

Federal Employee Death and Survivor Benefits - Drafting Traps.

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Attorneys crafting the death and survivor provisions of Domestic Relations Orders against a federal employee's pension benefits must be alert to differences in death and survivor benefits. The "Old Plan" does not provide death benefits, only a survivor annuity. Provisions for death benefits are found only in the "New Plan", and are substantial. The two federal retirement systems are:

Old Plan: Civil Service Retirement System (CSRS). Hired prior to January 1, 1984.

New Plan: Federal Employees' Retirement System (FERS). Hired after December 31, 1983.

When crafting a Domestic Relations Order against the pension benefits of a federal employee, attorneys should be aware that FERS offers an expanded package of benefits that should be considered in your negotiations and resulting Court Order Acceptable for Processing (COAP). A COAP is the federal equivalent of a Qualified Domestic Relations Order.

Under CSRS, if an employee dies while an active Federal employee, the sole form of benefit available to his or her eligible spouse is a survivor annuity. There is the mistaken assumption that this survivor annuity is always equal to 55% of that employee's benefit earned to the day preceding the date of death. Not true. If a larger benefit would result, this spouse would receive the smaller of the following computations: 22% of the average of the deceased employee's Final Three Years of Average Pay or 55% of the annuity that would have been paid if credited service was projected to age 60 (same high 3 years final average pay).

As a convenient guide, if the employee at death, has less than 22 years of service the highest benefit will vary between 22% of the decedent's high three years annual salary and the earned benefit projected to age 60. Most likely if death occurs between the second and tenth year of CSRS employment the "projected" benefit will be paid, then between ten years and up to twenty-two years of CSRS service it is likely to be the "22% of earned benefit". Again, this is a general guide to be confirmed by proper calculations for each matter. For those interested in correlating age and service at death to the survivor benefit then payable, Troyan has prepared a chart illustrating which survivor benefit will be paid based on age and service at death. In actual cases, it is the attorney representing the Federal employee who is obligated to recognize and negotiate with a clear understanding of the fact that should an active Federal employee die prior to attaining twenty-two

years of credited service the survivor benefit payable to the Former Spouse (recall, the Federal Government does not use the term "alternate payee") will greatly exceed his or her living benefit or the benefit computed pursuant to a "Time Rule" allocation formula. Significantly, CSRS will pay the larger survivor annuity benefit to the former spouse, unless specifically barred by the language of your COAP.

Time Rule Allocation Formula Explained (Defined Benefit Plan).

This formula had its genesis in the Brown case (544 P.2d 561). In many states the Time Rule is referenced as "Coverture Fraction". This format is well described in the New York decision in Majauskas (441 N.Y.S.2d 900) and the New Jersey decision in Marx (627 A.2d 691). At this date the Time Rule/Coverture Fraction format is applied in some form in all but two states; Texas and Florida. However, Florida will accept a Coverture Fraction if the parties agree to this format. Essentially this formula operates as follows:

Step I.

The Plan Administrator determines the actual monthly benefit payable to the retiree at the time of his or her actual retirement or death.

Step II.

The monthly benefit determined at Step I, shall be multiplied by a fraction.
Numerator: total period of time the parties were married and the employee was accruing benefits up to the jurisdiction's end of marriage date.
Denominator: total credited plan service of the employee.
The product of this calculation is the "marital" or "community property" component of the pension benefit.

Step III.

The product computed at Step II, shall be multiplied by the percentage to be given to the non-employee spouse. Generally 50%. The product of this calculation is the amount then payable to the non-employee spouse.

