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Plan Sponsor Basics

Webinar 3 of 6

QDRO Basics

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Agenda

- Background
- What is a QDRO?
- DRO evaluation
- QDRO administration
- What is a QMSCO?
- DROs re: options and executive compensation
- Questions

Factual Background

- Divorce rate: roughly 41%
- Divorce rate for college educated: roughly 25%
- Divorce rate for high school educated or lower: 50%+
- 2nd marriage divorce rate higher
- U.S. divorce rate materially higher than EU and Japan (Italian divorce rate quite low – U.S.: 4.33/1,000; Italy: 0.47/1,000 as of 2000)
- FRB study (2007): Retirement assets = 35% of median family financial assets (which in total = 34% of total net worth); total median = $221,000; nonfinancial assets = 66% of total net worth, with primary residence equaling 48% of the total

Background

- United States v. Davis (S. Ct. 1963): A spouse transferring property to a former spouse in extinguishment of marital rights recognizes gain equal to the excess of (i) FMV of property and (ii) its adjusted basis.
- §1041: Nonrecognition for transfer to spouse or former spouse "incident to divorce"; treated as gift and transferee spouse gets "carryover" basis.
- Alimony: Includible in gross income of recipient; deductible to payor (§71; §215).
- QDRO Statutory Provisions: §414(p); §206(d) of ERISA.

What is a Qualified Domestic Relations Order?

- A qualified domestic relations order (QDRO) is a domestic relations order that creates or recognizes the existence of an alternate payee's right to receive, 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 qualified retirement plan, and that includes certain information and meets certain other requirements.

What is a Domestic Relations Order?

- A domestic relations order (DRO) is a judgment, decree, or order (including the approval of a property settlement):
  - made pursuant to state domestic relations law (including community property law)
  - that relates to the provision of child support, alimony payments, or marital property rights for the benefit of a spouse, former spouse, child, or other dependent of a participant

What is a Domestic Relations Order? (cont'd)

- A state authority, generally a court, must actually issue a judgment, order, or decree or otherwise formally approve a property settlement agreement before it can be a DRO under ERISA.
- The mere fact that a property settlement is agreed to and signed by the parties will not, in and of itself, cause the agreement to be a DRO.
- Plan administration cannot accept an order that is not a DRO.

What is a Domestic Relations Order? (cont'd)

- There is no requirement that both parties to a marital proceeding sign or otherwise endorse or approve an order. It is also not necessary that the retirement plan be brought into state court or made a party to a domestic relations proceeding for an order issued in that proceeding to be a DRO or QDRO.
- Because state law is generally preempted to the extent that it relates to retirement plans, the DOL takes the position that retirement plans cannot be joined as a party in a domestic relations proceeding pursuant to state law. Moreover, retirement plans are neither permitted nor required to follow the terms of DROs purporting to assign retirement benefits unless the orders are QDROs.

Must a DRO be issued by a state court?

- A DRO may be issued by any state agency or instrumentality with the authority to issue judgments, decrees, or orders, or to approve property settlement agreements, pursuant to state domestic relations law (including community property law).

Who can be an Alternate Payee?

- A DRO can be a QDRO only if it creates or recognizes the existence of an alternate payee's right to receive, or assigns to an alternate payee the right to receive, all or a part of a participant's benefits. For purposes of the QDRO provisions, an alternate payee cannot be anyone other than a spouse, former spouse, child, or other dependent of a participant.

What information must a DRO contain to qualify as a QDRO under ERISA?

QDROs must contain the following information:

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

Are there other requirements that a DRO must meet to be a QDRO?

