FAMILY LAW NEWSLETTER

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Retirement Plans in Divorce
An Overview

By Terry Donahe

Saving for retirement is one of the greatest challenges facing Americans. While government pension plans still exist, few corporations provide them. Saving in employer-sponsored retirement accounts is limited. Saving outside of work is a struggle for many people. Social Security is underfunded and, consequently, its benefits will eventually be scaled back.

So, when a divorce occurs, the division of retirement accounts is among the most important components of the settlement. It is also among the most complex. As a result, mistakes are made. Let's review retirement plans.........

Categories of Retirement Plans

There are three categories of retirement plans:

- Plans that are provided by companies for their employees which are governed by ERISA (the Employee Retirement Income Security Act) law.
- Plans that fall under federal and state law, but which do not fall under ERISA.
- Plans that receive certain tax advantages under the Internal Revenue Code.

ERISA Retirement Plans – Defined Benefit and Defined Contribution

Under ERISA, there are two broad types of retirement plans.

In a defined benefit plan, the employer provides participants a specific monthly benefit (often described as an annuity) at retirement. The benefit may be stated as a specific dollar amount. More commonly the benefit will be calculated based on a formula that includes factors such as salary, age and number of years worked for the employer. The benefit may be indexed for inflation. It is noteworthy, that employees do not have a separate account in these plans. Defined benefit plans are pooled. There is no cash value.

In a defined contribution plan, the employer and employee contribute to an account in the employee's name. Employees decide how much of their pay to contribute, subject to limits. They also decide how their account balances are invested. The employer may contribute to the employee's account, often through matching a percentage of the employee's contributions. The value of the employee's account is a function of employee contributions, employer contributions, investment performance, and plan expenses. Defined contribution plans include: 401(k), Roth 401(k), SIMPLE IRA, Simplified Employee Pension (SEP), Employee Stock Ownership Plan (ESOP) and profit sharing.

Non-ERISA Retirement Plans

There are retirement plans to which ERISA does not apply. An employer providing a non-ERISA plan does not contribute to the plan. In addition, there are limits on the administrator for a such a plan.

There are two categories of non-ERISA plans. Plans can qualify under the Department of Labor's safe harbor provision which includes several requirements. Plans can also qualify, if they fall into one of the special exemptions for governmental plans for federal, state and local governments, "church plans" for religious organizations and private sector 403(b) plans established by 501(C)(3) tax-exempt organizations that meet certain requirements.

The military's retirement plan is also not subject to ERISA.

Non-Qualified Employer Retirement Plans

There are still other retirement plans that are not covered by ERISA rules. These non-qualified retirement plans are used by employers to provide highly-compensated executives with supplemental retirement savings. Non-qualified plans include deferred compensation, executive bonus, split-dollar life insurance, and group carve-out.

Contributions to these plans are not deductible to the employer. The contributions become taxable to the executive when they are received, typically in retirement.

Other Personal Tax-Advantaged Retirement Plans

There are two other personal retirement savings accounts which are widely-held. Very briefly, they are:

The traditional Individual Retirement Account (IRA). Contributions to a traditional IRA may be fully or partially deductible depending on the taxpayer's filing status and income. Amounts in a traditional IRA (contributions and earnings) are generally not taxed until they are distributed. In general, withdrawals cannot be taken from a traditional IRA before age 59 ½ and they must begin by age 72.

The Roth Individual Retirement Account (IRA). There is no deduction for contributions to a Roth IRA (i.e., they are made after-tax). If certain requirements are met, qualified distributions are received tax-free. Withdrawals can be taken from a Roth IRA after a five-year holding period. However, there are no minimum distribution requirements.

There are combined contribution limits that apply to an individual's combined traditional and Roth IRAs.

Valuing Retirement Plans

The valuation of retirement plans depends on the type of plan.

Defined benefit plans represent a promise by an employer to pay a participant income in the future. There is no separate employee account with a current value. Instead, the present value of the employee's future benefit must be calculated. The factors involved in the calculation include the participant's age, life expectancy, and retirement age and a discount rate. Note: The pension statement is not a reliable indication of the actual value of a participant's pension.

The coverture faction is used to calculate the marital and non-marital portion of a defined benefit pension plan. The numerator of the fraction is the number of years of participation in the employer's plan during the marriage. It usually starts with the date of marriage and ends with the date of divorce. The denominator is the total number of years of employment with the employer. It usually starts with the date of entry into the plan and ends with the date of divorce. The resulting fraction provides the portion of the benefit that is considered marital. The non-marital portion is simply the remaining amount of the benefit.

