IRA UPDATE: JUNE 2011

Beneficiary Forms

Usually the beneficiary form controls who gets money when a retirement account owner dies however there are some situations where the intended beneficiary will not get the inheritance.

One of those situations is the case of an employer based plan covered under ERISA (Employee Retirement Income Security Act) rules. In an employer plan, the default beneficiary is the employee's spouse unless a beneficiary form names other beneficiaries and the spouse signs a waiver. For example, if the employee executes a beneficiary form naming his children but does not get the spousal waiver, the beneficiary form will be trumped by ERISA rules and the spouse will get the funds.

So what to do in the case of remarriage where the employee wishes someone other than his new bride-to-be to receive the funds? Many individuals in this type of situation might execute a prenuptial agreement stating that the new spouse will not have rights to the retirement account in the event of death or divorce and update their beneficiary form to name their children instead. The problem is that a person signing a prenuptial agreement is not yet a spouse and therefore cannot sign a waiver for retirement funds. In such a case, the new spouse would have to execute the spousal waiver AFTER the marriage occurs.

This has happened in many cases where children of a retirement plan participant were expecting an inheritance because their parent specifically named them on a beneficiary form however because the participant later remarried (with or without a prenuptial agreement) and did not get the spousal waiver, the courts say sorry to the beneficiary because the new spouse gets the money. In a case in Louisiana that is exactly what happened. In the matter of Leonard Kidder, a former participant of the Cajun Industries, LLC 401k plan, Beth Kidder was only married to her husband for six-weeks before he passed away. Even though he had previously named his children as beneficiaries before his marriage, he never executed the spousal waiver and the court ruled in favor of Beth Kidder because the plan rules stated that the spouse's right to the plan assets were immediately vested upon marriage. While ERISA rules do allow for a plan to waive the spousal consent requirement when a plan participant has been married less than one year, this plan did not have such a waiver. Had Leonard Kidder executed the spousal waiver immediately after the marriage (or at least at any point before his death) then his children would not have been disinherited.

The Kidder case sounds like something right out of the movie Tommy Boy, but it is a real case and is not the first one. The solution is simple; if the plan participant rolls over the balance of the plan to an IRA (assuming he is eligible for a distribution) then the spousal waiver no longer applies and the IRA owner can name any beneficiary he/she chooses. If the participant is already married, in order to complete the rollover, the spousal waiver is still required. Once the funds are rolled over to the IRA, the spousal waiver no longer applies. You should also consider that each IRA custodian does have its own rules and some do have divorce provisions that will automatically revoke a spousal interest after a divorce. If the participant is still working and is not eligible for a distribution, then he/she should execute the spousal waiver as soon as reasonably feasible (after saying "I Do") AND update the beneficiary form to indicate the desired beneficiaries.

In *Schwab v. Chandler*, the opposite happened. The participant, Wayne Wilson took funds from his previous employer and rolled over to an IRA naming his children as beneficiaries. Some years later, Wilson married Katherine Chandler leaving his children as beneficiary of the IRA. When Wilson died, Katherine Chandler argued that she was the default beneficiary because the funds in the IRA originated from an ERISA based plan. The court ruled against Chandler.

In *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan*, the intended beneficiary, Kari Kennedy who was the participant's daughter was disinherited. William Kennedy, the participant, obtained the proper waiver from his ex-wife however he never updated his beneficiary form! In this case the beneficiary from trumped the waiver.

In these cases it is critical to understand the IRA custodian's or employer plan rules and plan accordingly to make sure your beneficiaries inherit what you want them to. Also keep in mind that some community property states do have exceptions to this rule. These are the types of issues that generally cannot be fixed and you only get one chance to get it right, because after all, how often does one's parent die? This is one of many reasons why an estate plan should be updated in particular if there have been any changes in family size or structure such as marriage, divorce, births, deaths, etc. These issues can get particularly complex when blended families are involved thus it is important to consult with a knowledgeable advisor and estate planning attorney familiar with these issues.

<u>Required Minimum Distributions for Annuity Contracts</u>

Taking a Required Minimum Distribution (RMD) is usually quite simple. The account value on 12/31 of the previous year is divided by the life expectancy factor according to the uniform lifetime table (unless a spouse is 10 year younger). In most cases, an IRA custodian will calculate your RMD although it is always a good idea to calculate on your own just to be sure and considering that the rules can get complicated when there are multiple accounts and account types.

The RMD can get complicated especially when there is an annuity contract which contains living and/or death benefits. In such a case, the insurance company will have to calculate your RMD using a very complicated IRS formula to determine how the value of those living and/or death benefits effect your RMD. This can result in the RMD being larger than expected which can trigger unintended consequences such as affecting the living benefits if the withdrawal amount surpasses the allowed withdrawal amount for the guarantee.

Annuities are very complicated products, so it is important to understand the valuation for annuities with respect to required minimum distributions and how they are integrated with non-annuity IRA and other retirement accounts.

If you have any questions on these IRA issues, feel free to contact me.

Sincerely,

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