There are certain provisions that a QDRO cannot contain:

- The order must not require a plan to provide an alternate payee or a participant with any type or form of benefit, or any option, not otherwise provided under the plan
- The order must not require a plan to provide for increased benefits (determined on the basis of actuarial value)

Are there other requirements that a DRO must meet to be a QDRO? (cont'd)

- The order must not require a plan to pay benefits to an alternate payee that are required to be paid to another alternate payee under another order previously determined to be a QDRO
- The order must not require a plan to pay benefits to an alternate payee in the form of a QJSA for the lives of the alternate payee and his or her subsequent spouse
- But can designate a former spouse as a spousal beneficiary (QJSA, QPSA, other death benefit)

May a QDRO be part of the divorce decree or property settlement?

- There is nothing in ERISA or the Internal Revenue Code (Code) that requires that a QDRO be issued as a separate judgment, decree, or order. Accordingly, a QDRO may be included as part of a divorce decree or court-approved property settlement, or issued as a separate order, without affecting its qualified status.
- The order must otherwise satisfy the requirements described above to be a QDRO.

Must a DRO be issued as part of a divorce proceeding to be a QDRO?

- A DRO that provides for child support or recognizes marital property rights may be a QDRO, without regard to the existence of a divorce proceeding. Such an order, however, must be issued pursuant to state domestic relations law and create or recognize the rights of an individual who is an alternate payee (spouse, former spouse, child, or other dependent of a participant).

Must a DRO be issued as part of a divorce proceeding to be a QDRO? (cont'd)

- An order issued in a probate proceeding begun after the death of the participant that purports to recognize an interest with respect to retirement benefits arising solely under state community property law, but that doesn't relate to the dissolution of a marriage or recognition of support obligations, is not a QDRO because the proceeding does not relate to a legal separation, marital dissolution, or family support obligation.
- DOL Advisory Opinion 90-46A; *see Egelhoff v. Egelhoff* 121 S. Ct. 1322, 149 L. Ed. 2d 264 (2001); *see Boggs v. Boggs*, No. 97-79 (S. Ct. June 2, 1997).

Will a DRO fail to be a QDRO solely because of the timing of issuance?

- Not if it otherwise meets the QDRO requirements under ERISA. A DRO issued after the participant's death, divorce, or annuity starting date, or subsequent to an existing QDRO, will not fail to be treated as a QDRO solely because of the timing of issuance.

Will a DRO fail to be a QDRO solely because of the timing of issuance? (cont'd)

- For example, a subsequent DRO between the same parties that revises an earlier QDRO does not fail to be a QDRO solely because it was issued after the first QDRO. Likewise, a subsequent DRO order between different parties that directs a portion of the participant's previously unallocated benefits to be paid to a second alternate payee does not fail to be a QDRO solely because of the existence of a previous QDRO. Further, a DRO requiring a portion of a participant's annuity benefit payments to be paid to an alternate payee does not fail to be a QDRO solely because the DRO was issued after the annuity starting date.
- Reference: 29 C.F.R. § 2530.206; *see* § 1001 of the Pension Protection Act of 2006, Pub. L. 109-280, 120 Stat. 780 (Aug. 17, 2006).

May a QDRO provide for payment to the guardian of an alternate payee?

- If an alternate payee is a minor or is legally incompetent, the order can require payment to someone with legal responsibility for the alternate payee (such as a guardian or a party acting *in loco parentis* in the case of a child, or a trustee as agent for the alternate payee).

Can a QDRO cover more than one plan?

- A QDRO can assign rights to retirement benefits under more than one retirement plan of the same or different employers as long as each plan and the assignment of benefit rights under each plan are clearly specified.

Must all QDROs have the same provisions?

- Although every QDRO must contain certain provisions, such as the names and addresses of the participant and alternate payee(s) and the name(s) of the plan(s), the specific content of the rest of the QDRO will depend on the type of retirement plan, the nature of the participant's retirement benefits, the purposes behind issuing the order, and the intent of the drafting parties.

Who determines whether an order is a QDRO?