Defined contribution plans provide employees with an individual account. That account will usually hold securities (e.g., mutual funds, exchange-traded funds, and annuities) which can be readily valued.

Non-ERISA retirement plans and non-qualified retirement plans can be valued based on the nature of their benefits. Plans providing future benefits can be valued using a present value calculation. Plans with accounts which hold marketable securities are easily valued.

Dividing Retirement Benefits

The process of dividing a retirement benefit depends on the nature of the plan. Benefits from qualified plans that fall under ERISA are divided by a Qualified Domestic Relations Order (QDRO).

ERISA retirement plans can be divided in two ways. Under the shared payment method, the QDRO establishes the amount or percentage of the participant's payments that will be allocated to the alternate payee and the number of payments or period during which the allocation to the alternate payee is to be made. Under this approach, the alternate payee will not receive payments unless the participant receives payments. Under the separate interest approach, the QDRO assigns to the alternate payee a percentage or dollar amount of the participant's account balance as of a specific date.

Benefits from non-ERISA retirement plans, non-qualified employer retirement plans, and personal tax-advantaged plans are divided by the divorce decree or via a Domestic Relations Order (DRO).

Transferring Retirement Benefits

The transfer of ERISA retirement benefits is addressed in the QDRO. Typically, but not always, the alternate payee's interest in a participant's defined benefit pension plan will remain with the plan. An alternate payee's interest in a defined contribution benefit plan will either remain with the plan or will be transferred to an alternate custodian.

The conveyance of non-ERISA retirement benefits, non-qualified employer retirement plans, and other personal tax-advantage retirement accounts is done through a "transfer incident to divorce" as specified in the divorce decree. If the transfer of funds in such plans is done directly from custodian to custodian, there is no withholding for taxes. If, instead, funds are transferred to the recipient spouse, they must be "rolled" into a suitable account (e.g., IRA) within 60 days to avoid taxation on the entire amount. In addition, if the recipient spouse is younger than 59 ½, a 10% early withdrawal penalty will apply.

Distributions from a Retirement Plan

In general, distributions from retirement plans are subject to ordinary income taxes. Withdrawals taken before age 59 ½ are subject to a 10% early withdrawal penalty. There are several ways for an alternate payee to take a distribution from a retirement plan.

A one-time distribution from an ERISA retirement plan can be done through a QDRO. If the alternate payee is not yet 59 ½, under IRC §72(t)(2)(c) the distribution will not be subject to the 10% penalty. The distribution would occur before the retirement assets are transferred to a separate account. The distribution would be subject to ordinary income taxes. A distribution from an ERISA retirement plan will be subject to mandatory withholding of 20% for federal income taxes and possibly for state income taxes. This withholding may over- or understate the amount of taxes that are ultimately due on the distribution.

A distribution from a non-ERISA retirement plan, a non-qualified employer retirement plan and an individual retirement account (IRA) will be subject to the premature 10% penalty (if the recipient is not yet 59 ½) and income

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Editor: Daniel R. Murphy
P.O. Box 1033, Albany, OR 97321
(541) 974-0567, danmurphyoffice@gmail.com

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Publication Deadlines

The following deadlines apply if a member wants an announcement or letter included in the newsletter.

Deadline	*Issue*
7-15-2022	August 2022
9-15-2022	October 2022
11-15-2022	December 2022
1-15-2023	February 2023
3-15-2022	April 2023
5-15-2022	June 2023

taxes. There is no mandatory withholding for taxes for a distribution from these plans.

Under certain circumstances found within IRC §72(t), an individual may take distributions from an IRA before age 59 ½ and avoid the 10% penalty. Some of the exceptions are: to pay for qualified higher education, to pay for a house as a first-time homebuyer, to pay for unreimbursed medical expenses, and to pay health insurance premiums while unemployed. It is also possible to take substantially equal period payments which must generally continue for at least five full years, or if later, until age 59 ½.

Issues and Pitfalls in Dividing Retirement Plans

Retirement plans are complex and dividing them in divorce requires great care. There are many pitfalls that lurk for the unwary.

Loans

Loans within retirement plans can create challenges in the settlement. The plan administrator will consider a loan as an asset within the account. It should be added to the value of the account to determine the account's proper value. The loan should be disclosed on the asset worksheet.

Loans are not permitted within Individual Retirement Accounts. So, a loan could not be transferred from a qualified plan with a loan to an IRA. The loan must remain in the qualified plan. Further, the maximum amount that may be borrowed from a qualified retirement plan is 50% of the vested account balance or $50,000, whichever is less. Imagine a 401(k) with a balance of $125,000 and a loan of $50,000 for a total account value of $175,000. It would not be possible to assign by QDRO half of the account ($87,500) to the non-participant spouse, because the remaining amount in the participant's 401(k) account ($75,000 or $125,000 minus $50,000) would not satisfy the loan rule. The account would be deficient $6,250 and that amount would be immediately due and payable by the plan participant.

