CITY OF FORT PIERCE - OFFICE OF THE CITY ATTORNEY

MEMORANDUM

TO: Gloria Johnson, Retirement Board Secretary

FROM: James T. Walker, Assistant City Attorney

RE: Florida Bar Article on QDRO's and Florida Municipal Pension Plans

DATE: February 6, 2015

This memo serves to attach a memorandum addressed formally to Tom Perona as Chair of the Retirement Board, to be copied by you to all Board members in their agenda packet. The memorandum addresses and attaches a recent article about QDROs that appeared in the Florida Bar Journal. Please let me know of any questions in this regard.

s/ James T. Walker

James T. Walker, Esq.
Assistant City Attorney

/mlp
Attachment
cc: Robert V. Schwerer, City Attorney

CITY OF FORT PIERCE - OFFICE OF THE CITY ATTORNEY

MEMORANDUM

TO: Thomas K. Perona, Retirement Board Chair

FROM: James T. Walker, Assistant City Attorney

RE: Florida Bar Article on QDRO's and Florida Municipal Pension Plans

DATE: February 6, 2015

In this month's issue of the Florida Bar Journal (February 2015) there is an interesting article that discusses application of QDROs to municipal pension benefits, entitled "Recurring Issues with Florida's Municipal Pension Plans in Family Law Cases". A copy of the article is attached for background purposes. It will be recalled that under our Board Rule 16 QDROs are honored against a retirant's benefit payment if the QDRO applies to either child support or alimony. If the QDRO is for division of marital property, not explicitly for either child support or alimony, the Board considers itself under no obligation to honor the order. Instead, a hearing is scheduled, the retirant is notified and if the retirant wants the Board to approve the order then, in its discretion, the Board may choose to do so.

But the article suffices to cause the reader to understand that this area of the law can be complicated. Frankly, I myself would feel comfortable were we to ask our expert, Jim Linn, to look over our rule on this subject and simply confirm that it does in fact conform to the law on this subject. With that in mind, a recommendation for procurement of such opinion will be made at the meeting.

s/ James T. Walker

James T. Walker, Esq.
Assistant City Attorney

/mlp
cc: Robert V. Schwerer, City Attorney

by Matthew L. Lundy

Recurring Issues with Florida's Municipal Pension Plans in Family Law Cases

F.S. §185.25 provides:

> For any municipality, chapter plan, local law municipality, or local law plan under this chapter, the pensions, annuities, or any other benefits accrued or accruing to any person under any municipality, chapter, plan, local law municipality, or local law plan under the provisions of this chapter and the accumulated contributions and the cash securities in the funds created under this chapter are exempt from any state, county, or municipal tax of the state, and shall not be subject to execution or attachment or to any legal process whatsoever and shall be unassignable.

Florida courts have interpreted §185.25 as prohibiting the division of any municipal pension through a qualified domestic relations order (QDRO), and have held that a nonparticipant spouse's only remedy for enforcing an assignment of a pension benefit is a court order requiring the participant spouse to make direct payments.[1] Courts in Florida have upheld this view as an adequate remedy for the former spouse, despite recognizing the obvious enforcement and contempt issues.[2] This article considers the complications and inequities of the current state of the law in Florida related to inability of nonparticipant spouses to obtain enforcement via QDRO or similar order.

The Employee Retirement Income Security Act of 1974[3] (ERISA) was created in part to protect the interests of plan participants by, among other things, establishing that benefits provided under a covered retirement plan could not be alienated or assigned. This is to say, ERISA was created, in part, to minimize the ability of plan administrators and plan participants, as well as their creditors, to access assets in ERISA-based retirement plans. This is commonly referred to as the "anti-alienation rule." Many other pension statutes contain such provisions as well. In the context of family law cases, an exception to ERISA's anti-alienation rule permits benefits to be assigned via a QDRO.[4]

A QDRO is a court order that enforces an alternate payee's[5] right to receive all or a portion of a plan participant's benefits under an ERISA-based retirement plan.[6] As a practical matter, a QDRO resolves a number of complicated tax, enforcement, and assignment issues because it links an alternate payee directly to the participant's retirement plan. More specifically, it gives a nonparticipant spouse a means to enforce rights to support and/or property division against a retirement plan directly, without having to rely on the participation of the participant spouse in collecting said assignment. In practice, a QDRO makes the process of dividing benefits seamless and reduces litigation in the already contentious world of family law.

