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Separate Property Tracing and 401(k) Records

Most 401(k) plans will do the market tracing analysis for you from date of separation to the date of transfer of funds through the QDRO process. So if the community interest is 100% community as of date of separation-it's 50% division of all assets as of date of separation plus gains and losses from date of separation to the date the funds are actually transferred to former spouse (The plan will exclude post separation contributions automatically).

Ball park calculation: Collect the date of separation statement and the monthly/quarterly/annual statements (whatever you can obtain) after date of separation and adjust according to the overall performance from date of separation to present day-just be careful of applying the correct rates of return.

Example:

June 1, 2014 Value $50,000 (date of separation) 100% is community property

September 1, 2014 value $60,000 and market increase for that quarter 8%APR (the rest of the increases are due to contributions)

8%APR means for the year so for 3 months that would be a 2% return or ($50,000 x 2%= $1,000) + $50,000 = $51,000 as of September 1, 2014.

December 31, 2014 value $80,000 and market increased for that quarter 8%APR

Again-pay attention to APR vs return for just that statement. ($51,000 x 2% = $1,020) + $51,000 = $52,020.

December 31, 2015 value $200,000 and market increase 8%APR for the year end summary

($52,020 x 8% = $4,161.60) + $52,020 = $56,181.60 community value as of December 31, 2015 and former spouse's ball park figure if paid on December 31, 2015 is ½ or $28,090.80

Usually tracing analysis is only <u>required</u> if there is a separate property interest mixed in with the community as of date of separation (most commonly when the plan holder had money in the account before marriage). Most plans will not calculate between two historical dates-only from one historical date to present day.

Using same numbers different facts-assume the following:

Date of marriage June 1, 2014 starting value $50,000 100% separate property

Fast forward to December 31, 2015 $56,181.60 separate property and account value is $200,000…but now the parties have been litigating for another year…do you really want to keep doing math to adjust what has happened in the market the first couple weeks of 2016? What if the market continues to take a nose dive?

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$200,000 total – 56,181.60 separate = $143,818.40 community property.

$143,818.40 x 50% = $71,909.20 former spouse's share

$71,909.20/$200,000 = 35.95% former spouse's share as stated as a percentage as of date of separation.

So QDRO reads 35.95% as of December 31, 2015 plus gains and losses from December 31, 2015 to date of transfer to alternate payee.

NOW-WHAT IF YOU WANT TO ADD AN EQUALIZATION PAYMENT FOR BACK SPOUSAL SUPPORT in the amount of $25,000??

QDRO reads 35.95% as of December 31, 2015 plus gains and losses from December 31, 2015 to date of transfer to alternate Payee. EQUALIZATION PAYMENT: Immediately prior to establishment of a separate account for Alternate Payee or distribution of funds to Alternate Payee, the amount awarded to Alternate Payee shall be INCREASED BY TWENTY FIVE THOUSAND DOLLARS and 00/100 ($25,000.00). Such amount is an agreement between the parties to offset for back spousal support payments from Participant to Alternate Payee.

What about taxes? Taxes are fine for spousal support equalizations because former spouse would have been responsible for the taxes on the $25,000 anyways as a spousal support payment. So the tax liability on the $25,000 follows the former spouse-as it would if the spousal support payments were made on time.

What about if I wanted to do an equalization payment for other property rights? Like a car? Think it through first with the tax ramifications-if you are equalizing for money due from a general property equalization-remember that pre-tax dollars, from a 401(k) are not worth as much as post tax dollars-because taxes still need to be taken out. Think about how much your client would receive if the car were sold and then compare that to if the car were sold and your client had to pay ordinary taxes on the proceeds.

401(k) records destroyed: What if the records are destroyed or cannot be found as of date of separation and both parties acknowledge employee spouse had a significant premarital interest? This is a tough situation as far as what to do.

Since we do not have statements to rely on-one potential option is an estimation of the premarital interest utilizing a time rule approach. Although normally reserved for defined benefit plans, without account statements or other data-this may be the only method in some cases.

The approach works like this: The parties agree to a date (or better-provide a record showing a date) when Employee Spouse began participating the 401(k) plan. Once that date is established, take the very first known value of the account, and then make the mathematical assumption for settlement purposes that the contributions and gains are equal to each other for every single month from the agreed beginning participation date to the first known date. Utilizing this assumption, we can calculate the date of marriage separate property value of the account and follow normal tracing principles up through date of separation using the records you do have.

Example:

Agreed date of Contribution commencement: January 1, 1990

Date of Marriage: January 1, 1997

Date of 1st Record January 1, 2000 $100,000

Mathematical assumption as follows: 100,000 of contributions and earnings in the past 10 years so assume $10,000 of contributions and earnings a year.

Date of marriage value is $70,000 and by January 1, 2000 the separate value remains $70,000 and the community is $30,000 (for purposes of settlement).

Normal tracing rules can then apply from January 1, 2000 up through date of separation-assuming all those records are present.

Alternative solutions are to look at historical market conditions, make some assumptions about contribution rates, and then do some reverse math to arrive at historical values and parse out what was the starting separate property value.

THERE ARE NO GOOD OPTIONS when records are destroyed and a separate property claim is made.

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