-25, Q&A-3.

Division of benefits in marital dissolution under an eligible deferred compensation plan is somewhat less onerous than is the case under a qualified plan. Sections 635(a), 635(b), and 635(c) of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") amended Code Section 414(p) to provide that 457(b) plans became subject to the same QDRO rules that apply to other governmental plans and nonelecting church plans. The anti-alienation provisions of ERISA and the Code do not apply to these plans. See Section I.F.2. below for a discussion of governmental and nonelecting church plans. Thus, favorable QDRO treatment under a 457(b) plan may be obtained in the absence of a full-blown QDRO. Distributions or payments from an eligible deferred compensation plan are treated as made pursuant to a QDRO if made pursuant to a DRO which meets the requirement of Code Section 414(p)(1)(A)(i). Code § 414(p)(11); Reg. § 1.457-10(c)(1). Thus, the DRO must create or recognize the existence of the alternate payee's right to receive all or a portion of the benefits payable for a particular participant under a plan. However, the QDRO requirements of Code Section 414(p)(2) and (3), relating to statement of specific facts and precluding alteration of amount and form of benefits, need not be satisfied in such a DRO.

2. <u>Plans of Governments and Non-Electing Churches</u>

a. Special Rules

The anti-alienation provisions of ERISA and the Code do not apply to a "governmental plan" or to a "nonelecting church plan." Code §§ 401(a) (flush language), 411(e)(1). Consequently, governmental plans and church plans are not required to pay benefits in accordance with a QDRO. However, these plans may choose to honor a DRO, and DROs applicable to such plans are not preempted by ERISA Section 206(d)(3)(A).

A "governmental plan" is defined in Code Section 414(d) and ERISA § 3(32) to include:

- a plan established by the United States government, or any of its agencies or instrumentalities;
- a plan established by the government of any state or political subdivision thereof, or any of their agencies or instrumentalities;
- any plan to which the Railroad Retirement Act of 1935 or 1937 applies;
- any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act;
- a plan which is established and maintained by an Indian tribal government or their subdivisions, or an agency or instrumentality of either.

"Church plans" include plans established and maintained by a church or by a convention or association of churches which is exempt from federal income tax under Code Section 501. Code § 414(e)(1); ERISA § 3(33)(A). Plans that are maintained primarily for the benefit of church employees who are employed in a trade or business unrelated to the church's tax-exempt purposes are excluded from this definition, as are plans where less than substantially all of the plan participants are church employees or duly ordained, commissioned, or licensed ministers of a church in the exercise of their ministry, regardless of the source of their compensation. Code § 414(e)(2); ERISA § 3(33)(B). Church plans have the option of electing to be subject to the participation, vesting, and funding requirements

of Code Section 410(b), and to certain portions of ERISA. Church plans that choose not to make these elections are referred to as "nonelecting church plans."

Governmental and nonelecting church plans are accorded the same QDRO treatment as 457(b) plans, discussed above at Section I.F.1.b. Thus, distributions from governmental and nonelecting church plans will be treated as made pursuant to a QDRO if made pursuant to a DRO that meets the requirements of Code Section 414(p)(1)(A)(i). Code § 414(p)(11). The DRO in question must create or recognize the existence of the alternate payee's right to receive all or a portion of the benefits payable for a particular participant under a plan. Moreover, distributions from governmental and nonelecting church plans will receive the same tax treatment as distributions from 457(b) plans. That is, distributions to the participant's spouse or former spouse as alternate payee pursuant to the DRO will be taxed to the spouse, not to the participant, and the distributions may be rolled over. Code §§ 401(a) (flush language); 402(e)(1)(A), (B); 411(e)(1)(A); 414(p)(9).

b. QDROs of Texas Governmental Plans – Texas Government Code Chapter 804

Division of retirement assets in public sector plans presents additional challenges to the practitioner. Not only are the federal laws relating to QDROs different from those for qualified plans, but other federal or state legislation may govern the operation of the plan. Practitioners must take care to recognize that a public sector plan may be subject to specific QDRO requirements that are creatures of state law, and to respect whatever requirements that law may set forth. This is unquestionably the case in Texas, where the Texas Government Code applies to all Texas governmental plans.

Governing bodies of Texas "public retirement systems," or governmental pension plans, have the option of adopting all (and not fewer than all) provisions of Chapter 804 of the Texas Government Code. Tex. Govt. Code § 804.002. This series of statutes is modeled on the federal QDRO statues, but contains additional restrictions and protections for adopting plans. Chapter 804 contains its own checklist for qualification of QDROs by adopting plans. Tex. Govt. Code § 804.003(f); (g). Public retirement systems have several incentives to adopt the application of Chapter 804. First, the administrative head of a public retirement system that elects the application of Chapter 804 has exclusive authority to determine whether a DRO is a QDRO. Tex. Govt. Code § 804.003(b). This determination may be appealed only to the board of trustees of the electing public retirement system. *Id.*

Second, and even more importantly, a court does not have jurisdiction over an electing public retirement system with respect to a divorce or other domestic relations action in which an alternate payee's right to receive all or a portion of the benefits payable to a member or retiree under the public retirement system is created or established. Tex. Govt. Code § 804.003(c). Any party who attempts to make an electing public retirement system a party to the action contrary to Texas Government Code § 804.003(c) is be liable to the public retirement system for the system's costs and attorney's fees. *Id.* (The foregoing rules do not apply in the case of the optional retirement system governed by Chapter 830 of the Texas Government Code, which is designed for the faculty of state-supported institutions of higher learning.)

Third, the board of trustees of a public retirement system that has elected the application of Chapter 804 is entitled to adopt a rule that that allows the system to pay the alternate payee the actuarial equivalent of the awarded interest in the form of a life annuity or a lump sum in lieu of the interest awarded by a QDRO. Tex. Govt. Code § 804.004(a). The electing retirement system may decide to pay awards in this fashion in its sole discretion. Tex. Govt. Code § 804.004(b).

Finally, the death of an alternate payee (or a spouse of a member or retiree) of an electing public retirement system terminates the interest of such alternate payee (or spouse) in that public retirement system. Tex. Govt. Code § 804.101.

DROs submitted to a governmental plan should be carefully reviewed by someone thoroughly familiar with the plan (including whether its governing body has adopted Chapter 804) and with the statute.