Distributions

If a non-participant spouse expects to need more than an initial distribution from an ERISA retirement plan, they should consider leaving the assigned interest within the plan. This would enable the non-participant spouse to take additional penalty-free withdrawals.

A non-participant spouse taking a distribution from an ERISA retirement plan should consider the 20% mandatory withholding. For example, if the need is for $100,000, then $125,00 should be requested in the QDRO.

Beneficiary Designation

The plan administrator will make payments based on the participant's designated elections. There have been many cases in which a participant failed to name a beneficiary, named a beneficiary who is deceased or named a beneficiary who is not the participant's legal spouse/partner.

Advisors should review the participant's elections in the context of reviewing …….

The imperiled DB Plan

If the qualified retirement plan held by the participant spouse is underfunded or in jeopardy of becoming so, or otherwise mismanaged, the non-participating spouse should carefully consider the risk of leaving an interest in the plan. While ERISA retirement plans are insured through the Pension Benefit Guarantee Corporation, the guarantee is limited and may not fully protect the participant's original interest in the plan.

The Roth Account

Contributions to a Roth account (Roth IRA or Roth 40(k)) are made on an after-tax basis. These accounts grow tax-free.

In the process of arriving at a settlement, a Roth account must be valued correctly. Qualified distributions from a Roth account are tax-free. In contrast, distributions from a traditional IRA are subject to ordinary income tax. Therefore, the settlement calculations involving Roth accounts must be adjusted for taxes.

Government Defined Benefit Pensions

These plans generally provide limited benefits to the named survivor, if the participant dies. For example, a participant in the Federal Employee's Retirement System (FERS) receives a retirement annuity that is reduced 10% to give the participant's surviving spouse an annuity of 50% of the participant's unreduced benefit.

Read Qualified Plan Documents

It is imperative that those who are valuing retirement plans and crafting their division read the relevant plan document and IRS determination letter. While ERISA sets minimum standards for retirement plans in private industry, a sponsor's plan will often contain unique provisions. For example, advisors should review the provisions for early and late retirement.

A QDRO must be written in a manner that is consistent with the plan. A QDRO cannot ask the plan to take an action (e.g., make payments) that the plan does not allow.

Points on the QDRO

The QDRO is a not qualified until the plan administrator qualifies it. QDROs are routinely rejected for a variety of reasons.

The QDRO should be entered into court with the Judgement of Dissolution of Marriage. Too often the QDRO languishes and, occasionally, it is not completed.

The QDRO can be used to collateralize a property settlement and protect it from a bankruptcy filing.

QDROs are complex and are written by experts. Those who lack expertise with QDROs are well-advised to seek the advice and services of a QDRO specialist.

Finding an Advisor

If your clients need divorce-related financial advice, please encourage them to consider working with a Certified Divorce Financial Analyst (CDFA®), Certified Financial Planner™ (CFP®), or Certified Public Accountant (CPA) with the Personal Financial Specialist (PFS™) credential. Advisors who hold these designations had to meet rigorous educational, experience and ethics requirements.

Disclaimer

The author does not provide tax, legal or accounting advice. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. Readers should consult their own tax, legal and accounting advisors before engaging in any transaction.

About the Author

Terry Donahe, CFP®, CDFA® is a principal with Springwater Wealth Management, LLC, a fee only registered investment advisor with offices in Oregon and California.

CASENOTES

OREGON APPELLATE DECISIONS

June 2022 Edition, OSB Family Law Newsletter

Family Law Opinions: April and May 2022

Editor's Note: these are brief summaries only. Readers should read the full opinion. Each case has a hyperlink to the case on-line when available.

Supreme Court

There were no family law decisions during this period in the Supreme Court.

Oregon Court of Appeals

Custody

Jeffrey Bryan Durocher and Amy Brooke Durocher (Pagán, J.) In this family law appeal, father contests supplemental judgments modifying custody of children and awarding certain attorney fees to mother. Father assigns error to the trial court's decision to exclude evidence from a custody and parenting time evaluator, who was appointed pursuant to an earlier court order. During the evaluation process, father provided over 200 pages of documents to the evaluator without also providing those documents to mother, in violation of the agreement and order.