- The administrator of the retirement plan that provides the benefits affected by an order is the individual (or entity) initially responsible for determining whether a DRO is a QDRO. Plan administrators have specific responsibilities and duties with respect to determining whether a DRO is a QDRO. Plan administrators, as plan fiduciaries, are required to discharge their duties prudently and solely in the interest of plan participants and beneficiaries.
- Plans must establish reasonable procedures to determine the qualified status of DROs and to administer distributions pursuant to qualified orders. Administrators are required to follow the plan's procedures for making QDRO determinations. Administrators also are required to furnish notice to participants and alternate payees of the receipt of a DRO and to furnish a copy of the plan's procedures for determining the qualified status of such orders.

Who determines whether an order is a QDRO? (cont'd)

- The DOL takes the view that a state court (or other state agency or instrumentality with the authority to issue DROs) does not have jurisdiction to determine whether an issued DRO constitutes a QDRO. In the view of the DOL, jurisdiction to challenge a plan administrator's decision about the qualified status of an order lies exclusively in federal court.

Who is the administrator of the plan?

- The administrator of an employee benefit plan is the individual or entity specifically designated in the plan documents as the administrator. If the plan documents do not designate an administrator, the administrator is the employer maintaining the plan, or, in the case of a plan maintained by more than one employer, the association, committee, joint board of trustees, or similar group representing the parties maintaining the plan. The name, address, and phone number of the plan administrator is required to be included in the plan's summary plan description (SPD). The SPD is a document that the administrator is required to furnish to each participant and to each beneficiary receiving benefits. It summarizes the rights and benefits of participants and beneficiaries and the obligations of the plan.

Will the DOL issue advisory opinions on whether a DRO is a QDRO?

- A determination of whether a DRO is a QDRO necessarily requires an interpretation of the specific provisions of the plan or plans to which the order applies and the application of those provisions to specific facts, including a determination of the participant's actual retirement benefits under the plan(s). The DOL will not issue opinions on such inherently factual matters.
- Reference: ERISA Procedure 76-1, 41 Fed. Reg. 36281 (1976)

“Sham” Divorces

- Plan permitted immediate cash-out distribution at age 50.
- Divorce proceedings commenced but spouses planned to continue the “relationship”; obtained DRO.
- Committee accepted the DRO as a QDRO, then sued for restitution in federal court.
- Fifth Circuit: Committee is not obligated or entitled to challenge the state court DRO on the ground that the divorce is a “sham”; as long as QDRO standards are met, the DRO must be implemented.
- DOL guidance: If committee thinks the DRO is a “sham,” notify state court; if no action taken, must implement the DRO.
- Could plan amendment address

  [*Brown v. Continental Airlines*, 5th Cir. 2011]

Combining QPSA with Separate Account

- DRO set up separate accounts for DB plan; AP got a 55% annuity
- Order also gave AP QPSA rights in P's remaining accrued benefit
- P argued that a separate account approach "nullifies the survivorship provision by negating the need for it."
- AP argued that the parties can divide up the total accrued benefits any way they agree to, so long as QDRO rules are not violated.
- Court sided with P, concluding that the QPSA result was inconsistent with the parties' intentions, but that the parties could have agreed on "both a separate interest approach and a shared interest."

  [*Krushensky v. Farinas*, (Alaska Sup. Ct. 2008)]

Other Issues

- Two types of QDROs – separate interest and shared payments
- Distribution to alternate payee
  - Can allow payments to commence before separation from service but after "earliest retirement date"
  - QDROs can allow payment at a time otherwise not allowed under 401(a) or 401(k)
  - Withdrawals and loans
  - Earliest and latest distribution date

Other issues (cont'd)

- Effect of QJSA/QPSA
- Death before distribution
- Disability
- Actuarial factors
- Loans
- QDRO fees

QDRO Administration

- QDRO Procedures
  - Provide benefit information
  - Suspend payments/restrict loans and distributions
  - Timeline
  - Appeal procedures
  - Retroactive division of benefits

QDRO Administration (cont'd)

- Model order
- Outsourcing
- Modification vs. Rejection of DRO
- Interpleader
- Don't get caught in the middle

Q1-1: What types of plans are subject to the QMCSO provisions?

