

Rules and Timing of Death Distributions



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Determining the Beneficiary



The Analysis

- Was plan payment wrong?
- If yes, does plan give administrator discretion to review claims (*i.e.*, *Firestone* language)?
 - If no, then plan erred
 - If yes, then were there reasonable grounds to support decision?
 - If yes, then case against plan dismissed

The Rules



IRC § 401(a)(11) (QJSA/QPSA)

- If a plan is subject to the QJSA requirements, then a surviving spouse entitled to a Qualified Preretirement Survivor Annuity (QPSA) if the participant dies prior to annuity starting date
- QPSA is only 50 percent of the accrued benefit
 - Many plans provide a death benefit equal to 100 percent of the accrued benefit to surviving spouse
- A DB plan not required to provide a death benefit to a non-spouse

Plans Not Subject to QJSA/QPSA Rules

- DC plan, other than money purchase plan, may be exempt from QJSA/QPSA rules if plan provides that 100 percent of the account balance is payable to the surviving spouse
- The spousal consent rules of IRC §417 apply for purposes of designating someone other than the spouse for the death benefit

Who Is a Spouse?

- Use state law
- Plan may require that participant and spouse be married throughout the one-year period prior to death



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Designation of Alternative Beneficiary (J&S Plans)

- Plan must:
 - Provide written explanations during “applicable period”
 - Permit election to designate another beneficiary during the “applicable election period” (exception for certain DB plans)
 - Spouse must consent to election (this applies to non-J&S plans as well)

Written Explanation (J&S Plans)

- Explanation must set forth terms of the QPSA, the right to make an alternative beneficiary designation, the rights of the spouse, and the right and effect of a revocation of an election
- Explanation must be provided within the “applicable period”



“Applicable Period” for Explanation

- Later of:
 - Period beginning with the first day of the PY in which the participant attains age 32 and ending on the last day of the PY in which participant attains age 35
 - A reasonable period after the individual becomes a participant
 - If participant terminates employment prior to age 35, a reasonable period of time after separation

“Applicable Election Period”

- Election must be permitted during the “applicable election period”
- Election may be revoked at any time during the “applicable election period”
- “Applicable election period” begins on the first day of the plan year in which the participant attains age 35 (or upon termination of employment, if earlier) and ends on the date of death

Designations Prior to Age 35

- Permitting waiver prior to age 35 can increase potential of mistakes
- Participants may object if designations prior to 35 not permitted
- Advisable to include statement on forms indicating that designation is invalid at age 35



Age 35 Example

- Married participant in a J&S plan, age 30, properly designates child as beneficiary
- Ten years later, participant dies and no new beneficiary designation has been made
- Who is entitled to death benefit: spouse or child?

Spousal Consent (All Plans)

- Must be in writing (Treasury Regulations permit E-signature but must still be witnessed in person)
- Must provide that no change may be made without spouse's consent or it must expressly permit changes without spousal consent (general versus specific consent)
- Must acknowledge the effect of the election and must be witnessed by a plan representative or notary public

General Versus Specific

- Specific consent requires spousal consent whenever beneficiary is changed
- Only permitting specific consent may reduce chances of errors
 - Consistent handling of designations - spousal consent always needed
 - No need to retain prior designations

Notary Versus Plan Representative

- Notary may be safer; but inconvenient for participants
- Plan representative may be easier; but may increase potential of claims



Spousal Consent (Continued)

- Spousal consent not needed if plan representative satisfied that:
 - Spouse is “lost”
 - Must perform a reasonable search
 - Spouse is legally incompetent (legal guardian must consent, even if guardian is the participant)
 - Spouse is legally separated or abandoned (must have court order)



Spousal Consent (Continued)

- Consent is not effective with respect to subsequent spouses
- Consent not valid if spouse is incompetent or obtained by using undue influence
- Advisable to provide that spousal waiver is irrevocable



Consent Example

- Jack is a participant in a non-J&S plan
- Jack names his parents as beneficiaries
- Jack then marries Jill
- Jack dies
- Who is entitled to the death benefit: the parents or Jill?



Designating a Beneficiary

- Calling the matter "a cautionary tale for ERISA administrators," the 9th Circuit commented that "plan administrators disserve both plan participants and beneficiaries when they accept a beneficiary designation that does not unambiguously identify the beneficiaries."