Generally, government pension plans are exempt from ERISA; thus, a government pension plan cannot be ordered to accept a QDRO (a creature of ERISA), unless they voluntarily accept orders similar thereto. This means that a government plan will not make direct payment to the former spouse of a plan participant unless they opt to do so by creating their own QDRO-like order.[7] If a retirement plan will not accept such orders, which is the case with Florida's municipal pension plans, a former spouse will have a potentially unenforceable interest in their former spouse/plan participant's pension, along with a number of other problems.

Issues Related to the Divisibility of Municipal Pension Plans

Although municipal pension plans are less common, general retirement plans are the most common assets addressed in family law. In fact, retirement assets actually have their own specific section of F.S. Ch. 61, addressing how they are to be valued and divided in family law cases.[8] In equitably distributing defined benefit retirement plans (commonly referred to as traditional pension plans), the parties typically have the option to either divide such plans (in which case there are several options for doing so) or to value the plans and offset them against other assets.

The latter option is known as the immediate offset method.[9] A "present value calculation" consists of taking a future amount of money and discounting it by prevailing interest rates to reflect its hypothetical current value as if it existed as a present-day dollar amount. The former option, known as the deferred distribution method, allows the court to determine the amount of the benefit as if the participant retired on a fictitious date without an early retirement penalty.[10] The court then determines the nonmember spouse's share by multiplying the resulting dollar amount by the nonmember spouse's interest.[11] This deferred distribution method is frequently employed when a QDRO will be utilized, but harder to employ in the case of municipal pensions.

Why might a party want to exercise

one option versus the other? In the case of parties on equal financial footing, with similar assets titled in their own names, it may save time and money to simply walk away from the assets titled in the other party's name. If the parties are not on equal financial footing, and one party has all or a majority of the retirement assets titled in their name, division of the retirement assets may be advisable. In that way, the parties can equally share in liquid or semi-liquid assets with real present values (such as cash or nonqualified investments) and equally share in retirement plans, which are generally not liquid.

In a small subset of cases, it is necessary to perform a present value calculation of a retirement annuity and offset it against another asset. In that way, a nonliquid, potentially contingent asset (such as a defined benefit municipal pension plan that will not payout for several years) is offset against an asset like a house, an investment fund, or even cash, which is more easily liquidated or liquid. Because this last option — the offset option — requires equating a nonliquid, contingent asset with assets that are liquid and/or noncontingent, a serious potential inequity is created.

For example, assume husband (H) and wife (W) are going to trial, and they own five pieces of property, a house worth $300,000, a bank account with $50,000 in cash, two cars worth $10,000 a piece, and H's pension, with a present value of $400,000. Assume further that they have $30,000 of debt. Assume all of this is marital. In Florida, a court's job is to add up all assets and liabilities and divide them equally. In fashioning an equitable distribution in this hypothetical scenario, the house, cars, cash, and debt are of immediate value/liability. The pension, however, might not be mature to payout for another 10 years. However, because the pension is not readily divisible by QDRO, W's counsel could make the argument that in equity, W should receive all $370,000 of the assets, leaving H with only his pension and the liability, plus a potential alimony obligation. Technically, this would be absolutely permissible under the existing law. Consider further that if H were to die prior to the maturation of the pension, then he would have actually reaped no benefit from the equitable distribution scheme here.

Because municipal pensions are exempt from ERISA and are under no obligation to comply with a court's order to directly pay an alternate payee who is not a member of the plan, a court could find enforcement of assignment of a portion of a municipal pension too difficult. Thus, equitable distribution of a municipal pension in a divorce is often treated differently than the division of an ERISA-based pension.[12] This difference in treatment benefits no one by complicating the issue for the court and the parties.

If the value and offset option is unavailable (such as when there are not sufficient assets to offset against the pension), the parties may choose to split the net benefit, requiring the participant to pay the former spouse directly every month for the remainder of the participant's life. In this scenario, the participant bears the entire tax burden, ultimately disturbing the delicate balance of equitable distribution, while creating potential enforcement issues. This option will place the participant in a higher tax bracket in which they will be taxed on the full amount of monies received from the plan, rather than just their share.[13] Not only does this negatively impact the participant, but the former spouse receives less money as well. Further, property settlement agreements generally cannot be enforced by contempt,[14] which limits the available remedies to the nonparticipant former spouse if the participant fails to make their direct payment.