The QMCSO provisions apply to “group health plans” subject to ERISA. For this purpose, a “group health plan” generally is a plan that:

- Is sponsored by an employer or employee organization (or both) and provides “medical care” to employees, former employees, or their families.
- “Medical care” means amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of a disease; for the purpose of affecting any structure or function of the body; transportation primarily for or essential to such care or services; or for insurance covering such care or services.

What types of plans are subject to the QMCSO provisions? (cont'd)

- ERISA does not generally apply to plans maintained by federal, state, or local governments; churches; and employers solely for purposes of complying with applicable workers' compensation or disability laws. However, provisions of the Child Support Performance and Incentive Act (CSPIA) of 1998 require church plans to comply with QMCSOs and National Medical Support Notices, and state and local government plans to comply with National Medical Support Notices.

  [ERISA §§ 4(b), 609(a), 607(1); Internal Revenue Code § 213(d); CSPIA § 401(f)]

Q1-2: What is a QMCSO?

"QMCSO" is a medical child support order that:

- Creates or recognizes the right of an alternate recipient to receive benefits for which a participant or beneficiary is eligible under a group health plan or assigns to an alternate recipient the right of a participant or beneficiary to receive benefits under a group health plan; and
- Is recognized by the group health plan as "qualified" because it includes information and meets other requirements of the QMCSO provisions.

In addition, a properly completed National Medical Support Notice must be treated as a QMCSO.

[ERISA § 609(a)(2), 609(a)(5)(C)]

Q1-3: What is a medical child support order?

A medical child support order is a judgment, decree, or order (including an approval of a property settlement) that:

- Is made pursuant to state domestic relations law (including a community property law) or certain other state laws relating to medical child support (see Q1-8); and
- Provides for child support or health benefit coverage for a child of a participant under a group health plan and relates to benefits under the plan.

  [ERISA § 609(a)(2); Social Security Act § 1908]

Q1-4: Must a medical child support order be issued by a state court?

No. Any judgment, decree, or order that is issued by a court of competent jurisdiction or an administrative agency authorized to issue child support orders under state law (such as a state child support enforcement agency) that provides for medical support of a child can be a medical child support order.

[ERISA § 609(a)(2)]

Q1-5: Who can be an alternate recipient?

- Any child of a participant in a group health plan who is recognized under a medical child support order as having a right to enrollment under the plan with respect to such participant is an alternate recipient.

  [ERISA § 609(a)(2)]
- Cannot be a former spouse

Q1-6: What information must a medical child support order contain to be a “qualified” order?

A medical child support order must contain the following information in order to be qualified:

- The name and last known mailing address of the participant and each alternate recipient. The order may substitute the name and mailing address of a state or local official for the mailing address of any alternate recipient;
- A reasonable description of the type of health coverage to be provided to each alternate recipient (or the manner in which such coverage is to be determined); and
- The period to which the order applies.

  [ERISA § 609(a)(3)]

Q1-7: What other requirements must a medical child support order meet in order to be a “qualified” order?

An order may not require a plan to provide any type or form of benefit, or any option, not otherwise provided under the plan, except to the extent necessary to meet the requirements of certain state laws.

[ERISA § 609(a)(4)]

Q1-8: What state laws relating to medical child support can be enforced by a QMCSO?

At the time that the QMCSO provisions were added to ERISA, Congress also added section 1908 to the Social Security Act. Section 1908 says that states cannot receive federal Medicaid funds unless they have in place specific state laws relating to medical child support. States must have laws that:

- Require health insurers to enroll a child under his or her parent's health insurance even if the child was born out of wedlock, does not reside with the insured parent or in the insurer's service area, or is not claimed as a dependent on the parent's federal income tax return;
- Require a health insurer to enroll a child pursuant to court or administrative order without regard to the plan's open season restrictions;
- Require employers and insurers to comply with court or administrative orders requiring the parent to provide health coverage for a child; and
- Require insurers to permit a custodial parent to file claims on behalf of his or her child under the noncustodial parent's health insurance and to make benefit payments to the custodial parent or healthcare provider.

