

Characterization of Retirement Plans – 2024

by Greg Enos

Game Changer: a pre-marital or post-marital property agreement can completely change the characterization analysis of a retirement plan. Most property agreements state that all of a spouse's retirement is his or her separate property. The analysis below assumes there is no marital property agreement.

There are two basic types of employer-based retirement plans:

- Defined contribution plans – 401k's, Simple IRA, 403b's, Federal Thrift Plan – that involve the employee contributing to his or her plan account and the employer matching a percentage of each contribution. The employee has choices in how the account is invested. These accounts have account balances.
- Defined benefit plans – private pension, Texas Teacher's Retirement, Federal FERS pension – these plans pay a monthly amount upon retirement based on years of service and how much was earned during the latter years of work. These plans do not have an account balance.

Characterization of Defined Contribution Plans (401k, Simple IRA, 403b, etc.)

Often, the separate property portion of a 401k or other defined contribution plan is the balance as of the date of marriage, but it depends on how the plan account is invested.

Tex. Family Code §3.007(c) states:

The separate property interest of a spouse in a defined contribution retirement plan may be traced using the tracing and characterization principles that apply to a nonretirement asset.

In other words, apply the usual rules for characterization, such as the doctrine of inception of title, tracing rules, etc. So, funds in the plan prior to marriage (if proven) would be separate property. Funds added to the plan during the marriage through employee contributions, employer matches, interest and/or dividends would be community property.

However, the attorney must check to see what the employee's plan account is invested in now compared to its investments at the time of marriage. Most are invested in mutual funds or cash, but some plan accounts are invested in individual stocks (often shares of the employing company). The general principle that applies is this: if you own a property before marriage it is separate and if that property increases in value

during the marriage the entire increased value remains separate (such as a painting valued at \$5,000 at marriage but at \$100,000 at divorce - the entire \$100,000 is separate property). If the 401k plan holds the exact same investment (100 shares or 622 units of the same mutual fund), that investment would still be all separate property even if its value has increased during the marriage.

Example: At marriage, the 401k has \$40,000, of which \$10,000 is in a money market account and \$30,000 is invested in company stock (1,000 shares at \$30 per share.) Eight years later at divorce, the 401k is worth \$110,000 but the account still holds the same 1,000 shares that are now worth \$50 each. So, the separate property portion of the 401k is \$60,000 (\$10,000 in cash at time of marriage plus \$50,000 in stock).

Characterization of Traditional Pensions - (defined benefit plan)

For traditional pensions, a mathematical formula has to be applied to determine how much is community property. If benefits are matured (in pay status or eligible to be paid), the *Taggart v. Taggart*, 552 S.W.2d 422 (Tex.1977) formula applies:

$$\text{community portion} = \frac{\text{\# of months married during employment}}{\text{total \# of months of employment}}$$

If benefits are not fully matured, the *Berry v. Berry*, 647 S.W.2d 945 (Tex. 1983) formula applies:

$$\text{community portion} = \frac{\text{\# of months married during employment}}{\text{\# of months of worked at time of divorce}} \times \text{(monthly benefit that employee would have received at divorce date, whether then eligible to retire or not)}$$

The *Berry* formula involves a fraction that is multiplied by the monthly benefit that employee would have received at divorce date, whether then eligible to retire or not. *Gainous v. Gainous*, 219 S.W.3d 97, 109 (Tex. App.—Houston [1st Dist.] 2006, pet. denied). This mythical value is called the “vested accrued benefit,” which refers to the amount of benefits that a participant has earned under a defined benefits pension plan as of any particular date and is usually stated in terms of a monthly pension amount. It is generally based on the employee's years of service with the company and his/her final average compensation as of the calculation date.

For example, the ExxonMobil pension calculates monthly retirement pay as follows:

1.6% x years of employment x the highest average of 36 consecutive months of pay during the last 10 years of employment. If the employee is 34 years old and has worked 11 years for ExxonMobil at the time of divorce, he or she is not eligible to retire and will continue to increase the pension amount by working after the divorce. The *Berry* formula would require the ExxonMobil pension plan to calculate what the employee would have received in a monthly pension at the time of divorce and award the other spouse his or her share of that amount. When the ExxonMobil employee finally does retire, he or she would get the full amount based on the pension equation less the amount awarded to the ex-spouse as of the time of divorce.

Cash Balance Pension - the community portion should be the amount contributed during the marriage.

Cost of Living Adjustments (COLAs) - a pension plan provides for annual increases to keep up with inflation. Generally, some part of COLAs will be community property. *Phillips v. Parrish*, 814 S.W.2d 501, 505 (Tex. App.—Houston [1st Dist.] 1991, writ denied); *Stavinoha v. Stavinoha*, 126 S.W.3d 604,612 (Tex. App.—Houston [14th dist.] 2004, no pet.). The court can award a percentage of postdivorce COLAs as community property. *Sutherland v. Cobern*, 843 S.W.2d 127, 132 (Tex. App.—Texarkana 1992, writ denied).

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Military Retirement - This is a very complicated issue and attorneys need to consult with texts or experts on military retirement. *Caracciolo v. Caracciolo*, 251 S.W.3d 568, 572 - 3 (Tex. App.—San Antonio 2007, no pet.) provides an example of calculating the 50% of military retirement awarded a wife while the husband was still on active duty:

Anthony testified that he retired under the “high 36” plan, which was his only retirement option under federal law. He testified that under this plan, he first had to average the last 36 months of his base pay as the base line for calculating his retirement pay. He further testified that based upon his pay statements, at the time of the divorce his average base pay during the 36 months preceding his divorce was \$2,241.61. He multiplied this amount by a percentage derived from the number of years he served times 2.5. Since he had served in the military for 17.5 years at the time of divorce, the result was 44%. He thus multiplied \$2,241.61 by 44%, computing a total of \$986.30. To

determine Joanne's share, he divided this amount in half as required by the divorce decree, which equaled \$493.15. He rounded this figure up to \$494.

Stock Options and Restricted Stock - Texas Family Code §§3.007(d) and (e) provide specific equations to determine the separate property share of a stock option or restricted stock, depending on whether the grant was made prior to marriage or during the marriage.