The Trap Illustrated

Assume a CSRS employee died at age 48 with fourteen years of federal service (all marital). At the time of her death her Final Three Years of Average Pay (FAP) was: \$68,000.00. Based on these statistics her monthly earned annuity benefit at death was \$1,374.17. The maximum survivor benefit that is likely to be assumed by the parties is:

55% of the decedent's earned annuity at the time of death

Based on this flawed assumption the Former Spouse's survivor annuity monthly benefit would be \$755.79. However, based on the CSRS calculation procedure the survivor benefit paid as a result of the death of the age 48 employee after fourteen years of service and a FAP of \$68,00.00 would be \$1,246.67. Naturally, this will be the calculation unless a COAP calls for an alternate calculation. The standard CSRS calculation is as follows:

Final Average Pay: \$68,000.00
Multiply by 22%
Annually: \$14,960.00
Monthly Survivor Annuity: \$1,246.67

Thus, the death of the CSRS employee results in an unanticipated and most substantial increase in the Former Spouse's monthly survivor benefit. The percentage of this unanticipated increase is 64.95%. In effect, the Former Spouse's Survivor Annuity is in this case 90.72% of the decedent's earned monthly benefit as of the date of death.

Monthly Survivor Annuity: \$1,246.67
Earned Annuity At Death: \$1,374.13

$\$1,246.67 \div \$1,374.13 = 90.72\%$

As a result the Former Spouse will receive, over his lifetime, a benefit well in excess of any benefit computed pursuant to a "Coverture Fraction" formula. Does your Property Settlement Agreement recognize this circumstance and is this potentially unique outcome understood and accepted by the parties at the time of divorce?

FERS (New Plan) SURVIVOR ANNUITY BENEFIT.

The FERS Former Spouse Survivor Annuity is the second focus of this article. This retirement system has been in effect more than twenty-six years and will clearly be the prevalent retirement system moving forward. The trap for the practitioner representing a Former Spouse, is to presume when negotiating or drafting a Court Order Acceptable for Processing (COAP) that the Former Spouse survivor annuity payable is similar or identical to that payable from CSRS. This leads to the incorrect assumption that regardless of service at the time of death the former spouse survivor annuity will be 55% of the decedent's earned annuity (at the time of death).

This is a most flawed assumption! The survivor benefits payable by the respective retirement systems are dramatically different. Essential to negotiation and drafting in this area is clarity on the fact that FERS provides two benefits upon the death of an active employee. Recall, CSRS was limited to a survivor annuity benefit. There is no lump sum death benefit from

CSRS. This is not so with FERS. Here there are two possible benefits payable to a Former Spouse as a result of the death of an active employee:

Benefit # 1. Basic Employee Death Benefit (BEDB).

Attorney Alert:

The BEDB is only paid to a surviving Former Spouse upon the death of an active FERS employee. This benefit is not paid to the Former Spouse of a FERS employee who died subsequent to retirement.

The BEDB has two components:

First Component

A lump sum payment that is equal to fifty percent (50%) of the employee's final pay (Final Three Years of Average Pay) at the time of death.

Second Component

\$15,000 (increased by cost-of living adjustments beginning December 1, 1987). Through the year 2010 this additional single sum is \$29,722.95.

For Example:

At the time of her death, FERS employee Mary Jones Final Three Years of Average Pay was: \$68,000.00. Based on this final pay her BEDB is:

$\$68,000.00 \div 2 = \$34,000.00$

Second component: \$29,722.95

Total Death Benefit: \$63,722.95

ATTORNEY ALERT!

Practitioners must recognize that this "BEDB" described above is not an automatic entitlement of a Former Spouse. To provide this BEDB to a Former Spouse it is necessary to specifically award these death benefits in the Property Settlement Agreement and then draft this award into the Court Order Acceptable for Processing (COAP). Absent such clear and specific assignment of "death benefits" to the Former Spouse he or she will not have an entitlement to the BEDB.

Tax Treatment Of BEDB

This death benefit will be taxable to the beneficiary unless appropriate tax avoidance action is timely implemented. Toward this end, the informed attorney when crafting a Property Settlement Agreement will first inform the Former Spouse of his or her "rollover" opportunity and then insert language into the Property Settlement Agreement and subsequent Court Order Acceptable for Processing (part one and part two death benefits) affording this Former Spouse the right to directly rollover the BEDB lump-sum payment into a traditional IRA (as a result of legislation enacted late 2010 a rollover into a "Roth IRA may also be possible). Failure to insert such language into these two documents is likely to result in a Lump Sum

Distribution of these sums to the Former Spouse, resulting in a mandatory 20 percent federal income tax withholding. To avoid confusion and loss of opportunity it is further suggested that the rollover election be submitted with the Former Spouse's application for death benefits. This action will expedite the IRA rollover election process.