[ERISA § 609(a)(2), 609(a)(4); Social Security Act § 1908]

Q1-9: What may a QMCSO do to enforce these state medical child support laws?

If a QMCSO refers to these state laws or requires a plan to comply with the substantive requirements contained in the state laws, the plan must comply with them. For instance, a QMCSO may require a plan to enroll a child before the plan's next open enrollment period.

[ERISA § 609(a)(2), 609(a)(4)]

Q1-10: Who determines whether a medical child support order is qualified?

The administrator of the group health plan is required to determine whether an order is qualified. The administrator is required to make this determination within a reasonable period of time pursuant to reasonable written procedures that have been adopted by the plan. The administrator must first notify the participant and the alternate recipient when the plan receives a medical child support order and must give them copies of the plan's procedures for determining whether it is qualified. The administrator must notify those parties of its determination whether or not the order is qualified.

[ERISA § 609(a)(5)]

Q1-11: How long may a plan administrator take to determine whether a medical child support order (other than a National Medical Support Notice) is qualified?

Plan administrators must determine whether a medical child support order is qualified within a reasonable period of time after receiving the order. What is considered a reasonable period will depend on the circumstances. For example, an order that is clear and complete when submitted should require less time to review than one that is incomplete or unclear. The National Medical Support Notice provisions contain separate, specific time limits on the processing of the Notice by employers and plan administrators (see Qs 2-3 and 2-4).

[ERISA § 609(a)(5)]

Q1-12: If an order names an employee who is not enrolled in the plan but is eligible to enroll, can the order be a medical child support order within the meaning of the QMCSO provisions?

Yes. An employee who is eligible to enroll is a participant in the plan and thus the order is a medical child support order.

[ERISA §§ 3(7), 609(a)(1)]

Q1-13: In the case of an employee named in a medical child support order who is not enrolled, what is the plan's obligation?

The plan administrator must determine if the order is qualified and, if so, provide coverage to the child. If the employee is eligible to participate in the plan, the child must be covered. If, as a condition for covering his dependents, the employee must be enrolled, then the plan must enroll both.

Q1-14: If an order names an employee who has not yet satisfied the plan's generally applicable waiting period, can the order be a medical child support order within the meaning of the QMCSO provisions?

Yes. An employee who has not yet satisfied a plan's generally applicable waiting period (such as requiring that the person be employed for a certain number of days or work a certain number of hours before being eligible for benefits) is also a participant in the plan, and the order is a medical child support order.

[ERISA §§ 3(7), 609(a)(1)]

Q1-15: In the case of an employee named in a medical child support order who has not satisfied the plan's generally applicable waiting period, what is the plan's obligation?

The plan administrator must determine if the order is qualified. If the order is qualified, the administrator should have procedures in place so that the child will begin receiving benefits upon the employee's satisfaction of the waiting period.

Q1-16: If a group health plan does not provide any dependent coverage, may a medical child support order require the plan to provide coverage for a child of a participant pursuant to a QMCSO?

No. As stated in Q1-7, a medical child support order is not qualified if it requires a plan to provide a type or form of benefit or option not otherwise available under the plan. An order may not require a plan to provide dependent coverage when that option is not otherwise available under the plan.

[ERISA § 609(a)(4)]

Q1-17: In determining whether a medical child support order is qualified, is the plan administrator required to determine whether the order is valid under state law?

No. A plan administrator generally is not required to determine whether the issuing court or agency had jurisdiction to issue an order, whether state law is correctly applied in an order, whether service was properly made on the parties, or whether an individual identified in an order as an alternate recipient is in fact a child of the participant.

Q1-18: Is a plan administrator required to reject a medical child support order as not qualified if the order fails to include factual identifying information that is easily obtainable by the administrator?

