Divorce, Pensions and Retirement Benefits

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Understanding the Very Substantial Differences Between a Regular Active Duty and a Reserve Military Pension

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Practice Tip of the Month:

Some Individual Retirement Accounts (IRA's) will require the submission of a Domestic Relations Order to make a dissolution-based distribution, while others may not. It is the responsibility of the attorney to make the determination as to what will be required.

Technically, IRA's do not require the submission of a QDRO to equalize, or distribute, the court ordered values between the divorcing parties. The Retirement Equity Act of 1984 did not address them because they are not "qualified" accounts subject to the same ERISA and IRS regulations, which govern "qualified" retirement savings plans. If the account is in the names of both the husband and the wife, then the balance can easily be transferred from a joint account to two separate accounts in the names of each individual. This does not trigger a taxable event. Even if the account is in the name of one party to the marriage, a transfer of the portion awarded to the other party can be made using a trustee-to-trustee transfer from the existing account into a new IRA account established by the individual whose name is not on the account. This, too, will not trigger a taxable event if it is based on a settlement agreement approved by the cout or a court imposed settlement. Usually, IRA's that can be distributed using these methods are non-work related accounts maintained at a bank, credit union or savings and loan institution.

There are situations where a Domestic Relations Order (not a "Qualified" order because you are not addressing "qualified" plans) will be required when trying to equalize marital IRA account values. Typically, these are situations where the IRA account is being managed by a mutual fund company (Fidelity, Magellan, Putnam, etc.), a stock brokerage firm or is being maintained by an employer. These plan custodians often require an order to protect their own interest and to avoid involvement in litigation that may ensue from an improper IRA distribution that was not sanctioned by the court. They want a specific order, signed by the judge, addressing the IRA, before they take any action. Most custodians who require orders prefer an order structured similar to a QDRO, with which they are familiar. They feel it better covers their potential liability.

When dealing with IRA's always contact the account custodian to determine their rules covering dissolution based distributions. Knowing beforehand whether or not an order will be required can avoid last minute additional expense and enhance your reputation for expertise.

Understanding the Very Substantial Differences Between a Regular Active Duty and a Reserve Military Pension

The U.S. Military Services, like all government bureaucracies, have established myriad rules governing their operations. In some cases, a retired member's pension is dependent upon the regulations in the year they entered service or retired. This can mean some retired members, with the same exact service time and rank, receive different benefits than others because of an arbitrary fact like the rules in place on the date of their retirement or enlistment. This article is not going to deal with these or, other anomalies, but, rather, take a fairly general view at the actual differences between a regular active duty serviceman's retirement benefits and those of a military reservist. This is the kind of basic knowledge you, as a Family Law attorney, will need to know when you encounter situations involving military personnel.

Active Duty Military Personnel:

Regular active duty members of the military services qualify for a monthly pension after 20 years of service at any age. The pension is based on the rank achieved and the years of service. For a retiree the formula is base salary based on the rank of the participant X 2.5% X years of service plus annual post-retirement COLA increases. This means that a member is eligible to receive 50% of their final base pay after 20 years with payment commencing immediately upon retirement. (There is a voluntary program for an enlistee who enters the service after 1986 whereby they can receive a one time bonus of $30,000 after 15 years of service but their pension is accrued at 2% instead of 2.5%. After 20 years they will only receive 40% of their final average salary. At age 62 it is recomputed again using 2.5%.). The pension benefit maximizes with 30 years of service. This produces a benefit of 75% of the member's final base salary. Living allowances, hazard pay, etc. are not usually included in the computations. The military is always massaging their personnel requirements, so there may be times when a member can retire with 18 years and get credit for 20. At other times a member may be able to retire with less than 20 years but only get credit for the actual years served. Fifteen years is the least number of years we have seen, where an individual was able to retire and that was some years ago. Unless there is a program in place with a reduction in force as its goal, the norm is 20 years of active service to qualify for immediate retirement. As I said in the beginning, there are a lot of anomalies.

There is no such thing as vesting in the military. You either earn a pension or you don't. That means a member who leaves with 17 years of service is usually not eligible for any retirement benefits unless there is a program in place to encourage a reduction in force. Conversely, in private industry an employee usually vests after 5 years of service. If they leave employment after 5 years of service they are still entitled to receive the monthly pension benefit they accrued up to the day they left employment, payable on their normal retirement date, usually age 65. In other words, they have a "vested" right to the earned pension

There are some States that require that a pension be vested before it is considered a marital asset. This presents a very real problem when the only really valuable marital asset accrued over a 16 year marriage is the military retirement that will not be vested for 4 more years. Does this mean the non-participant spouse gets nothing while the participant spouse might be eligible for an asset of $2,500 per month commencing on his 39th birthday? That asset might be worth over $300,000 on the date of the dissolution of the marriage. Laws requiring vesting in the case of military personnel before their pensions are considered marital assets are patently unfair and preclude any chance of an equitable dissolution. Requiring vesting negates the use of a Uniformed Services Former Spouses Protection Act order (the military equivalent of a Qualified Domestic Relations Order) which would take out any of the risk that the member might not reach eligibility for retirement; which is what I suppose the vesting requirement is trying to address.