Metro. Life Ins. Co. v. Parker, 2006 U.S. App. LEXIS 2561 (9th Cir.2006)

Details, Details, Details

- Designation should specify primary and contingent beneficiaries
- Form may contain rules
 - Unless specified otherwise, benefit distributed equally to all living beneficiaries
 - Per-stirpes – benefit paid to heirs of beneficiary (e.g., deceased child's share will go to child's children)

Minors

- If beneficiary is a minor then distribute to the guardian
- Requires proof that individual is the guardian of the minor
- Most states have laws providing that the mother and father are the joint natural guardians of their minor children
- *Stills vs. Janney Montgomery Scott LLC*, 62 EPC 1662 (D. SC 2016): reasonable for plan to determine that mother is guardian so plan not liable when mother spent half the money for personal expenses

Can You Rely on a Designation?

Anti-Alienation (IRC §401(a)(13))

- Benefits cannot be assigned or alienated
- Exception for QDROs (IRC §414(p))

QDRO - PPA

- Case law varied on recognition of QDRO issued after death of participant
- DOL issued regulations pursuant to Pension Protection Act of 2006 (PPA) providing that a DRO will not fail to be a QDRO merely because of when it is issued (PPA §1001)
- If on notice that a participant was going through a divorce prior to death, it would be advisable to delay paying the death benefit

Divorce and No QDRO

Waivers

ERISA

- ERISA §404(a)(1)(D) imposes a fiduciary duty on plan administrators to discharge their duties “in accordance with the documents and instruments governing the plan”
- Policy of ERISA is to have certainty and uniformity in the administration of ERISA plans
- Administrators should not be required to know all state laws
- Federal common law should be used to fill in “gaps” in ERISA, not to create law

ERISA

- ERISA is silent on the issue of beneficiary determinations
- State laws that directly impact beneficiary designations are generally pre-empted by ERISA

ERISA Pre-Emption

- Participant's ex-spouse attempted to designate benefits to children upon her death (no QDRO existed)
- Claim was based on entitlement to benefit due to community property laws
- U.S. Supreme Court held that state law was pre-empted by ERISA and new spouse entitled to benefits

Boggs v. Boggs, 520 U.S. 833 [21 EBC 1047] (1977)

Redesignation Statutes

- Washington has law providing that divorce is an automatic revocation of beneficiary designation
- Participant remarried, named new spouse as beneficiary, divorced and then died two months later (no change to beneficiary designation)
- U.S. Supreme Court held that due to ERISA preemption, plan documents, and not state law, are used to determine the proper beneficiary of an ERISA plan

Egelhoff v. Egelhoff ex rel. Breiner, 532 U.S. 141 [25 EBC 2089]
(2001)

Kennedy Decision

- Participant changed designation in one plan but not the Savings and Investment Plan
- Court held:
 - Waiver is not an assignment
 - Plan had procedure for waiving benefits so plan did not need to look at divorce decree to determine if it was a waiver
- “We do not address a situation in which the plan documents provide no means for a beneficiary to renounce an interest in benefits.”

Kennedy v. Plan Administrator for DuPont Savings and Investment Plan et al, 129 S.Ct. 865 (2009)

Post *Kennedy*

- Plan paid the participant's ex-husband because he was the designated beneficiary
- Estate argued that plan had no formal procedure for waivers and therefore plan not bound to look solely at the designation
- Court held that it's easy for a participant to designate a new beneficiary and it's easy to disclaim a benefit – refuse to accept the money
- Even though plan had no formal process, the footnote in *Kennedy* was not germane to the ruling

Boyd v. Metropolitan Life Insurance Co., 4th Circuit 3/31/11

What Is a Waiver?

- Black's Law Dictionary:
 - Waiver is the voluntary relinquishment or abandonment – express or implied – of a legal right or advantage
 - Alienation and assignment refer to the conveyance or transfer of property to another
- IRC §2518 has disclaimer provisions for tax purposes
 - Irrevocable and in writing
 - Received by transferor within nine months
 - Doesn't assign to anyone else
- Prenuptial agreements are not recognized

Avoiding the Problem

- Many plans include a provision stating that divorce revokes the designation of a spouse as beneficiary
- Use of such provision would require that administrator determine whether a divorce had taken place before making payment
 - You always need to know marital status even if you don't include this provision

Litigation After Payment

- Estate sued ex-spouse for proceeds of plan arguing that it was breach of contract since benefits were waived
- Court held no pre-emption since estate wasn't bringing suit under ERISA against the plan

Estate of Boss v. Boss, U.S. District Court, WD of KY; No. 5:10-CV-190; 2/3/2011

Optional Provisions to Include on Forms

Doctrine of Substantial Compliance

- Some courts will recognize substantial compliance with requirements to designate a beneficiary
- Most cases deal with employer group-term life insurance – subject to ERISA but plan terms can dictate how beneficiary designations are made