No. In many cases, an order that is submitted to the plan may clearly describe the identity and rights of the parties, but may be incomplete only with respect to factual identifying information within the plan administrator's knowledge or easily obtained through a simple communication with the alternate recipient's custodial parent, the participant, or the state child support enforcement agency. For example, an order may misstate the names of the participant or alternate recipients, and the plan administrator can clearly determine the correct names, or an order may omit the addresses of the participant or alternate recipients, and the plan administrator's records include this information. In such a case, the plan administrator should supplement the order with the appropriate identifying information, rather than rejecting the order as not qualified.

Q1-19: What is a “reasonable description” of the type of coverage to be provided to the child?

The order need only provide a coverage description that enables the plan administrator to determine which of the available options and levels of coverage should be provided to the child. For instance, if an order requires that a child be provided any coverage available under the plan, the plan administrator would determine the coverage available under the plan (e.g., major medical, hospitalization, dental) and provide that coverage to the alternate recipient. However, if the plan offers more than one type of coverage (e.g., an HMO and a fee-for-service option), the order should make clear which should be provided or how the choice is to be made. If the order is unclear, the plan’s procedures may direct the administrator to contact the submitting party, or may provide other selection methods similar to those established for the processing of National Medical Support Notices. If the plan does not have such procedures, the administrator may have to reject the order.

Q1-20: If a plan provides benefits solely through an HMO or other managed care organization with a geographically limited benefit area, is the plan required to create and provide comparable benefits to an alternate recipient who resides outside of the HMO's service area?

No. A medical child support order is not qualified if it requires a plan to provide a type or form of benefit that is not otherwise available under the plan. Requiring a plan that provides benefits solely through a limited-area HMO to provide benefits to alternate recipients outside of the HMO's service area (i.e., on a fee-for-service or any other basis) would be requiring the plan to provide a form of benefit that the plan does not ordinarily provide. On the other hand, if the child is able to come into the HMO's service area for medical care, the plan would be required to provide benefits to the alternate recipient.

[ERISA § 609(a)(4)]

Q1-21: May a plan provide benefits to a child of a participant pursuant to a medical child support order that is *not* a qualified order?

Nothing in Title I of ERISA would prohibit the plan from providing such coverage pursuant to the terms of any medical child support order, regardless of whether the order satisfies the qualification requirements of section 609(a), provided that the terms of the plan do not otherwise prohibit coverage of the child for any other reasons, such as the child does not reside with the participant or is not claimed as a dependent on the participant's federal income tax return.

Q1-22: If a child is covered by a group health plan pursuant to a QMCSO, does the child have any rights to continuation coverage?

Yes. A child covered by a group health plan pursuant to a QMCSO is a beneficiary under the plan. The Internal Revenue Service (which has jurisdiction over such questions related to continuation coverage) has informed the DOL that a child covered pursuant to a QMCSO is therefore a "qualified beneficiary" with the right to elect continuation coverage under COBRA, if the plan is subject to COBRA and if the child loses coverage as a result of a qualifying event.

[ERISA §§ 609(a)(7)(A), 607(3)]

Q1-23: When must a plan begin to provide coverage to an alternate recipient pursuant to a QMCSO?

It is the view of the DOL that following a determination that an order is qualified, the alternate recipient (and the participant, if necessary) must be enrolled as of the earliest possible date following such determination. For example, if an insured plan only adds new participants or beneficiaries as of the first day of each month, that plan would be required to provide coverage to the alternate recipient as of the first day of the first month following the determination that the order is qualified. The state laws described in section 1908 of the Social Security Act require that when a child is enrolled in a plan pursuant to a court or administrative order, such enrollment be made without regard to open season restrictions.

[Social Security Act § 1908]

Q1-24: What information should a group health plan make available to parties seeking to obtain health coverage for a child before the plan receives a medical child support order?