The reality is that in most cases when dealing with active duty military personnel you will be using a Uniformed Services Former Spouses Protection Act order. This is because military pay has increased substantially in the last decade, and, with the early age that members qualify for immediate payment of pensions, the values involved are substantial. Another reason the use of a Uniformed Services Former Spouses Protection Act order is so prevalent is that, because of frequent moves and other social factors, military members rarely accrue sufficient marital assets to make an immediate offset distribution against the value of the pension a possibility. The only practical method of distribution is the Uniformed Services Former Spouses Protection Act order but there are some things to watch out for when contemplating their use. The most important is that the military will only honor the order if the parties have been married for at least 10 years during which time the member was a member of the military. That means the ten-year marriage must overlap ten years of military service. You can still include the value of the military pension if that is not the case but you cannot use a Uniformed Services Former Spouses Protection Act order. You will have to compensate the non-participant spouse with a payout of their share of the value of the pension over time or by immediate offset, if possible.

When negotiating a settlement agreement anticipating the use of a Uniformed Services Former Spouses Protection Act order, if you represent the non-participant spouse, always insist on survivor benefits. If the participant were to die anytime before or after retirement and the non-participant spouse is not designated the beneficiary of the participant's survivor annuity (55% of the participant's total pension), then all payments to the non-participant spouse would cease. Also, the participant is limited to naming only one beneficiary so the survivor's annuity cannot be shared with a subsequent spouse. These rules apply to both regular military and reservist pensions.

If the member was injured anytime during his or her service, they might be eligible for a portion of their pension to be treated as V.A. benefits. V.A. benefits are tax-free and will not be included in the Uniformed Services Former Spouses Protection Act order. Only "disposable" pension income is eligible for a Uniformed Services Former Spouses Protection Act order. Disposable pension benefits do not include V.A. benefits. If the parties were married for at least 20

years during which time the member served 20 years in the military, then the non-participant spouse is entitled to free healthcare for life. If the non-participant spouse remarries before age 55, they will lose any survivor benefits that have been awarded to them but not their share of the monthly pension if it is being paid through a Uniformed Services Former Spouses Protection Act order.

Reserve Military Personnel

Military reserve members also earn pensions but their pensions do not go into pay status until they reach age 60 (unless they qualify for a service connected 100% disability). Their pensions are also based on their rank and they also have to participate at least 20 years but their 20 years can consist of as little as 3 weeks in the summer and one weekend per month each year. They receive credit of one point for each day of service. The formula to determine a reservist's pension is base annual active duty salary based on rank X 2.5% X the number of days of active service ÷ 360 plus annual post-retirement COLA increases. You can use a Uniformed Services Former Spouses Protection Act order to distribute the marital portion of the asset but it is rarely necessary. Reservists have full time civilian employment, usually accrue substantial other marital assets and their pensions are far less valuable. Deferred vested methodology is used for valuation because payment is deferred until age 60, unless the pension is already in pay status. Pension values are usually small because of the part-time nature of their employment so immediate offset of the non-participant's value against other marital assets is the norm and the most practical method of distribution.

If you do use a Uniformed Services Former Spouses Protection Act order for a reserve pension, the same rules requiring 10 years of marriage during military service apply. Again, to protect the non-participant spouse survivor benefits must be included in the order. There is no free healthcare available for former spouses of reservists.

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It is good practice to always inquire as to reserve military participation because that retirement asset is sometimes overlooked.

Conclusion

Military pensions can be very valuable marital assets. They present an interesting problem to the attorneys involved in the divorce case because military families rarely have a lot of other marital assets. With more reservists being called up for active duty, expect to see an increase in the value of their pensions in the future. Also, we have encountered a number of situations where reservists, called back to active duty, have remained in that status and qualified for active duty pensions. Again, watch out for the anomalies. To give just one concluding example,; consider the following. What do you do with a 49 year old reservist colonel who has over

20 years of reserve duty but because of call-ups going back to the first Gulf war, plus the six full years of military service he had in his youth, plus his actual reservist annual commitments and the fact that he is currently in Iraq, already has a full 19 years worth of active duty service? If the military gives him a regular active duty retirement pension, he suddenly has an asset worth well over $500,000. But as far as I can tell, the military is under no obligation to do so. Only a Uniformed Services Former Spouses Protection Act order based on a percentage of the marital property portion of the pension actually received can insure equity in a situation like that.

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Mr. Commerford has been active in the valuation of pensions and the preparation of Domestic Relations Orders for his attorney clients since the founding of LawDATA, Inc. in 1984. He has presented Continuing Legal Education programs, dealing with the valuation and distribution of retirement assets incident to divorce cases, for State Bar Associations throughout the country and written many articles on the subject for legal publications.

For any questions or ideas for upcoming articles you can reach Paul Commerford at paul@lawdatainc.com.

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