Doctrine of Substantial Compliance

- Circuit Courts that recognize the doctrine:
 - 3rd, 4th, 7th, 8th
- 6th and 11th Circuits do not recognize the doctrine
 - Not clear whether doctrine would apply for “optional” provisions on beneficiary form

KMATZ vs. Met Life, 37 EBC 2281 (U.S. District Court SD of Ohio, 2006)

Doctrine of Substantial Compliance

- Open to facts and circumstances test as to what constitutes substantial compliance
- Much more limited with respect to qualified plans where law imposes restrictions on spousal consent
- *Teacher's Insurance and Annuity Association of America v. Bernardo* (ED PA; 1/26/2010)
 - After *Kennedy*
 - Court held that using doctrine was not contrary to *Kennedy* because ambiguous facts
 - Policy holder tried to change and information he submitted was same information TIAA-CREF had on its forms and TIAA-CREFF sent letter indicating that their records agreed with policy holder

Substantial Compliance – Example 1

- Married participant in a non-J&S plan designates child as beneficiary
- Beneficiary form was not signed by spouse and did not include language regarding the effect of the election (*i.e.*, the rights the spouse was giving up)
- Who is entitled to the death benefit: surviving spouse or child?

Substantial Compliance – Example 1

- The surviving spouse

Sun Microsystems, Inc. v. Lema, No. C 04-04968 JF (N.D. Cal. Feb. 2, 2006)

Substantial Compliance – Example 2

- Participant elected partial lump-sum and a single life annuity
- Spouse signed consent
- Notary did not include standard language stating that spouse had signed it in notary's presence
- Is surviving spouse entitled to any benefits?

Alfieri v. Guild Times Pension Plan, 2006 U.S. Dist. LEXIS 54228 (E.D.N.Y. 2006)

Substantial Compliance – Example 2

- Yes
- Other cases did not involve “the ERISA strict requirements leading to the loss of benefits by a surviving spouse”

Alfieri v. Guild Times Pension Plan, 2006 U.S. Dist. LEXIS 54228 (E.D.N.Y. 2006)

Items to Consider

- Social Security Number
- Birthdates
- Relationship
- Address (especially if foreign individual)
- New designation revokes all prior designations

Require Full Completion

- If you ask for information on the form, make sure it's completed
- Receipt versus acceptance of form by plan
 - May be safer to require acceptance
 - Consistently return to participants all forms that are not complete

Receipt Versus Acceptance

- Participant names wife; stepdaughter as secondary
- Participant attempted to change to stepdaughter
 - Spouse signed consent
 - Relationship not completed on form and plan returned to participant
 - Plan was already on notice of relationship
 - Plan only required receipt, not acceptance
- Who is entitled the benefit, the surviving spouse or the stepdaughter?

Receipt Versus Acceptance

- Stepdaughter is beneficiary unless undue influence or lack of capacity
 - Case was remanded to determine if there was lack of capacity or undue influence

Alliant Techsystems, Inc. v. Marks, No. 05-3614 (8th Cir. Oct 19, 2006)

Other Issues

Slayer Statutes

- Slayer rule – common law principle that a person should not be permitted to profit from his or her wrongdoing
- Many states have slayer statutes – but they vary; some limited to murder – some apply to manslaughter
- Some argue that strict plan document rule would prevent application of slayer statute
- U.S. Supreme Court (*Kennedy* case):
 - The “slayer” case is not before us, and we do not address it

Slayer Statute (Murder)

- NC has slayer statute
- Court applied slayer rule – did not address pre-emption because result would be same under state statute or federal common law
- Court held that the plan fiduciary should have delayed payments to a beneficiary who had been indicted for the participant's death

Atwater v. Nortel Networks, Inc., No. 1:04CV00503 (M.D.N.C. Sept. 6, 2005)

Slayer Statute (Murder)

- Kathleen died on 12/9/2001 (fell down stairs)
- Michael (husband) indicted for murder on 12/20/2001
- Michael was designated beneficiary; decedent's estate contacted plan around 1/7/2002
- Plan provided that benefits must be paid "to the participant's beneficiary as soon as administratively or reasonably practicable"
- Administrator paid Michael (prior to conviction)
- After conviction on 10/10/2003, decedent's estate filed a claim for benefits
- Estate sued the plan and won

Problem with Slayer Statutes

- Is voluntary manslaughter intentional killing?
- Court held that it is; doesn't matter whether it's Michigan law or federal common law
 - Manslaughter = murder without malice
 - But there's still "intent"

Nale v. Ford Motor Co. UAW Retirement Plan, U.S.D.C. ED Mich; No. 09-cv-13401, March 31, 2010

Simultaneous Death

- Uniform Simultaneous Death Act adopted by most states
- Presumption that if both die within 120 hours, then beneficiary is deemed to have died first
- No cases addressing ERISA plans and simultaneous death
- Likely that federal common law would recognize similar principle

More Examples

Example 1

- Participant named two individuals as beneficiaries
- One individual died before participant
- Is the surviving beneficiary entitled to the entire death benefit or does the plan apply the plan's default beneficiary provisions for the portion that would have been paid to the deceased beneficiary?