The parties may also choose to reclassify the payment as support rather than property, and the parties may in that case opt to execute an income withholding order (IWO) in order to ensure direct payment. This is problematic for several reasons. First, alimony is generally modifiable,[15] and, therefore, a reclassification as support is potentially dangerous unless the reclassification is qualified to address modifiability. Utilizing this avenue also unbalances equitable distribution and does not provide for survivor benefits or cost-of-living adjustments (COLAs). The parties may, however, agree to COLAs, but this would require the parties to stipulate to continued discovery throughout their lifetimes, requiring each party to exchange tax filing information at a minimum each year. Additionally, if the parties can agree to include COLAs, the former spouse will be unable to enforce the agreement through an IWO because of the regularly changing benefit.

QDROs not only assign regular pension income, but also address ancillary economic benefits, such as survivor benefits, deferred retirement option plan benefits, and early retirement subsidies. Thus, the inability to obtain a QDRO again requires the nonparticipant spouse to rely on the participant spouse to make direct pay. It further requires continued exchange of discovery over the life of the pension, so the nonparticipant spouse can ensure they are receiving their share of such benefits.

Tax Treatment

Generally speaking, the transfer of property between spouses pursuant to a divorce decree is not taxed.[16] However, monies received from a retirement plan are taxable to the recipient of such monies.[17] Thus, if a municipal pension will not permit a participant to assign income via QDRO, the participant must be the recipient of the money from the plan, and will, thus, receive a 1099 for such income. The parties cannot then simply shift the income to their former spouse and deduct it. It is true that the Internal Revenue Code permits such deduction for purposes of alimony,[18] but not for property distribution.

Thus, when retirement benefits are divided pursuant to a divorce and subsequent QDRO, the tax burden shifts and falls proportionally to each party.[19] This is equitable. There is no comparable provision for municipal pensions that would shift the tax burden to the recipient. Therefore, the participant is taxed, and without provision for how to deal with that result, the nonparticipant is still owed a portion of the gross amount payable from the plan. Even if the parties agree to net out the taxes, as noted above, the money will be taxed maximally as it is being

received in whole by a single person, versus being received in two parts by two separate people for tax purposes, increasing both parties' tax liability on the money.

Considerations of Other States' Municipal Pension Divisibility Laws

Many other states have held pension plan anti-alienation provisions in their own state's statutes are invalid as they pertain to equitable distribution. This exception is generally based on the conflict that arises when a state has laws, like Florida's laws, which make a pension a marital asset subject to equitable distribution.[20] For example, like Florida, retirement benefits in Arizona are considered marital property to be divided for equitable distribution.[21] However, unlike Florida, Arizona holds that the anti-alienation provision pertains to creditors and not a former spouse because a former spouse is a co-owner of the property under the state's community property laws.[22]

The question becomes whether the intent behind a municipal pension statute was to deprive the former spouse of the right to exercise their interest in property acquired during the marriage, which it likely was not. Thus, in *Haynes v. Haynes*, 148 Ariz. 191, 197 (Ariz. App. Div. 1 1984), the court held that the acts of "anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, charge, garnishment, execution or levy" were intended "to protect the benefits and interest in the fund from the creditors and assignees of the member, and a spouse's interest is not that of a creditor."[23] Entitlement to a spouse's pension or retirement benefit comes from a state's community property statute; thus, ownership interests do not entail a "sale, assignment, pledge, encumbrance, charge, garnishment, execution, or levy."[24] Several courts have concluded that a nonmember spouse's interest in the benefits is not that of a creditor, but that of an owner, therefore, the interest is not barred by statute.[25] Additionally, the court held that property acquired during the marriage is community property and does not constitute a transfer, and, as such, does not fall under the anti-alienation provision. Connecticut,[26] Illinois,[27] and Michigan,[28] among many other states, also construe their relevant anti-alienation provisions to exclude awards to former spouses for equitable distribution clarifying the legislature's intent to uphold community property laws in the face of anti-alienation provisions.