G. QDRO Issues for Nonqualified Deferred Compensation Plans

1. Nonqualified Plans and QDROs

Plans that do not satisfy the requirements of Code Section 401(a) are not qualified plans. Practitioners might rationally conclude that the QDRO rules do not apply to nonqualified plans, but the analysis is somewhat more complex because a nonqualified plan may still be subject to portions of ERISA. If the plan is subject to Part 2 of Title I of ERISA (relating to participation and vesting), of which ERISA Section 206(d)(3) is a part, the plan will be subject to ERISA's QDRO provisions. Pension plans subject to Part 2 are required to pay benefits in accordance with a QDRO. ERISA § 206(d)(3)(A). However, ERISA Section 201

excludes from the application of Part 2 unfunded plans maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees ("top hat plans"), among others. Practically speaking, most nonqualified plans will be top hat plans, and therefore not subject to the ERISA or Code QDRO rules. However, nothing prevents a nonqualified plan from honoring a QDRO.

2. Tax Treatment of Nonqualified Deferred Compensation Plan QDROs

Distributions made pursuant to a QDRO that applies to a nonqualified plan will not be afforded the same preferential tax treatment that qualified plans receive. Distributions from a qualified plan are taxable under section 72 to the distributee, including an alternate payee under a QDRO, when the distribution is made, and the distribution may be eligible for rollover. Code §§ 402(a); 402(c); 402(e)(1)(A), (B). In contrast, QDRO distributions from nonqualified plans will not be eligible for rollover treatment. Further, Code Section 402(b)(2) does not define "distributee" to include assignee spouses and former spouses, and the rule in Code Section 402(e)(1)(A) treating an alternate payee under a QDRO as a distributee does not apply to distributions from nonexempt trusts or from other unfunded arrangements. Prior to 2002, the Internal Revenue Service ("IRS") took the position that the assignment of income doctrine applied to distributions of an assigned interest in a nonqualified plan. Thus, distributions from nonqualified plans were taxable to the participant, and not to the assignee former spouse.

In Revenue Ruling 2002-22, the IRS issued guidance on the tax treatment of the transfer of nonstatutory stock options ("NSOs") and unfunded nonqualified deferred compensation rights incident to a divorce. The ruling concluded that because of Code Section 1041, a spouse who transfers interests in NSOs and unfunded nonqualified deferred compensation to his or her former spouse incident to divorce does not recognize income on the transfer. Under Code Section 1041, no gain or loss is recognized on a transfer of property from an individual to that individual's former spouse if the transfer is incident to the divorce. Code § 1041(a)(2). The transferee spouse who receives the option/deferred compensation must include the amount in income under Code Section 83 upon exercise of the option or when the compensation is paid or made available. Code Section 83 generally provides that when property is transferred in connection with services, the transferee includes in income an amount equal to the fair market value of the property minus any amount paid for the property, at the time the property becomes transferable or is not subject to a substantial risk of forfeiture. Code § 83(a).

3. Code Section 409A and Regulations

Code Section 409A generally provides that if a nonqualified deferred compensation plan ("NQDP") fails to meet specific requirements pertaining to distributions, acceleration of benefits, and elections, or is not operated in accordance with these requirements, all compensation deferred under the plan for the year of the failure and all prior years is currently includible in income. Code § 409A(a)(1)(A). Furthermore, the participant is also subject to an excise tax equal to 20% of the amount included in income, plus interest. Code § 409A(a)(1)(B)(i). Final Regulations under Code Section 409A became effective for taxable years beginning on or after January 1, 2008.

QDROs present a significant issue in the context of Code Section 409A for a number of reasons. First, NQDPs generally may not allow the acceleration of the time or schedule of any payment or amount scheduled to be paid under the plan, regardless of the plan's terms. Reg. § 1.409A-3(j)(1). However, the Regulations under Code Section 409A provide an exception to this general rule. NQDPs may provide for acceleration of the time or schedule of a payment under the plan to the extent necessary to fulfill a DRO, provided that the payment is made to the alternate payee and not the person providing services under the plan. Reg. § 1.409A-3(j)(4)(ii). Note that only a DRO (as defined in Code section 414(p)(1)(B)), and not a QDRO, is required in order for the exception to anti-acceleration to apply.

Second, DROs and Code Section 409A may also intersect in the case of a payment under an NQDP upon the service provider's separation from service. Code § 409A(a)(2)(i) and Reg. § 1.409A-3(a) generally permit payments under an NQDP when the service provider separates from service. However, if the service provider is a key employee of a publicly traded company, payments must be delayed for at least six months after the date of separation. Code § 409A(a)(2)(B); Reg. § 1.409A-3(i)(2)(i). Nevertheless, payments made to a person other than the service provider pursuant to a DRO are exempt from the six-month delay rule. Again, the DRO need not be a QDRO to obtain this favorable treatment.

Next, NQDPs are subject to a host of stringent requirements with respect to subsequent elections to delay payments or to change the form of payment. Code § 409A(a)(4)(C); Reg. § 1.409A-2(b). Conveniently, these rules do not apply to individual elections made by someone other than the service provider that are made in accordance with, or that are

reflected in, a DRO. As is the case above, the payments cannot be made to the service provider, and the DRO need not be a QDRO.

Finally, one might wonder whether a QDRO would subject a grandfathered NQDP to Code Section 409A. Code Section 409A applies only to amounts deferred in taxable years beginning before December 31, 2004, and to amounts deferred in taxable years beginning before that time if the plan under which the deferral was made is "materially modified" after October 3, 2004 (the date that Code Section 409A was enacted). Reg. § 1.409A-6(a)(1)(i). Material modifications generally include material enhancements of benefits or rights existing as of October 3, 2004, or the addition of a new material benefit or right that affects amounts earned and vested before January 1, 2005. *Id*. The final regulations provide that compliance with a DRO, or amending a plan to require compliance with a DRO, is not a material modification. Reg. § 1.409A-6(a)(4)(i)(C). Of course, this rule applies only with respect to payments to an individual other than the service provider. *Id*.

H. Benefits Not Subject to Division by a QDRO

As has been discussed, QDROs are generally required to divide retirement plan benefits in a marital dissolution while still obtaining favorable tax consequences, although a DRO will be adequate to divide the benefits under certain plans. Parties to a marital dissolution will probably have other assets to divide. While this article is not intended to be a comprehensive exegesis on the division of all marital assets on divorce, some other benefits, where a DRO or QDRO is not the appropriate apportionment vehicle, merit attention.