Example 1

- Administrator relied on plan language providing for an order of beneficiaries if there is no designated beneficiary (i.e., living beneficiary was not entitled to the total benefit)
- Court held that relying on the plan terms was not arbitrary and capricious

McGowan v. NJR Service Corp., 3d Cir., No. 04-3620, 9/13/05

Example 2

- Participant dies
- Beneficiary form designated spouse and niece as primary beneficiaries (50/50)
- Spouse never signed the designation
- Can spouse waive 50 percent of benefit so that it can go to the niece?

Example 2

- Spouse can waive the 50 percent
- Spouse cannot assign benefits to someone else - the portion that is waived would go to the default beneficiaries under the plan

Example 3

- Single participant named her children as beneficiaries
- Participant was later married but never submitted a new beneficiary form
- Participant died and default under plan is estate
- Plan provides for minimum spousal death benefit (50 percent)
- Does the marriage invalidate the executed beneficiary form or append it (*i.e.*, invalidate means 50 percent to spouse and 50 percent to estate (per plan); append means 50 percent to spouse and 50 percent to children)?

Example 3

- Open to interpretation



Example 4

- Participant signed beneficiary designation
- At the time, participant was in a hospital and was under the influence of strong pain medications
- Is the designation valid?

Example 4

- Designation is not valid if improperly procured
- Courts apply federal common law since ERISA does not contain provisions relating to designations that are forged, the result of undue influence, or improperly procured

Metropolitan Life Insurance Co. v. McCloskey, N.D. Ohio, No. 1:03 CV 1523 (12/23/05) and *Iron Workers Mid-America Pension Plan v. Nevers*, N.D. Ill., No. 05 C 3470 (11/10/05)



Timing of Payments

**We Know Who and What – Now
We Need to Know When to Pay**

Timing of Payments

- Death benefit for spouse in a DC plan must be “available” within a reasonable period of time after death
 - Within 90 days of death is deemed reasonable
 - Longer than 90 days is unreasonable if participants can obtain an earlier distribution
 - Example: if participants can get a distribution within 90 days of severance then it’s unreasonable to provide that the death benefit is not distributable until after the end of the plan year of death
- Death benefit in a DB plan must be payable no later than the month in which the participant would have otherwise been entitled to receive a distribution

RMD Rules

- IRC §401(a)(9) sets forth period when distributions must be made and the amount of the distributions
- Depends on who the “designated beneficiary” is and whether distributions have begun under IRC §401(a)(9)

“Designated”

- “Designated”
 - Named by the participant in a beneficiary designation
 - Named by the plan as a default beneficiary in absence of the participant’s specific designation
 - Can be named by position, rather than name: “spouse,” “children,” etc.

“Designated Beneficiary”

- The participant is considered to have a “designated beneficiary” for RMD purposes if:
 - The beneficiary is a person
 - The beneficiary is a trust (see next slide)

Trust as Beneficiary

- The trust is valid under state law (or would be but for the fact that there is no corpus)
- The trust is irrevocable or will be at death
- Beneficiaries are identifiable (*i.e.*, okay if the group is capable of expansion or contraction so long as it is possible to identify the person with the shortest life expectancy)
- The plan administrator receives a copy of the trust and certification by the trustee

“Designated Beneficiary”

- If the beneficiary (or one of the beneficiaries) is an organization or the estate, there is no “designated beneficiary” for RMD purposes
 - For example, if I designate the Red Cross as my beneficiary, I would not have a “designated beneficiary” for RMD purposes
- This does not affect who gets the money, but only the rules regarding the timing and amount of RMDs

“Designated Beneficiary”

- The designated beneficiary is determined for RMD purposes on September 30 of the year following the year of death
 - Gives beneficiaries the opportunity to renounce their benefit
 - Consistent with timing of waiver for tax purposes

Death Distributions After RBD

- If the RBD (required beginning date) has passed, then remaining distributions are based on whichever results on longest period:
 - Remaining life expectancy of participant reduced by one each subsequent year
 - Life expectancy of beneficiary reduced by one each subsequent year
 - If spouse is beneficiary, can use spouse's recalculated life expectancy
- If the participant has no designated beneficiary, then use the remaining life expectancy of the participant reduced by one in each subsequent year