Conclusion

Municipal pensions are exempt from ERISA and cannot be ordered to make direct payment to a nonparticipant former spouse for purposes of property division even with a court order. The anti-alienation provision is in direct conflict with Florida's family laws regulating equitable distribution. F.S. §61.075(6)(a)(d) defines marital property as "[a]ll vested and non-vested benefits, rights, and funds accrued during the marriage in retirement, pension, profit-sharing, annuity, deferred compensation, and insurance plans and programs." In order to avoid prolonged pre- and post-judgment litigation and achieve true equitable distribution, Florida must follow suit and create a QDRO, or similar type of order, that effectuates a simpler division of a municipal pension. Until then, practitioners must be extremely cautious in cases involving municipal pensions in order to ensure the best outcome for their clients. ❑

[1] *See generally Carollo v. Carollo*, 920 So. 2d 16 (Fla. 3d DCA 2004) (affirming the denial of wife's request for a QDRO as the applicable city code expressly limited the assignability of municipal pension benefits); *see also generally Bd. of Trs. of the Orlando Police Pension Plan v. Langford*, 833 So. 2d 230 (Fla. 5th DCA 2002); *Bd. of Pension Trs. of Cty. Gen. Employees Pension Plan v. Vizcaino*, 635 So. 2d 1012 (Fla. 1st DCA 1994).

[2] *Langford*, 833 So. 2d at 233; *see also Vizcaino*, 635 So. 2d at 1012.

[3] 29 U.S.C. §1001 *et seq.* (2012).

[4] *See* 29 U.S.C. §1056(d).

[5] An alternate payee means any spouse, former spouse, child, or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant. *See* 29 U.S.C. §1056(k).

[6] *See* 26 U.S.C. §414(p)(1)(a).

[7] *See* 29 U.S.C. §1003(b)(1). Note that the Florida Retirement System pension plan has opted to create a QDRO-like order and, thus, this article will not assess that plan directly.

[8] *See generally* FLA. STAT. §61.076 (2014), which specifically addresses distribution of retirement plans upon dissolution of marriage.

[9] *Trant v. Trant*, 545 So. 2d 428, 429 (Fla. 2d DCA 1989) (*citing Braderman v. Braderman*, 488 A.2d 613 (Penn. Super. 1985)).

[10] *Id.*

[11] *Id.*

[12] *Edwards v. Edwards*, 819 So. 2d 837, 838 (Fla. 2d DCA 2002) (*citing Vizcaino*, 635 So. 2d 1012).

[13] *See generally King v. King*, 719 So. 2d 920 (Fla. 5th DCA 1998).

[14] *See generally Carlin v. Carlin*, 310 So. 2d 403 (Fla. 4th DCA 1975); *Howell v. Howell*, 207 So. 2d 507 (Fla. 2d DCA 1968)

[15] FLA. STAT. §61.14(1) (2014).

[16] *See* 26 U.S.C. §1041(a).

[17] *See* 26 U.S.C. §72(a)(1) (2012).

[18] *Compare* 26 U.S.C. §71 (addressing the inclusion of alimony and maintenance payments in an individual's gross taxable income) *with* 26 U.S.C. §215 (addressing alimony and maintenance payments as potential tax deductions).

[19] 26 U.S.C. §§402(a), (e)(1)(a) (2012).

[20] *Haynes v. Haynes*, 148 Ariz. 191, 197 (Ariz. App. Div. 1 1984).

[21] *Id.* at 197-198.

[22] *Id.* at 197.

[23] *Id.* at 197.

[24] *Id.* (*citing Collida v. Collida*, 546 S.W.2d 708, 710 (Tex. App. 9th Dist. 1977)); *see also Phillipson v. Bd. Admin. Public Employees' Retirement System*, 473 P.2d 765, 772 (Cal. 1970) (nonmember spouse made a claim to member spouse's state pension as an owner with a "present, existing, and equal interest," which could not be described as the levy of execution, garnishment, attachment, or assignment of property).

[25] *Id.*

[26] *Foley v. Foley*, 1997 Conn. Super. LEXIS 2229, 1997 WL 536328 (Aug. 14, 1997) (transfer of pension benefits to nonemployee spouse is not prohibited by anti-alienation clause).

[27] *In re Marriage of Hackett*, 113 Ill.2d 286 (Ill. 1986) (anti-alienation provisions were to protect firefighters and their beneficiaries from creditors, and do not prevent division of benefits between divorcing parties).

[28] *Lindner v. Lindner*, 137 Mich. App. 569 (Mich. Ct. App. 1984) (taking pension into account in arriving at equitable distribution did not violate statute that exempts teacher's pension plan from execution, garnishment, attachment, or other legal process protects employee from creditors' claims).

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This column is submitted on behalf of the Family Law Section, Norberto Sergio Katz, chair, and Sarah Kay, editor.