1. Nonqualified Stock Options and Nonqualified Deferred Compensation

As discussed above at Section I.G.2., the IRS ruled in Revenue Ruling 2002-22 that transfers to a former spouse of vested NSOs and unfunded deferred compensation rights incident to divorce receive nonrecognition treatment by virtue of Code Section 1041. Significantly, the IRS stated in the ruling that the assignment of income doctrine did not apply to the transfers. Furthermore, this ruling is a reversal of the IRS's position in Field Service Advice 200005006, which advised under similar facts that a transfer of stock options to the non-employee former spouse in a divorce was a taxable event. The transferor employee-spouse was required to realize and recognize compensation income under Code Section 83(a).

The IRS was careful to point out that conclusions in Revenue Ruling 2002-22 do not apply to transfers of NSOs, unfunded deferred compensation rights, or other future income rights that are unvested at the time of transfer. Furthermore, the ruling did not apply to the extent that the transferor's rights to such income are subject to substantial contingencies at the time of the transfer. Regardless, the ruling also contains a section entitled "Prospective Application," which indicates that the IRS's position in the ruling may extend beyond NSOs and unfunded deferred compensation rights to "other similar intangible property rights." Practitioners faced with the division of these types of assets in a divorce should carefully consider the IRS's conclusions in Revenue Ruling 2002-22.

2. Incentive Stock Options and Employee Stock Purchase Plans

Special rules, rather than Code Section 83, apply to the transfer of incentive stock options ("ISOs") and options granted under Code Section 423 Employee Stock Purchase Plans ("ESPP options") in a marital dissolution. Code § 83(e)(1). Transfer of stock pursuant to the exercise of ISOs or ESPP options will not result in income to the taxpayer provided that the taxpayer does not dispose of the stock for two years from the date of grant of the option or within one year after the transfer of the stock to the taxpayer, and the taxpayer remains employed with the corporation granting the option for a specified time. Code §§ 422(a), 423(a). Code Section 424(c)(4) provides that a transfer of the stock upon exercise of the ISO or ESPP option to a spouse or former spouse incident to divorce, within the meaning of Code Section 1041(a), is not treated as a disqualifying disposition. Furthermore, a subsequent disposition by the transferee will receive the same tax treatment that would have applied to the transferor with respect to such stock. Code § 424(c)(4).

3. Archer MSAs

Parties to a marital dissolution may also divide an Archer medical savings account. An Archer MSA is a trust created as a medical savings account that is used to pay certain qualifying medical expenses of the account holder. Code § 220(d)(1). The trust must satisfy the requirements set forth in Code Section 220(d)(1) in order to be an Archer MSA. Eligible individuals with Archer MSAs may claim a deduction for amounts contributed to their own accounts, subject to certain limitations. Code § 220(a), (b). Transfer of an individual's interest in that individual's Archer MSA to the individual's spouse or former spouse pursuant to a divorce or separation instrument described in Code Section 71(b)(2)(A) is not considered to be a taxable transfer. Code § 220(f)(7). Subsequent to such a transfer, the account is

considered to be an Archer MSA with the spouse as the account holder. *Id*.

I. Application of QDROs to Welfare Benefit Plans

ERISA Section 206(d)(1) provides an "anti-alienation" rule which by its terms applies only to pension plans and includes no reference to welfare benefit plans. Specifically, pension plans must "provide that benefits under the plan may not be assigned or alienated." ERISA § 206(d)(1); Mackey v. Lanier Collection Agency & Serv., 486 U.S. 825, 836 (1988) (noting that Congress did not enact an anti-alienation provision applicable to ERISA welfare plans as it did for pension plans). A QDRO is an exception to the anti-alienation rule, and pension plans are required to pay benefits in accordance with a QDRO. ERISA §206(d)(3)(A). Again, no mention is made of welfare plans. Even more importantly, ERISA Section 201 provides that Part 2 of Title I of ERISA, of which ERISA Section 206(d)(3) is a part, does not apply to welfare plans. Furthermore, ERISA Section 206(d)(3)(L) states that ERISA Section 206(d)(3) does not apply to any plan to which ERISA Section 206(d)(1) does not apply (i.e., a pension plan).

In spite of the seemingly straightforward language in ERISA Sections 201 and 206(d), the Federal Circuit Courts are in conflict regarding the applicability of the QDRO provisions to employee welfare benefit plans. A brief survey of the cases tackling this issue immediately makes clear that the welfare benefit most frequently being litigated is life insurance. The controversy turns on the application of ERISA's preemption provisions, which are found in ERISA Section 514. ERISA Section 514(a) states the general rule that ERISA preempts all state laws that relate to any employee benefit plan (both pension and welfare plans). However, ERISA Section 514(b)(7) provides an exception to the general rule that ERISA Section 514(a) does not apply to QDROs as they are defined in ERISA Section 206(d)(3)(B)(i). This section in turn refers to only to an alternate payee's right to receive benefits under a "plan."

Some Circuit Courts have seized upon the interplay between these sections to hold that the reference in ERISA Section 514(b)(7) to ERISA Section 206(d)(3)(B)(i) does not restrict application of ERISA Section 514(b)(7) to pension plans. Consequently, the statutory exception in ERISA Section 514(b)(7) is interpreted to apply to all QDROs whether they involve pension plans or welfare plans. See Metropolitan Life Ins. Co. v. Marsh, 119 F. 3d 415, 421 (6th Cir. 1997) (ERISA Section 514(b)(7) excepts QDROs from ERISA preemption with respect to welfare plans as well as pension plans); Metropolitan Life Ins. Co. v. Wheaton, 42 F. 3d 1080, 1084 (7th Cir. 1994) (concluding that the exception to ERISA preemption applies to all ERISA plans); Carland v. Metropolitan Life Ins. Co., 935 F. 2d 1114, 1119-20 (10th Cir. 1991) (the exception applies to all QDROs whether they involve a pension or welfare benefit plan).

In contrast, the Fifth Circuit has held that ERISA's anti-alienation provision does not apply to welfare plans. In Brandon v. Travelers Ins. Co., 18 F. 3d 1321, 1324 (5th Cir. 1994), the court reached this conclusion with little discussion, stating only that ERISA Section 206(d)(1) by its plain language applied only to pension plans. In similar fashion, the Eighth Circuit in Equitable Life Assur. Soc. of U.S. v. Crysler, 66 F. 3d 944, 947-48 (8th Cir. 1995) decided that ERISA Section 206(d)(1)'s anti-alienation provision did not apply to welfare plans. However, a recent unreported District Court case from Texas may conflict with Brandon. The court in Metropolitan Life Ins. Co. v. Valpena, 2006 WL 505442, 3 (W.D. Tex. 2006) ruled that the QDRO exception to ERISA preemption applies to all ERISA plans. Apparently unaware of the Fifth Circuit's decision in Brandon, the Valpena court stated that, "The Fifth Circuit has not yet decided this issue [of whether the QDRO exception to ERISA preemption applies to both pension plans and welfare plans]." 2006 WL 505442, 3 fn. 1.