It is the view of the DOL that Congress intended custodial parents and/or state child support enforcement agencies acting on the child's behalf to have access to plan and participant benefit information sufficient to prepare a QMCSO. Information important for that purpose would include the SPD, relevant plan documents, and a description of particular coverage options, if any, that have been selected by the participant.

The DOL believes that Congress did not intend to require parties seeking coverage of a child to first submit a medical child support order to the plan in order to establish rights to information in connection with a child support proceeding. However, a plan administrator may condition disclosure of such information on receiving information sufficient to reasonably establish that the disclosure request is being made in connection with a child support proceeding. A disclosure request from a state child support enforcement agency should be assumed to be made in connection with a child support proceeding.

Q1-25: What effect does an order that a plan administrator has determined to be a QMCSO have on the administration of the plan?

The plan administrator must act in accordance with the provisions of the QMCSO as if it were part of the plan. In particular, any payment for benefits in reimbursement for expenses paid by an alternate recipient or an alternate recipient's custodial parent or legal guardian must be made to the alternate recipient, custodial parent, or legal guardian.

[ERISA § 609(a)(1), 609(a)(8)]

Q1-26: If a plan provides that dependents of participants must be enrolled in the same coverage and option as the participant, must an alternate recipient be enrolled in the same coverage and option in which the participant is enrolled?

Yes. Pursuant to section 609, an alternate recipient under a QMCSO is treated as a beneficiary under the plan. Accordingly, in the view of the DOL, an alternate recipient is also treated as a dependent of the participant under the plan. (However, if a QMCSO specifies that an alternate recipient is to receive a particular level of coverage or option that is available under the plan, but the participant is not enrolled in the particular coverage or has not selected the particular option, the plan may be required to change the participant's enrollment to the extent necessary to provide the specified coverage to the alternate recipient.)

[ERISA § 609(a)(7)(A)]

Q1-27: If the plan requires additional employee contributions or premiums for coverage of a child named in a QMCSO, who is obligated to pay that additional amount?

The medical child support order will ordinarily establish the obligations of the parties for the child's support. In most cases, the obligor under a medical child support order will be the noncustodial parent who is a participant in a group health plan and is responsible for the payment of any costs associated with the provision of coverage.

Q1-28: What is the plan's obligation in the event that the employer is unable to withhold from the participant's paycheck the employee contributions necessary to provide coverage to the child?

If federal or state withholding limitations prevent withholding from the participant's paycheck the additional contribution required to provide coverage to the child under the terms of the plan, the employer should notify the custodial parent and the child support enforcement agency, if the agency is involved. Unless the employer is able to withhold the necessary contribution from the participant's paycheck, the plan is not required to extend coverage to the child. However, the custodial parent or the agency may be able to modify the amount of cash support to be provided in order to enable the employer to withhold the required contribution to the plan. The participant may also voluntarily consent to the withholding of an amount otherwise in excess of applicable withholding limitations.

Q1-29: To whom should the plan pay benefits?

The plan should pay benefits to the alternate recipient, the custodial parent, or the provider of health services to the child notwithstanding plan terms that may require benefit payments be made to the participant. In some instances, payment will be required to be made to the state child support enforcement or Medicaid agency.

[ERISA §§ 609(a)(8), 609(a)(9), 609(b)(3); Social Security Act § 1908(a)(5)]

Q1-30: When and under what conditions may a plan disenroll an alternate recipient?

A plan may disenroll an alternate recipient at the same time and under the same conditions as it can disenroll other dependents of participants under the plan. For instance, if the plan terminates coverage when a participant terminates employment, and neither the participant nor the alternate recipient elects COBRA continuation coverage, the plan may discontinue coverage for the alternate recipient. Similarly, if the plan ceases to provide coverage for dependents who are over the age of 18, the coverage of an alternate recipient who is over the age of 18 may be terminated (assuming that continuation coverage is not elected).

Q1-31: May a group health plan impose its generally applicable preexisting condition restrictions or exclusions to an alternate recipient named in a QMCSO?