RMD if There Is No “Designated Beneficiary”

- “Five Year Rule”: the death benefit must be paid out by not later than the December 31 of the calendar year that contains the fifth anniversary of the participant’s death
- Distributions can be made as slowly or as quickly or in any form permitted by the plan prior to that date

RMD if Non-Spouse Designated Beneficiary

- Beneficiary may choose between:
 - Five-Year Rule
 - Lifetime distribution:
 - Distributions must begin by December 31 following the year of death
 - Distributions may be spread over the participant's life expectancy (based on Single Life Table of Treasury Regulation §1.401(a)(9)-9, Q&A-1)
 - If multiple beneficiaries, use life expectancy of the oldest beneficiary (*i.e.*, shortest life expectancy)
 - There is a special rule for “separate accounts”

RMD if Spouse Is the Designated Beneficiary

- If the sole beneficiary of the participant is the spouse, the spouse has three choices as to the RMD:
 - Five-Year Rule
 - Lifetime Distribution Rule
 - Spousal exception:
 - Distributions must begin on or before December 31 of the year in which the participant would have attained age 70½; and
 - Distributions may be spread over the spouse's life expectancy under the Single Life Table



DonkeyHOTEX

Taxes After Death

- Estate taxes
 - Retirement plan benefits are subject to estate tax
 - Even Roth
 - Although estate tax currently applies to very few
 - Current exemption (2017) is \$5.49M per individual
 - Tax paid by estate, not by beneficiary of plan
- Income taxes
 - Paid by recipient when funds distributed
 - Can take itemized deduction for estate tax attributable to the taxable income
 - Roth rules carry through

Fundamental Tax Rule

- Your final tax year ends when you do
- You don't pay tax on income received/accrued after you die
 - Your estate or other successor is taxed



Examples (Code 4 for Death)

Check sent to participant before death

- Issue 1099-R to participant

Check sent to estate after death

- Issue 1099-R to estate, using estate's EIN

Check sent to individual beneficiary

- Issue 1099-R to beneficiary

Ten Percent Penalty for Early Distributions

- Ten percent 72(t) tax doesn't apply after death
 - Regardless of age of deceased
 - Regardless of age of recipient/beneficiary
- Note:
 - Suppose spouse rolls over distribution to spouse's IRA or plan account
 - Premature distribution penalty tax would apply if spouse takes distribution before 59½
 - Strategy:
 - Roll to inherited IRA (or leave in plan) enough to take care of spouse's likely needs through 59½

Foreign Beneficiary

- Use IRS Form W-8BEN if the beneficiary is an individual who is a nonresident alien
- Publication 515 to determine withholding rate (it varies based on the treaty with the foreign entity)
- Report on Form 1042 and Form 1042-S

Best Practices and Handling Claims



Who Retains Beneficiary Designations?

- It is the legal responsibility of the plan administrator
- Whomever has this responsibility:
 - Must retain the designations carefully and conscientiously
 - Be sure that the form of the beneficiary designation is as required by the plan or administrative procedures

Best Practices

- Ensure that beneficiary designation forms contain the four requirements for a designation:
 - Written
 - Designation of beneficiary: general versus specific
 - Effect of election
 - Notary or plan representative signature

Best Practices

- Spousal consent irrevocable
- New designation revokes all prior designations
- Be sure that the designation is readable, not ambiguous, and contains whatever information is necessary to enable the plan administrator to find the beneficiary
- Be consistent on completion of optional information (address, date of birth, etc.)

Check for QDROs!

- Make sure that the beneficiary currently designated is entitled to the entire death benefit, and that it has not been entirely or partially assigned to an alternate payee
- If a divorce was pending or recently finalized, it is possible that a QDRO is still pending

Best Practices

- Follow the terms of the plan
 - One-year marriage rule
 - Default beneficiary provisions
 - Amount of QPSA and death benefit for non-spouses
- Pay benefits quickly?
- Interpleader – expensive but only safe method of ensuring who is the correct beneficiary

If There Are Contrary Claims

- Follow the plan's claim procedures
- Must likely give notice to both parties that there are conflicting claims, and be prepared to justify the basis of the grant made by the plan
 - If there is an appeal to the claim, follow those procedures as well
- If all else fails, contact an attorney – interpleader can be used to have the issue a declaratory judgment as to who is the beneficiary

Education Is Key

- Educate employees to ensure that notification of changes in marital/family status are reported
- Educate employers to:
 - Review beneficiary designations for completeness and specificity
 - Be proactive if aware of change in family circumstances (*e.g.*, divorce or marriage)