Conspicuously, none of these cases discuss ERISA Section 206(d)(3)(L) in their holdings. ERISA Section 206(d)(3)(L) is a stand-alone paragraph that seems to plainly indicate that the QDRO rules in ERISA Section § 206(d)(3) are limited to pension plans. Therefore, one might reasonably conclude that even though ERISA preemption does not apply to QDROs as defined in ERISA Section 206(d)(3)(B)(i), ERISA Section 206(d)(3)(L) ought to override any plain reference to "plan" in ERISA Section 206(d)(3)(B)(i) because ERISA Section 206(d)(3)(L) specifically limits the application of ERISA Section 206(d)(3) to pension plans. That is, because ERISA Section 206(d)(3)(B)(i) is part of ERISA Section 206(d)(3), the rule of exception to ERISA preemption should not be extended to QDROs involving welfare plans). In any event, there is no specific Code provision for favorable tax treatment to assignees of welfare benefits.

Each of the above cases involved similar fact scenarios relating to competing claims to the proceeds of a life insurance policy. The individuals named in a QDRO (or a court order determined to substantially comply with QDRO requirements) as beneficiaries of the policy argued that the QDRO should allow

division (alienation) of the life insurance benefit. The named beneficiary reasoned that ERISA's QDRO exception to alienation applies only to pension plans. Practitioners faced with a DRO that attempts to assign benefits in a welfare plan should consider the foregoing case law when deciding whether to accept or reject the DRO. Given the conflicting views of the Circuit Courts regarding these issues, this area is ripe for litigation.

J. Model QDRO Forms and Other Resources

Although not required to do so, plan administrators may develop and make available "model" QDRO forms to assist alternate payees and their counsel in preparing QDROs. Model forms can greatly assist the parties in the preparation of a QDRO, reducing the time and expense typically involved in the QDRO drafting and review process. Note, however, that the DOL takes the position that a plan administrator is obligated to honor any DRO that satisfies the requirements of a QDRO. DOL QDRO Manual, 2-7. Consequently, a plan administrator may not condition acceptance of a QDRO on the use of any particular form. *Id*.

Set forth in Appendix A are sample QDRO procedures containing alternate provisions for both defined contribution and defined benefit plans. Appendix B contains model QDRO forms for defined contribution and defined benefit plans. These documents are designed as a generic starting point only. As previously stated, QDROs and QDRO procedures are like snowflakes: each one is different and they must be drafted (and updated as necessary) to reflect the particular provisions of the plan. Furthermore, each QDRO must be written to take account of the unique factual circumstances of the marital dissolution in question.

Additional QDRO guidance is available from the DOL and the PBGC on their websites. The DOL provides general information in question and answer format in "The Division of Pensions Through Qualified Domestic Relations Orders," available at http://www.dol.gov/ebsa/publications/qdr os.html. Similarly, the PBGC offers a free booklet online called "Qualified Domestic Relations Orders & PBGC" that is available at http://www.pbgc.gov/docs/ QDRO.pdf. The PBGC is the federal agency that insures private-sector defined benefit plans and administers plans it has assumed. Although the PBGC booklet is generally targeted at situations where a the PBCG has become trustee of a financially distressed employer's plan, the booklet contains a wealth of information that may be relevant to all private-sector defined benefit plans, including separate interest and shared interest model QDROs.

II. GROUP HEALTH PLANS; QUALIFIED MEDICAL CHILD SUPPORT ORDERS

A. Introduction to QMCSOs

1. <u>ERISA Section 609; Basic Definitions</u>

ERISA Section 609(a)(1) provides that group health plans subject to ERISA are required to provide benefits in accordance with a "qualified medical child support order," or "QMCSO," that applies to the plan. A QMCSO is essentially an order to a group health plan to provide health coverage for children pursuant to that order. For this purpose, a "group heath plan" means an employee welfare benefit plan providing medical care under Code Section 213 to participants or beneficiaries directly or through insurance, reimbursement, or otherwise. Thus, most group health plans will be subject to QMCSO provisions, including major medical plans, many dental and vision plans (even if the plans provide benefits that are excepted from HIPAA), and Health Flexible Spending Accounts. Qualified long-term care services plans are not considered to be group health plans for QMCSO purposes, and Health Savings Accounts will generally also not be subject to QMCSO provisions. In spite of the foregoing, the determination of whether a QMCSO will apply to a plan should be made on a plan-by-plan basis.

The definitional structure of ERISA Section 609(a) is very similar to that provided for QDROs under Code Section 414(p) and ERISA Section 206(d)(3). Thus, a QMCSO is a "medical child support order," or "MCSO," which creates or recognizes the existence of an "alternate recipient's" right to (or assigns the right to) receive benefits for which a participant or beneficiary is eligible under a group health plan. ERISA Section 609(a)(2). The QMCSO must clearly specify (A) the name and the last known mailing address (if any) of the participant and the name and mailing address of each alternate recipient covered by the order. However, the order may substitute the name and mailing address of an official of a state or a political subdivision. ERISA Section 609(a)(3)(A). The QMCSO might specify the name of a state official in cases where it is necessary to preserve the privacy of the alternate payee. Such circumstances might arise, for example, if the participant had physically abused the alternate payee, and revealing the name of the alternate payee in the QMCSO could put the alternate payee in additional danger.

Furthermore, the QMCSO must clearly provide a reasonable description of the type of coverage to be provided to each alternate recipient, or the manner in which such type of coverage is to be determined, and must state the period to which the order applies.

ERISA Section 609(a)(3)(B), (C). Noticeably absent from this list is a requirement that the QMCSO clearly specify the name of the plan. This is in contrast to QDROs, where the plan to which the QDRO applies must be clearly stated. Thus, the potential impediment to qualification of a QDRO for failure to correctly name an employer's group health plan does not exist for QMCSOs.