Held: A court has powers, both inherent and granted by statute, to ensure that its orders are enforced. In this case, ORS 107.425 specifically authorized the court to appoint the evaluator to make recommendations for child custody and the parenting plan, and as part of the order appointing the evaluator, the parties were required to contemporaneously provide each other with any documents that were provided to the evaluator. The court did not abuse its discretion in excluding the evaluator's evidence as a sanction for failing to comply with the court's order. Affirmed. COA 04.20.22

Katarina Rose Henretty v. Malcolm D. Lewis (Aoyagi, J.) Mother appeals a judgment awarding custody of the parties' young son, J, to father. She contends that the trial court erred in making its best-interests determination under ORS 107.137, because it failed to designate a primary caregiver, such that neither party was given the benefit of the statutory preference for the primary caregiver under ORS 107.137(1)(e). Mother further contends that, on this record, she should have been designated as the primary caregiver and given the preference.

Held: The trial court erred in failing to designate a primary caregiver for purposes of ORS 107.137(1)(e). Further, on this record, the only finding possible is that mother is J's primary caregiver within the meaning of ORS 107.137(1) (e). On remand, the trial court is to reconsider its custody determination, taking into account the primary-caregiver preference under ORS 107.137(1)(e). Vacated and remanded. COA 04.27.22.

Property and Spousal Abuse

Austin Wayne Coates and Yvonne M. Coates (Hellman, J.) Husband appeals the trial court's general judgment of dissolution of marriage, challenging the trial court's distribution of marital property, award of spousal support to wife backed by a life insurance policy, and award of attorney fees to wife.

Held: The trial court did not abuse its discretion in its property division or award of spousal support, including requiring husband to maintain life insurance. The trial court also did not abuse its discretion in ordering an award of attorney fees to wife. Affirmed. COA 04.06.22

Lisa J. Wilkins and Todd L. Wilkins (DeHoog, J. pro tempore.) Husband appeals a general judgment of dissolution of marriage, challenging the trial court's property division and the amount of spousal support awarded to wife; he also appeals a supplemental judgment awarding wife her attorney fees. Husband contends that the trial court erred in imposing spousal support in too high of an amount and for too long a duration, and as part of that error, overstated husband's income, understated wife's income, and failed to consider wife's earning capacity.

Held: The trial court failed to properly consider all of the statutory factors of ORS 107.105(1)(d)(C) in its decision to award maintenance spousal support. The Court of Appeals, therefore, reversed and remanded the judgment for the trial court to reconsider the relevant factors to determine a just and equitable spousal support award. The court affirmed the property division without discussion. In light of the disposition reversing the general judgment, the court reversed and remanded the supplemental judgment concerning the issue of attorney fees. General judgment reversed and remanded for reconsideration of spousal support award; otherwise affirmed. Supplemental judgment reversed and remanded. COA 04.06.22

Elizabeth Louise Piller and Stephen Louis Piller (Kistler, S. J.) In this dissolution case, husband appeals three supplemental judgments dividing various deferred compensation accounts between the parties. Husband and wife were divorced in 2004. The trial court issued a dissolution judgment awarding wife half the value of husband's PERS member's account and directed wife to submit a Qualified Domestic Relations Order (QDRO) to the court. Wife did not submit the QDRO until almost 15 years later, resulting in three supplemental judgments. Those judgments awarded wife her share of husband's deferred compensation accounts, a portion of the PERS benefit payments that husband alone had received after his retirement, and a percentage of husband's gross monthly retirement benefit going forward. On appeal, husband argues that the supplemental judgments are inconsistent with the unambiguous terms of the dissolution judgment, and that the trial court used an incorrect rate of return in calculating the growth of his deferred compensation account.

Held: The Court of Appeals concluded that the 2004 dissolution judgment did not unambiguously preclude the trial court from entering supplemental judgments awarding wife a share of husband's retirement benefits. Husband's interpretation of the 2004 judgment was at odds with the language of the administrative rules governing the division of retirement benefits in place when the 2004 judgment was entered. The court further concluded that the trial court did not err in calculating the growth of husband's deferred compensation account, because husband provided no evidence to support that his proposed rate of return was more accurate than the rate ultimately adopted by the trial court. Affirmed. COA 04.06.22

Theresa Marie Brush and Patrick Jay Brush (Ortega, P. J.) In this domestic relations case, wife appeals from a general judgment of dissolution, arguing that the trial court erred in awarding to husband $125,000 of wife's inheritance as an equalizing payment. This case is before us again following our remand of the original property division on grounds that the trial court had not applied to the presumption of equal contribution the statutory exception for gifted property. On remand, the trial court made the same property division of wife's inheritance that it had made in the original dissolution judgment. Wife appeals that ruling.