Commentary:

Regarding the BEDB, attorneys will recognize the following rights of a Former Spouse that may be applicable and significant to your specific matter.

The surviving spouse has additional choices regarding the BEDB:

Single Lump Sum Payment (fully taxable)

36 monthly payments (the total paid in 36 monthly installments is slightly greater than a single lump sum payment because it includes interest (taxable as received)

Additionally, it is worth noting that an election to receive monthly BEDB payments may be revoked at any time. The Former Spouse may then elect to receive a lump sum payment of the unpaid balance. Additionally, if the Former Spouse decided to elect monthly payments and dies before the completion of thirty-six payments, the unpaid balance is paid in a lump sum to the Former Spouse's next of kin.

ATTORNEY ALERT:

Death Prior to Completion of Ten Years of Credited Service.

If death occurs prior to the employee's completing ten years (but subsequent to the completion of eighteen months) of federal service there is no, repeat no survivor annuity benefit payable. In particular, attorneys must be alert to the fact that FERS employees with less than ten years of federal service have significantly reduced death and survivor benefits compared to a federal employee with more than ten years of federal service. When crafting a Domestic Relations Order this difference should be known to the parties and recognized in your negotiations.

Benefit # 2. FORMER SPOUSE SURVIVOR ANNUITY

There are two separate circumstances pursuant to which a Former Spouse Survivor Annuity may be paid.

Circumstance ONE.

A Former Spouse Survivor Annuity Payable as a Result of the Death of an active Employee.

For this annuity benefit to be payable in addition to the BEDB the deceased employee must meet the following criteria:

completed at least 10 years of total creditable service, and

died while subject to FERS deduction (was actively employed)

Attorney Alert:

Regarding this ten year threshold requirement. When making this computation as to meeting the ten year total service requirement, a decedent's active duty military service time may be included. However, military service time alone is not recognized unless specific deposit requirements have also been met.

Active Employee's Former Spouse Survivor Annuity.

An annuity equaling fifty percent (50%) of the decedent's monthly accrued benefit (FERS term is "basic retirement benefit") as of the day preceding his or her date of death.

Circumstance TWO.

A Former Spouse Survivor Annuity Payable as a Result of the death of a retired FERS employee.

It is to be noted that this annuity will only be available to a Former Spouse if a COAP was in place prior to the retirement of the retiree. Provided a COAP is in place, then upon retirement the retiree's benefit will be reduced by ten percent to provide this Former Spouse Survivor Annuity. For example: At the time of retirement the member had a Basic Monthly Benefit of \$3,250.00. The reduction to provide the Former Spouse Survivor Annuity of ten percent reduces the monthly benefit to \$2,925.00. Assume for ease of discussion a 50/50 division of the benefit. The resulting allocation of benefits over the lifetime of the retiree is as follows:

To the retiree: \$1,462.50 and an identical sum to the Former Spouse.

However, upon the death of the retiree, the Former Spouse's monthly benefit is increased to half of the basic benefit. Thus, subsequent to the death of the retiree the Former Spouse's monthly benefit is \$1,625.00 (half of the unreduced basic benefit).

Commentary:

FERS retirees have by statute a post-retirement Cost-of-Living addition to their retirement benefits. Thus, the benefits shown above will increase over time. For the calendar years 2010 and 2011 there will be no COLA. The average annual FERS COLA since 1999 has been 1.95%. Alternatively, the average annual CSRS COLA since 1999 has been 2.42%. During the lifetime of the retiree the Basic Benefit is growing due to COLA, thus, the amount deducted increases proportionately. However, once survivor benefits begin, the Former Spouse receives fifty percent of the Basic Benefit without any reduction for the costs of the Former Spouse Survivor Annuity.