Finally, a QMCSO may not require a plan to provide any type or form of benefit, or any option, that the plan does not otherwise provide. For example, if the plan provides benefits solely through an HMO with a geographically limited benefit area, and the child resides outside that area, an MCSO that requires the plan to provide coverage to the child would not be a QMCSO. There is one narrow exception to this rule. The plan must provide benefits as required by state laws relating to medical child support described in section 1908A of the Social Security Act (42 USC §1396g-1). ERISA Section 609(a)(4). These laws typically prohibit limitations on the provision of coverage to children on the basis that the child is illegitimate, is not claimed as a tax dependent by the parent, does not reside with the parent, or lives outside the plan insurer's service area. States enact such laws in order to obtain Medicaid funds. Texas' laws relating to medical child support are discussed below at Section II.A.5. QMCSOs are deemed to apply to each group health plan under which the participant or beneficiary is eligible to receive benefits that has received the QMCSO, provided that the above restriction regarding additional benefits or options is met. ERISA § 609(a)(1).

"MCSOs" are defined to mean any judgment, decree, or order (including approval of a settlement agreement) which either (i) provides for child support or health benefit coverage to a plan participant's child, is made pursuant to a State domestic relations law (including a community property law), and relates to benefits under such plan; or (ii) is made pursuant to a law relating to medical child support described in section 1908A of the Social Security Act (42 USC §1396g-1). ERISA Section 609(a)(2(B). Note that an MCSO can arise only from a judgment, decree, or order; voluntary out-of-court agreements relating to the provision of health coverage cannot create a MCSO. The judgment, decree, or order must either be issued by a court of competent jurisdiction or through an administrative process established under State law that has the force and effect of State law. Administrative notices issued pursuant to an administrative process that has the effect of an order described above satisfy the definition of an MCSO.

An "alternate recipient" is any child of a participant who is recognized under an MCSO as having a right to enrollment under a group health plan with respect to that participant. Although "child" is not defined in ERISA, ERISA does provide that the term extends to adopted children by, or placed for adoption with, the group health plan participant. ERISA § 609(a)(2)(D). Alternate recipients are treated as beneficiaries under the plan for all purposes under ERISA and as participants in the plan for purposes of ERISA reporting and disclosure requirements of Part 1 of Title I of ERISA. ERISA § 609(a)(&)(A), (B).

Compared to QDROs, QMCSOs can generally be handled with somewhat more ease. Nevertheless, practitioners are well advised not to approach QMCSOs as a simple matter of "form practice." A practitioner's failure to acquire a working knowledge of the group health plan at issue, ERISA Section 609(a), and National Medical Child Support Notices, is likely to lead to additional time, expense, and aggravation for the practitioner and her client. Common obstacles encountered in the QMCSO arena are presented below in Section II.B.

2. Employers Subject to QMCSOs

Unlike QDROs, QMCSOs apply to almost all employers. Private employers, whether taxable or tax-exempt, and regardless of the form of business organization, are subject to QMCSOs. QMCSOs also reach religious organizations and state and local government employers, although QMCSOs do not apply to the federal government. However, a special law, the Federal Employees Health Benefits Children's Equity Act of 2000, which operates in similar fashion to QMCSOs, does apply to the federal government. Note that no "small employer" or "small plan" exception exists for QMCSOs.

3. Requirement to Maintain QMCSO Policies and Procedures

As is the case with retirement plan QDROs, ERISA requires group health plans to establish require a plan to establish reasonable procedures for determining whether MCSOs are QDROs and for administering distributions under MCSOs. ERISA § 609(a)(5)(B). These QMCSO procedures must be in writing, and must provide for the prompt notification of each benefits-eligible person named in the MCSO of the existence of the procedures. ERISA § 609(a)(5)(B)(i)-(ii). Alternate recipients must also be allowed to designate a representative for receipt of copies of notices that are sent to the alternate recipient that pertain to the MCSO. ERISA § 609(a)(5)(B)(iii).

4. National Medical Child Support Notice

The National Medical Child Support Notice ("NMSN") is a standardized form medical child support order jointly developed by the Secretary of Health and Human Services and the Secretary of Labor pursuant to a directive in Section 401(b)(1) of the Child Support Performance and Incentive Act of 1998 ("CSPIA"). The NMSN is used by state child support enforcement agencies enforce health care provisions of medical child support orders to obtain health care coverage for children. CSPIA 401(b)(1). NMSNs consist of the "Notice to Withhold for Health Care Coverage" (Part A) and the "Medical Support Notice to Plan Administrator" (Part B).

When an employer receives an NMSN, the employer must transfer Part B to the group health plan (or plans) for which the child may be eligible for enrollment within 20 business days after the date stamped on the Notice. The employer is still obligated to transfer Part B to the plan administrator even though the employee may be subject to a "waiting period" before the employee may enroll in the plan. If the NMSN fails to specify which types of benefits or coverage the child is to receive, an employer with (and the plan administrator of each plan) should assume all plans are covered by the NMSN, and send copies of Part B of the Notice to each plan administrator. DOL Reg. § 2590.609-2(c)(3). If the employee named in the NMSN is not an employee of the employer, if the employer's group health plan does not provide dependent coverage, or if the employee is not eligible for enrollment in the plan (for example exclusion due to part-time or non-union status), the employer must check the appropriate box on the Part A and return it to the issuing agency within 20 business days after the date stamped on the Notice (or sooner if reasonable). The employer retains Part A because it may be needed later after the employer has been notified of the qualification of the NMSN Notice and has determined that necessary employee contributions cannot be withheld from wages.

A plan administrator who receives an NMSN must review it to determine whether it is appropriately completed. If the NMSN is appropriately completed, the NMSN is deemed to be a QMCSO. ERISA § 609(a)(5)(C)(i); DOL Reg. § 2590.609-2(a). The plan administrator must in that case inform the state agency that issued the NMSN when coverage for the child named will begin and must provide the custodial parent of the child (or, in some cases, a named state official) with information about the child's coverage under the plan and any forms of documentation necessary to effectuate the coverage. Examples include the plan's summary plan description, and forms or documents necessary to make claims under the plan. The information necessary to complete an NMSN is very similar to that required to be set forth in a garden variety QMCSO, and the NMSN must still satisfy paragraphs (3) and (4) of ERISA Section 609(a). However, the very design of the NMSN meets these requirements. DOL Reg. § 2590.609-2(b) – (d). Thus, an NMSN will generally be "appropriately completed" if all of the information requested on the form is supplied by the state enforcement agency. If any of the necessary information is omitted but is reasonably available to the plan administrator, the NMSN should not fail to be "appropriately completed" solely because of such omission. Department of Labor, Compliance Guide For Qualified Medical Child Support Orders ("DOL QMCSO Compliance Guide"), Q2-5 (available at http://www.dol.gov/ebsa/publications/qmcso.html).