Held: The trial court abused its discretion by misapplying the statutory and equitable factors in its division of the property. Under a proper application of those factors, the law required awarding to wife her entire separate inheritance. Judgment modified to remove equalizing judgment in favor of husband; otherwise affirmed. COA 04.13.22

Spousal Support

Cheryl Elaine Wirth and Carl John Wirth (Mooney, P. J.) In this marriage dissolution case, wife appeals a general judgment of dissolution, specifically challenging the spousal support award. She contends that the trial court erred in (1) calculating husband's income, (2) calculating wife's income, (3) denying wife's request for transitional spousal support, and (4) limiting the spousal support award to ten years. In support of her first assignment of error, wife contends that the trial court failed to consider husband's voluntary overtime in calculating his income. As to her second and third assignments of error, wife contends that there was no evidence that she could return to work in her previous field of employment. She also contends that the trial court erred in forecasting her salary based on how much she earned during her employment from 10 years before. Finally, in her fourth assignment, wife contends that there was no evidence to support the trial court's finding that husband's job was physically demanding and that, therefore, the court abused its discretion in limiting support to 10 years due to the demanding nature of that work.

Held: The Court of Appeals concluded that the trial court did not err in excluding voluntary overtime wages from its spousal support calculation given evidence that the availability of overtime was changing, and that husband would not continue to work overtime on a regular basis. The Court of Appeals also concluded that the trial court did not err in calculating wife's income, which it used in its calculation of the amount and duration of spousal support. There was evidence that (1) wife could return to work in her previous field of employment; and that (2) she could earn at least as much as she had earned in that field 10 years before. Lastly, there was sufficient evidence to support the trial court's finding that husband's job was physically demanding. Affirmed. COA 04.20.22

Full Case Opinions may be found here:

Supreme Court: *https://www.courts.oregon.gov/publications/sc/Pages/default.aspx*

Court of Appeals: *https://www.courts.oregon.gov/publications/coa/Pages/default.aspx*

Note on Opinions Reviewed:

The Editor tries to include all the Family Law related decisions of the Oregon Appellate Courts in these Notes. Some cases do not have holdings that have precedent significance however they are included to insure none are missed.

Seeking New Editor

After 96 issues and sixteen years, Hon. Daniel R. Murphy has notified Chair Murray Petitt that it is time to pass along his duties as editor of the OSB Family Law Section newsletter.

The section's newslettter editor is responsible for putting out six newsletters each year and receives a per newsletter stipend. Section members interested in serving as editor beginning with the October 2022 issue are encouraged to apply to Murray Petitt at mpetitt@thorp-purdy.com.

Family Law Newsletter Editors

The dates of the first and last issues by the previous editors are listed below:

Ira Gottlieb
November 1980 to March 1982

Hon. Kristina A. LaMar
July 1982 to January 1985

Richard Fowlks & Deanna Cereghine Fowlks
April 1985 to April 1988

Timothy Travis & Lynn M. Travis
October 1988 to Octobr 1989

Conral G. Hutterli
December 1989 to December 2005

Hon. Daniel R. Murphy
February 2006 to present

SAVE THE DATE

2022 Family Law Section Annual Conference

October 13th-15th • Salishan Coastal Lodge, Gleneden Beach, OR

familylaw.osbar.org/annual-conference/

Lawyers for Literacy Campaign in Benton and Linn Counties

Did you know that *sixty* percent of low-income families in Oregon don't own any books? And that kids who are not reading at benchmark level by third grade are *four times more likely to not graduate from high school* than their reading proficient peers?

SMART Reading is thrilled to announce **Lawyers for Literacy** in support of our work to spark joy and opportunity through the magic of a shared book! SMART Reading is a proven community program that helps address this critical issue by providing Oregon kids with reading support and new books to keep. **I urge you to take <u>two minutes to watch this inspiring video</u> about how SMART Reading is making a big impact on children's literacy.**

Our South Valley Area (Benton, Lane, and Linn Counties) has formed a team to raise 10K toward our statewide goal of $75,000 by June 30th. Any amount is welcome, **<u>here's the link to our fundraising page</u>**.

Firms or individuals who donate $500 or more will receive a generous gift from one of several local businesses that support low-income youth and charitable organizations in our community.

Firms or individuals who raise or donate $1,000 can become a school sponsor and **unlock double matching funds!**

Please contact South Valley Area Director, Laurie McNichols, at **<u>LMCNICHOLS@smartreading.org</u>** or (541) 600-8035 for more information.

In a profession where the written word is fundamental to who we are, the legal community's support of SMART Reading is critical, and kids need our help now more than ever.

Will you join us to support young readers with a gift today?

Sincerely,

SMART Reading Lawyers for Literacy Steering Committee