

Child Support and Security Interests.

Child Support. Often overlooked is the use of a qualified domestic relations order (QDRO) to provide for the collection or security of child support. The term “domestic relations order” means any judgment, decree or order which relates to the provision of **child support**, alimony payments or marital rights to a spouse, former spouse, child or other dependent of a participant. Most uses of QDROs are for the outright, unconditional assignment of present or future monetary interests in the participant’s benefits to an alternate payee for his or her marital property rights. However, a QDRO can be used to assign benefits to fund or secure payment child support obligations. Without the use of a QDRO, child support is simply an unsecured obligation to make support payments. If the obligor fails to make the required payments, the obligee and the state have an enforcement problem. However, with a use of provisions incorporated in a QDRO, a third party, the retirement plan, insures that the support payments will be made, at least to the extent that a participant has an interest in the plan.

When considering the use of a QDRO to provide for support payments, the timing of the payments is an important consideration. There are generally two types of plans to be evaluated when considering the use of a QDRO to provide for or secure the payment of child support: (1) traditional defined benefit plans and (2) defined contribution plans and cash balance defined benefit plans. Defined benefit plans generally provide for a series of payments over the life of the participant beginning at the retirement age of the participant. Defined contribution plans provide for a lump sum payment on or after the participant’s retirement. However, alternate payees, in the case of qualified plans, can have access to a participant’s benefits at the participant’s “earliest retirement age”.

When considering a QDRO for the collection of child support, the limitations of each type of plan should be considered. Defined benefit plans which do not provide for lump sum distributions, pay the benefits out over the life of the alternate payee. If the alternate payee is the child and the child is of a young age, the payments will be greatly reduced from the participant’s accrued benefit to account for the increased length of time the benefits will be paid.

The requirements of the support should be matched as close as possible to the plan provisions. If a defined benefit plan is to be considered for the payment of immediate benefits, it should be close to or in pay status. If a defined contribution plan is to be considered, the child support should be in the form of a lump sum payment. Either a defined benefit plan or defined contribution plan can be considered when dealing with past due child support.

While there are no special rules for the use of QDROs for child support, state family law rules and the requirements of a QDRO cannot be in conflict.

Example 1: if support payments are ordered to be paid at \$1,000 per month and that option is not available under the plan, the plan cannot be made to comply with that state family law provision.

Example 2: if a defined contribution plan's only payment option is a single lump sum payment, it cannot be ordered to pay monthly payments if monthly child support payments are required. There are many conflicts between state family laws and QDRO requirements that must be avoided for the effective use of a QDRO to provide for the payment of child support or as security for the payment of child support.

A QDRO may be prepared and entered many years after a divorce has occurred, if allowed by state law. Most states either require or allow a court to retain jurisdiction to enter orders to clarify or enforce the orders contained in the original decree. This would allow for the use of a QDRO to be entered at a later date for the payment of past due child support.

The use of a QDRO for child support is not without pitfalls, however. Generally, distributions made pursuant to a QDRO are includable in the gross income of the alternate payee in the year in which the distribution is made. However, if the distribution is made to an alternate payee pursuant to a QDRO for child support, the distribution is includable in the gross income of the participant, not the alternate payee, only if the alternate payee is the child. If the alternate payee is the former spouse, the distributions will be includable in the gross income of the former spouse. When requesting a court to enter a QDRO for the payment of child support, whether current or past due, it is important that the court understand the tax effects to the former spouse and consider naming the child as alternate payee, regardless of the age of the child, and designating the custodial spouse as the child's agent for receipt of the funds.

In the world of child support, the payment of child support does not give rise to a taxable transaction. However, you can see that if structured improperly, child support payments can result in taxable income to the custodial parent. This was clearly not the intent of Congress. When using a QDRO as security for child support and the alternate payee is the custodial parent, you may want to consider increasing the amount of the payments eventually paid from the plan to cover the unintended tax costs.

Questions & Answers:

Q1. Can QDROs be used for more than one purpose, i.e., for a property settlement and for child support?

A1. Yes. A QDRO can be used for the assignment one or more of any benefit payable to a participant.

Q2. Are there any special rules that must be followed when preparing a child support?

A2. No. However, tax and state family law considerations should be taken into account.

Q3. Can child support QDROs be used for any type of plan?

A3. No. All ERISA plans accept child support QDROs. All military systems accept similar child support orders. Federal government systems, CSRS and FERS will accept any state child support garnishment order which comply those system's requirements.

Q4. Does a plan administrator have to accept a child support QDRO?

A4. Yes, but only if the plan is an IRC Section 401(a), 401(k), 403(b), 409(d) or 457(d) plan which contains a Section 401(a)(13) anti-alienation provision or is otherwise allowed by the plan or system. It is best to check with the plan.

Security Interests. Often in property settlements or judgments, security interests are granted in property awarded to the other spouse. This is generally the case where there is a disproportionate division of community property and the court or parties attempt to equalize the division by awarding one of the spouses a note for the difference. Disproportionate divisions of the property results because property by its nature, has more utility value in the hands of one party or the other. Awarding a note for the disproportionate division of the property without security amounts to an unsecured promise to pay. The property awarded to the other spouse is subject to the claims of other creditors on par with the spouse. Had the parties' property been in a different form, this may not have occurred.

A little-known use of QDROs is to provide for a security interest in a participant's qualified plan benefits to the non-participant spouse. These security interests are especially useful in securing these "equalization notes". Generally, other than for the security of plan loans, a participant's plan benefits are not subject to assignments. However, QDROs are the "gateway" through the anti-alienation provisions of IRC Section 401(a)(13). Section 401(a)(13) is the anti-assignment rule which prohibits the assignment of a participant's retirement benefits to anyone.

Section 1.401(a)-13(c)(1)(ii) of the IRC regulations defines "assignment" broadly to include any direct or indirect arrangement whereby a party, such as a spouse, acquires from a participant, a right enforceable against the plan in all or any part of a plan's benefits payable to the participant. A security arrangement between spouses regarding plan benefits is an assignment normally prohibited by Section 401(a)(13)(A). Section 401(a)(13)(B), however, provides that an assignment normally prohibited by Section 401(a)(13)(A) will be permitted, if the assignment is made pursuant to a QDRO. Note here that these assignments can be made only for the benefit of an alternate payee. These assignments do not provide any additional benefit to third party creditors.

When considering the use of a QDRO to provide for a security interest, you should keep in mind that if the QDRO provides that the alternate payee (if the alternate payee is a spouse

or former spouse of the participant) can force a distribution from the plan to satisfy the debt which has been secured, the distribution will be taxable to the alternate payee and the tax effects should be considered.

When considering the use of a QDRO to provide for a security interest, you should also keep in mind that the order cannot contradict the provisions of Section 414(p). Section 414(p) provides that the order cannot require the plan to provide any type or form of benefit, or any option, not otherwise provided under the plan. Some plan administrators have interpreted this to mean that when considering security interests in QDROs, the plan administrator does not have to assume the responsibility for providing notice to either of the parties regarding the security interest.