The administrator must also complete the Plan Administrator Response of Part B, which indicates whether the plan administrator has found the NMSN to be a QMCSO. The Plan Administrator Response must be returned to the issuing state agency within 40 business days after the date stamped on the Notice. If the participant is not enrolled in the plan, and the plan provides more than one coverage option for the child, the plan administrator must also use the Plan Administrator Response to inform the issuing agency of the available options for coverage. If the agency does not make a selection of coverage within 20 business days, the plan administrator may enroll the child in the plan's default option (if any). 29 CFR § 2590.609-2.

5. Texas Law Pertaining to QMCSOs

In Texas, the Child Support Division of the Office of the Attorney General (or similar agency of another state) is responsible for sending the NMSN to the employer. Tex. Fam. Code § 154.186(b). An employer that receives an NMSN must comply with the notice, and must immediately enroll the child in the plan regardless of the whether the employee is enrolled (if dependent coverage is offered by the plan). Tex. Fam. Code § 154.187(a), (h). Once the child is enrolled, the employer must mail a statement to the sender of the NMSN confirming that fact. Tex. Fam. Code § 154.187(c). If the plan does not offer dependent coverage, the child cannot be permanently enrolled, or if the employer is not responsible or otherwise liable for providing the coverage, the employer must mail a statement to the sender of the NMSN explaining the reason why coverage or permanent coverage cannot be provided. *Id.* If additional premiums are incurred as a result of adding the child to the health insurance plan, the employer is required to deduct the premiums from the employee's earnings in accordance with Chapter 158 of the Texas

Family Code and use the withheld amounts to pay the premiums. Tex. Fam. Code § 154.187(c).

In the event that the insurance coverage lapses or the employee terminates employment, the employer is required to mail notice of the termination or lapse to the sender of the NMSN with fifteen days. Tex. Fam. Code § 154.187(d). This mailing must also advise the NMSN sender of the availability of any conversion privileges available under the plan. *Id*. Employers who fail to enroll a child, who fail to withhold or remit premiums or cash medical support in accordance with Texas Family Code § 154.187 are subject to penalties and fines specified in Subchapter C of Texas Family Code Chapter 158. Tex. Fam. Code § 154.187(g). These penalties and fines also apply to employers who discriminate in hiring or employment on the basis of a medical support order or the need to provide the above notices. *Id*.

B. Common QMCSO Problems

1. Plans with More than One Level of Benefits

An MCSO is only a QMCSO if it provides a reasonable description of the type of coverage to be provided to each alternate recipient (or how the choice is to be made). However, some group health plans offer different levels of benefits. If an MCSO is unclear as to what level of coverage is to be provided to the alternate payee, the MCSO is technically not qualified. However, the plan administrator may not wish to reject an otherwise qualified MCSO. The plan's QMCSO procedures can address this situation by directing the plan administrator to contact the submitting party, or to simply enroll the alternate recipient in the plan's default option (if available). As noted above, where a plan administrator receives an NMSN but the participant is not enrolled in the plan, the plan must provide coverage option information to the issuing agency. If the agency does not respond in 20 days, the plan can use its default option.

2. Plans that Require Dependents to Have the Same Coverage as the Participant

Some group health plans provide that dependents of participants must be enrolled in the same coverage and option as the participant. In such a case, the alternate recipient must be enrolled in the same coverage as the participant because an alternate recipient under a QMCSO is treated as a beneficiary under the plan. ERISA § 609(a)(7)(A). The DOL points out that where a QMCSO specifies that an alternate recipient is to receive a particular level of coverage, but the participant has different coverage, the plan may be required to change the participant's enrollment to the extent necessary to provide the specified coverage to the alternate recipient.

3. Multiple Alternate Recipients

Sometimes a QMCSO will require a plan to provide coverage for alternate recipients of different ages. This would occur, for example, in a divorce where the participant and non-participant former spouse had more than one minor child who was to be provided coverage by the QMCSO. If the parties intend the QMCSO to require the plan to provide coverage for an alternate recipient until that alternate recipient reaches the age of majority (or some other date or event), the plan administrator should ensure that the QMCSO makes that intention clear. To take into account the different ages of the alternate payees, the QMCSO could state that coverage under the plan shall continue even if some but not all of alternate recipients reach the age of majority (or otherwise become ineligible for coverage).

4. Preexisting Condition Exclusions

HIPAA and regulations issued thereunder do not address whether a group health plan may impose its generally applicable pre-existing condition restrictions or exclusions ("PCEs") to an alternate recipient. The DOL states in is QMCSO Compliance Guide that an alternate recipient (subject of course to ERISA Section 701 PCE limitations) would be subject to a plan's generally applicable PCE. However, the DOL qualifies this statement with the proviso that a group health plan's receipt of an MCSO would toll the running of the 63-day break-in-coverage period for determining the child's creditable coverage. Thus, time that elapses while the plan administrator determines whether the MCSO is qualified would not count towards a 63-day break. Moreover, the DOL takes the position that if the participant disenrolled the child from the plan in anticipation of the MCSO (for example, when divorce or separation was impending), then the time between the disenrollment and the date the plan administrator determines that an order is a QMCSO would also not count as part of the 63-day break-in-coverage period. In spite of the DOL's stance on this issue, the plan administrator should consult with the plan's insurer or stop-loss carrier in advance of applying these rules for determining the alternate payee's creditable coverage.

If a PCE applies to an alternate payee, the plan administrator will need to analyze the alternate payee's coverage eligibility without regard to the QMCSO. Depending on the specific circumstances, the alternate payee may be a new enrollee, a late enrollee, or a special enrollee, and this may affect the PCE period. The plan administrator may also choose to apply the rule that is most beneficial to alternate payees, but should first consult with the plan's insurers and stop-loss carriers.