Subject to the limitations on the imposition of preexisting condition restrictions and exclusions contained in section 701 of ERISA, an alternate recipient would be subject to the plan's generally applicable preexisting condition restrictions or exclusions. However, it is the view of the DOL that a group health plan's receipt of a medical child support order would toll the running of the 63-day break-in-coverage period for determining the child's creditable coverage. The time taken by the plan administrator to determine whether the order is qualified would not count toward a 63-day break. In addition, if the child had been previously covered under the plan and had been disenrolled by the participant in anticipation of, e.g., divorce or separation, it is the view of the DOL that the period between the date the child's coverage is terminated and the date the plan administrator determines that an order is qualified would also not count as part of the 63-day period.

Executive Compensation/Options

- Unlike qualified plans/health plans, there is no requirement under the Code or ERISA that equity compensation plans or other nonqualified plans accept a state court order dividing up rights under such plans.
- Plans not covered by ERISA technically cannot be covered by a QDRO.
- Inherently a plan design issue.
- State courts or senior executives may advocate for a specific result.

IRS Rulings

- Rev. Rul. 2002-22: Extends section 1041 treatment to option gain on exercise of vested NQSOs when spouse or former spouse does so incident to divorce
- Rev. Rul. 2004-60:
  - FIT: reportable to nonemployee spouse on Form 1099-MISC
  - FICA/FUTA: withheld from nonemployee spouse but reported as if employee spouse had exercised
- ISOs: disqualified if transferred in divorce (and become NQSOs)

ISO Treatment

LTR 200519011: ISOs generally nontransferable from E (employee spouse) to X (nonemployee spouse):

1. The court's recognizing X's community property interest in the ISOs and requiring E to exercise X's ISOs only in accordance with X's instructions and requiring E to designate X as the beneficiary of X's share of the options will not violate the requirements of section 422(b)(5) of the Code relating to nontransferability and lifetime exercise by an employee.
2. Alternative minimum taxable income recognized on E's exercise of X's ISOs will be includible in X's alternative minimum taxable income for federal tax purposes.
3. Income recognized on E's exercise of X's NSOs that remain in E's name or under E's control will be included in X's income for federal income tax purposes.
4. X will be entitled to any alternative minimum tax credits as a result of E's exercise of X's ISOs.
5. Under principles regarding taxation of equal division of community property, none of the following will be a taxable event: (i) the recognition of X's ownership of X's options; (ii) the transfer to X of X's NSOs; (iii) the transfer of stock from E or company to X after the exercise by E of any of X's options; or (iv) E's designation of X as beneficiary of X's options.
6. Under section 424(c) of the Code, a transfer between E and X (or directly from company to X) of stock resulting from the exercise of X's ISOs will not be a disposition of such stock, and all subsequent tax consequences with respect to such stock will be X's.

ISOs

7. Income recognized on X's exercise of X's NSOs that have been fully transferred to X will be included in X's income for federal income tax purposes.
8. Gain or loss on the sale of stock received by E on exercise of any of X's options that remain in E's name is includible in calculating X's gross income, regardless of whether such stock is first registered in X's name.
9. Gain or loss on the sale of any stock received by X on the exercise of any of X's NSOs is includible in calculating X's gross income.
10. Reimbursements made by one former spouse to the other in the event that company withholds any taxes from a former spouse that are properly the liability of the other former spouse will be tax-free transfers incident to divorce.
11. X is entitled to the credit for income tax withheld from the stock or cash proceeds (or paid to company by X for properly due income tax withholding) at the time of the exercise of the nonstatutory stock options of which X is beneficial owner.
12. The division of the options between X and E pursuant to the divorce order will be made for full and adequate consideration in money or money's worth and will not be a taxable gift by X under section 2501.
13. If E dies while X's ISOs are in E's name, X, as beneficial owner and designated beneficiary, may subsequently exercise such options and receive and dispose of the resulting stock with the same tax consequences as if E had exercised the ISOs.

Questions?

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