5. Employees Not Enrolled in the Plan and Waiting Periods

Most group health plans do not offer dependent-only coverage. Nevertheless, a plan may receive an order directing the plan to enroll a child of an employee who is not enrolled in the plan. ERISA does not address whether the plan is obligated to enroll the child. However, the DOL's QMCSO Compliance Guide states that if the employee is eligible to enroll in the plan, the order is an MCSO because an eligible employee is a participant in the plan for QMCSO purposes. DOL QMCSO Compliance Guide, Q1-12. If the MCSO is determined to be qualified, the plan must provide coverage to the child. DOL QMCSO Compliance Guide, Q1-13. The plan will also have to enroll the employee if employee coverage is a condition to coverage for dependents. *Id.*

Group health plans may also encounter an order naming an employee who has not yet satisfied the plan's generally applicable waiting period (such as a requirement that the person be employed for a certain period of time or work a certain number of hours before being eligible for benefits). Such an employee is also considered to be a participant in the plan, so the order is an MCSO. DOL QMCSO Compliance Guide, Q1-14. As with any other MCSO, the plan administrator must determine if it is qualified. DOL QMCSO Compliance Guide, Q1-15. If the MCSO is a QMCSO, the plan administrator will have to enroll the child once the employee completes the waiting period. *Id.* The plan's QMCSO procedures should address this temporal issue to ensure that the child will begin receiving benefits upon the employee's satisfaction of the waiting period. The DOL QMCSO Compliance Guide recommends procedures for plan administrators to use in such a case. DOL QMCSO Compliance Guide, Q2-7. Although the procedures are given in the context of an NMSN, they should work equally well for any other QMCSO. If the waiting period is 90 days or less, the plan administrator qualifies the MCSO, and enrolls the child at the expiration of the waiting period. *Id.* The plan administrator would also notify the employer of the need, if any, to withhold from the employee's wages to provide coverage. *Id.* For waiting periods greater than 90 days, or where the period is measured by other means, such as hours worked, the plan administrator should inform the employer of the waiting period. *Id.* The employer is then responsible for notifying the plan administrator of the employee's satisfaction of the waiting period. *Id.*

6. Effective Date of Enrollment

The Social Security Act does not provide a time period within which an alternate payee coverage by a QMCSO must be enrolled in a group health plan. However, Section 1908A of the Social Security Act does provide that the child must be enrolled without regard to the plan's open season restrictions. The DOL has stepped in and stated that the alternate recipient must be enrolled as soon as possible following a determination that an order is a QMCSO. The plan's QMCSO procedures should be crafted to manage prompt enrollment of alternate payees under QMCSOs, which will necessarily require coordination with the provisions of the plan. For example, the QMCSO procedures could provide that if the plan administrator qualifies an MCSO and receives the necessary enrollment forms within a specified number of days, an alternate recipient will be enrolled in the plan as of the date of the MCSO. For enrollment forms received after such time period, the alternate recipient would be enrolled at the earliest possible date the plan permits (for example, the first day of month following receipt of the enrollment forms). Such date would be determined without regard to open enrollment period restrictions. To avoid ambiguity, the QMCSO procedures could also state that in all cases, coverage is effective as of the date of enrollment.

7. Plans Offering No Dependent Coverage

As mentioned above, some group health plans may not offer coverage for dependents of a plan participant. If an MCSO attempts to order a plan that does not offer dependent coverage to provide coverage for an alternate payee, the MCSO would violate ERISA Section 609(a)(4) and could not be a QMCSO. A plan administrator should reject an MCSO that attempts to award an option, benefit, or type of coverage not available under the plan.

8. Health FSA and Cafeteria Plan Issues

Neither ERISA nor the NMSN specifically address coverage under a Health FSA. The ability to use a Health FSA to pay for the alternate recipient's health coverage is potentially advantageous for both the participant and the alternate payee. Under such an arrangement, the participant would be able to meet his or her QMCSO obligations with pre-tax dollars, and the alternate payee would be able to tap into a source of reimbursement for medical expenses that would otherwise not be covered. Payment through health FSAs will not work for all QMCSOs; although a child need not be a tax dependent for coverage under a QMCSO, the child must be a tax dependent to be able to participate in the health FSA. Note that because Code section 125 generally requires cafeteria plan elections to be irrevocable for the entire plan year, the cafeteria plan of which the health FSA is a part would have to be properly drafted to allow a plan election

change to add a child to a health FSA under a QMCSO.

9. Payment of Benefits or Reimbursements

Even though a plan may provide that benefit payments are to be made to the participant, if a plan reimburses expenses incurred by the alternate recipient, the custodial parent, or the health service provider pursuant to a QMCSO, the plan is required to pay the benefits to the party incurring the expense. ERISA § 609(a)(8); DOL QMCSO Compliance Guide, Q1-29. If the plan pays benefits to the state official named in the QMCSO whose name and address are substituted for those of the alternate payee, the plan is treated as paying benefits to the alternate payee. ERISA § 609(a)(9). In cases where the plan is making a payment pursuant to a state law enacted under Section 1908A(5) of the Social Security Act (requiring payment to be made directly to the custodial parent, provider, or state agency), the plan must pay the state child support enforcement agency or Medicaid agency. ERISA § 609(b)(3); DOL QMCSO Compliance Guide, Q1-29. If the plan or plan insurer refuses to pay the alternate recipient or custodial parent, this may constitute a violation of both ERISA and state law enacted under Section 1908A(5) of the Social Security Act. DOL Information Letter (Jan. 19, 1995). Such violations could give the alternate recipient a cause of action against the plan for the payment or reimbursement for benefits, regardless of whether the plan already paid the benefits to the employee. *Id.* The alternate recipient may also have a state law cause of action for violation of a law enacted pursuant to Section 1908A(5) of the Social Security Act.

10. Wage Withholding Limitations

Despite the directive of a QMCSO, federal or state withholding limitations may prevent the participant's employer from withholding from a participant's paycheck amounts sufficient to provide coverage to the alternate recipient. If such a conflict arises, the plan is not required to extend coverage to the child. However, the DOL advises employers to notify the custodial parent (and the child support enforcement agency, if an agency is involved). DOL QMCSO Compliance Manual, Q1-28. The parent (or agency) may be able to modify the amount of support the participant is required to provide. This would enable the employer to withhold the required contribution to the plan. The DOL also notes that the participant may voluntarily consent to the withholding that would otherwise exceed applicable withholding limitations. *Id.*

C. COBRA

When an alternate payee loses coverage under the plan, the plan administrator might wonder whether the child has any rights to continuation coverage under COBRA. As discussed above at Section II.A.1. and II.B.2., a child covered by a group health plan pursuant to a QMCSO is a treated as a beneficiary under the plan. The DOL QMCSO Compliance Guide notes that the IRS (which has jurisdiction over pertinent COBRA matters) has informed the DOL that a child covered under to a QMCSO, by virtue of being a beneficiary under the plan, is thus a "qualified beneficiary" with the right to elect COBRA continuation coverage. DOL QMCSO Compliance Guide, Q1-22. This of course assumes that the plan is subject to COBRA (certain governmental and church plans are exempt, as are plans of employers with fewer than 20 employees, determined on a controlled group basis), and that the child loses coverage as a result of what COBRA defines as a "qualifying event." Plan administrators need to be alert to COBRA issues because ignorance could be a costly mistake. Failure to offer COBRA coverage where it was required may make the plan liable for the alternate payee's medical expenses during the COBRA coverage period without the benefit of insurance or stop-loss coverage.

D. HIPAA Privacy Rule

The Health Insurance Portability and Accountability Act ("HIPAA") restricts the use and disclosure of "protected health information," or "PHI" by most group health plans and certain other entities. PHI is individually identifiable health information relates to the physical or mental health or condition of an individual; the provision of health care to an individual; or the payment for the provision of health care to an individual. 45 C.F.R. § 160.103. Although this HIPAA privacy rule applies to the alternate recipient enrolled in a group health plan pursuant to a QDRO, the DOL QMCSO Compliance Guide does not specifically mention the HIPAA privacy rule. However, the DOL believes that plans should disclose certain plan information, such as plan documents or the summary plan description, to custodial parents and state agencies even prior to a receipt of an MCSO so that the parent or agency may properly prepare an MCSO. DOL QMCSO Compliance Guide, Q1-24. Such documents should not contain PHI, so no HIPAA issues should be implicated.

Requests for information about a participant's coverage choices may present obstacles under the HIPAA privacy rule. If the request is directed to the plan, the plan may disclose the information only is permitted by the HIPAA privacy rule. In contrast, if the request is made to the employer sponsoring the

plan, HIPAA might not apply. If the employer obtained the participant's enrollment information in its employer files while performing the employer's part of the enrollment process, the information would not be subject to the HIPAA privacy rule because the employer would be using the information to perform an "enrollment function" on behalf of the participant, and not on behalf of the plan. 65 Fed. Reg. 82496 (Dec. 28, 2000). However, if the employer received the information from the plan, the employer would be performing a function on behalf of the plan, and HIPAA would apply. Note that plan administrators may be able to allay HIPAA concerns if the participant consents to the disclosure of his or her PHI. 45 C.F.R. § 164.508.

After a group health plan receives a QMCSO, disclosures required under the QMCSO should generally not pose HIPAA concerns because of the exception to the HIPAA privacy rule for uses and disclosures required by law. 45 C.F.R. § 164.512(a). This includes disclosures made in the course of a judicial or administrative proceeding. 45 C.F.R. § 164.512(e). However, the use or disclosure must comply with and be limited to the relevant requirements of such law. 45 C.F.R. § 164.512(a).

The Office of Child Support Enforcement ("OCSE"), an agency of the Department of Health and Human Services, has issued guidance stating that a health plan may disclose PHI to a state child support enforcement agency in response to am NMSN. OCSE Policy Interpretation Question PIQ-04-03 (June 24, 2004) ("PIQ-04-03"). The basis for the OCSE's position is that the HIPAA privacy rule permits a group health plan to disclose protected health information to a "law enforcement official" for law enforcement purposes in compliance with court orders, grand jury subpoenas, or certain written administrative requests under 45 C.F.R. 164.512(f)(l)(ii). *Id.* The OCSE also states that the NMSN constitutes a written administrative request by a law enforcement official, but it must include or by accompanied by written assurances by the law enforcement official that (1) the information sought is material and relevant to a legitimate law enforcement inquiry; (2) the request is specific and limited in scope; and (3) de-identified information cannot reasonably be used, as required by 45 CFR 164.512(f)(l)(ii)(C). *Id.* The Department of Health and Human Services has stated that a group health plan may rely on the NMSN to conclude that these three requirements are satisfied. HHS Frequently Asked Questions on HIPAA Privacy, "May a health plan disclose protected health information to a State child support enforcement (IV-D) agency in response to a National Medical Support Notice?" (http://www.hhs.gov/hipaafaq/permitted/law/759.html.)

E. Model Forms

As with QDROs, plan administrators are not required to develop and make available model QMCSO forms for use by alternate recipients and their counsel in preparing QMCSOs. However, plan administrators may find that model QMCSOs will expedite the MCSO approval process. The DOL does not provide any guidance in the DOL QMCSO Compliance Manual regarding whether a plan administrator is obligated to honor any MCSO that satisfies the requirements of a QMCSO. Nevertheless, due to the nature of benefits provided under QMCSOs, plan administrators should use caution if they choose to condition acceptance of a QMCSO on the use of any particular form.

Appendix C contains sample QMCSO procedures, while Appendix D sets forth a model QMCSO designed for general use. These documents are intended to provide only general guidance; each set of QMCSO procedures must be custom-tailored to account for the provisions of the plan at issue. Likewise, each QMCSO should be drafted in light of the unique facts and circumstances of the plan, the participant, and the alternate recipient. Appendix D also contains a copy of the NMSN, which can also be found at http://www.acf.hhs.gov/programs/cse/forms/ OMB-0970-0222.pdf and in the appendix to 29 C.F.R. § 2590.609-2.

Additional QMCSO guidance is available from the DOL on its website, as well as the websites of other federal agencies. The DOL provides general information relating to QMCSOs in question and answer format in its "Compliance Guide For Qualified Medical Child Support Orders," which is freely available at http://www.dol.gov/ebsa/publications/qm cso.html. Information for employers, practitioners, and alternate recipients (or their representatives) specific to Texas QMCSOs and medical child support is available from the Child Support Division of the Office of the Attorney General at http://www.oag.state.tx.us/cs/index.shtml.

APPENDIX A

SAMPLE QDRO PROCEDURES
(DEFINED CONTRIBUTION PLAN)

APPENDIX B

MODEL QDRO FORMS
(DEFINED CONTRIBUTION PLAN, PARTICIPANTS IN PAY STATUS)

APPENDIX C

MODEL QDRO
(DEFINED CONTRIBUTION PLAN, PARTICIPANTS NOT IN PAY STATUS)

APPENDIX D

MODEL QMCSO

APPENDIX E

QUALIFIED MEDICAL CHILD SUPPORT ORDER PROCEDURE