

# Everything You Need to Know about Beneficiary Forms



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Making Retirement Plans Work

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# Agenda

- Law and Guidance Governing Beneficiary Options
- Timing Rules for Beneficiary Payouts
- Documents Governing Beneficiary Provisions
- Beneficiary Forms: Contents and Process
- Challenging Beneficiary Scenarios
- Tax Treatment and Reporting of Death Distributions
- For Review of Some Key Points: Sample Plan Doc Language

# Who is the Beneficiary?

- ERISA Definition – Section 3(8)
  - “The term “beneficiary” means a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder”
- ERISA generally preempts state law – Section 514

# ERISA Preempts State Law SC Case

- Participant's ex-spouse attempted to designate benefits to her children upon her death
  - No QDRO existed
- The ex-spouse's claim was based on entitlement due to community property state laws in state of Louisiana
- U.S. Supreme Court\* held that state law was preempted by ERISA (ERISA Section 514)
  - and thus, the new spouse was entitled to the benefits

\* *Boggs v. Boggs US Supreme Court 520 US.833 (21 EBC 1047) (1977)*

# ERISA Spouse Beneficiary Requirement

- ERISA 205(c)(2)(A)(ii); and IRC 401(a)(11) requires the spouse to be the beneficiary of a qualified plan participant
- Spouse consent required if other beneficiary named
  - Must be in writing, and witnessed by notary or plan representative
  - ERISA spousal consent rules apply to QP and not IRAs
    - IRAs may have state required spousal consent in community property states



# ERISA Spouse Beneficiary Req. *(cont'd)*

- Spouse Consent
  - Consent must acknowledge the effect of the election, i.e. : the spouse is foregoing his/her benefits under the plan
  - Required for All Beneficiary Changes
    - ***Operational tip:*** *Plan and Beneficiary Form should limit spousal consent to the specific designation, i.e. no future changes in beneficiary without spousal consent*
  - Without specific limiting language, spousal consent required only once

# Witnessing Spousal Consent

A notary or a plan representative may witness spousal consent

Who should witness the spousal consent, as a recommended best practice?

- Plan representative is acceptable and usually easier than a notary, however, potential risk is increased.
- Notary is the safest method, regardless of any inconvenience to participants.



# Sample of Beneficiary Designation Form: Spousal Consent Language

I hereby consent to the designation of the above Beneficiary(ies) to my Spouse's benefit. I understand that I am entitled to receive a benefit under the Plan unless I consent to the Beneficiary designated above. I also understand that my Spouse may not change the Primary Beneficiary designation without first obtaining my written consent.

- NAME OF SPOUSE: \_\_\_\_\_
- SIGNATURE OF SPOUSE: \_\_\_\_\_ Date: \_\_\_\_\_

*The signature of the Spouse must be witnessed by a Plan representative or a notary public.*

- WITNESS: Notary Public \_\_\_\_\_
- Subscribed and sworn to before me on this \_\_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_.
- NOTARY'S SIGNATURE: \_\_\_\_\_
  
- PLAN REPRESENTATIVE'S SIGNATURE: \_\_\_\_\_
- The Plan Representative may not witness his or her own form or the form of any relative.

# Invalid Beneficiary Forms

- The beneficiary for a married participant is the spouse, unless the spouse appropriately consents in writing.
- Naming a non-spouse beneficiary without the consent of the spouse creates an invalid designation.
- Participant failing to sign creates an invalid beneficiary form also
  - We'll address more later

# Relation to Estate

- Death distributions pass outside the estate (generally)
- Plan death benefit and beneficiary provisions determine who receives the distribution
  - Could be that no beneficiaries survives the participant and it goes to the estate.
- If estate is named or is default then passes through estate – generally requires probate



# Timing Requirements for Death Benefit Payments

Code Section 401(a)(9) and in the as Required Minimum Distribution (RMD) Regulations (1.401-9)

Options in the Rules depend on whether death occurs:

- Before Required Beginning Date (RBD)
- Or on or After Required Beginning Date (RBD)

# Required Beginning Date

- Defined in IRC Section 401(a)(9)
- 5% owner – April 1 of the calendar year following the year when age 70-1/2 is reached
- Non-5% Owners – April 1 of the calendar year following the later of the year in which non-5% owner:
  - Reaches age 70-1/2, or
  - Retires
- Unless TEFRA 242(b)(2) election

# When Did Death Occur?

## Death Before RBD

- 5-year rule (plan can eliminate)
- Single life expectancy (plan can eliminate)
  - Based on beneficiary
  - Reduced by one
  - Establish by end of year after participant's death
- Non-spouse direct rollover to inherited IRA
  - Then can choose from above rules
- Spouse special rules (addressed later)

## Death On or After RBD

- No five-year rule
- RMD for year of death must be paid and is not eligible for rollover
- Must establish beneficiary by Sept. 30 of year after death
  - Pay installments (reduced by 1 each year) based on beneficiary's life (or participant, if younger) – special spouse rules; or
  - Lump sum if plan provides (some DCs)
- Non-spouse timely direct rollover to inherited IRA
  - Then can choose from above rules
- Spouse special rules (addressed later)

# Significant Deadlines for Death Benefit Payments

- September 30 of year after year of death
  - Determine post-death beneficiaries who have not taken their portion or disclaimed
- October 31 of year after year of death
  - Documentation to be received to calculate beneficiary RMD payments due
- December 31 of year after year of death
  - First life expectancy/annuity payment due to beneficiary selecting this form of payment
- December 31 of 5th year after year of death (only if death occurs before RBD)
  - Last date for total distribution to beneficiary under five-year rule

# Other Occasionally Used Deadlines for Death Benefit Payments

- December 31 of 4th year after year of death before RBD
  - Last date for non-spouse beneficiary to roll over to an inherited IRA and use the five-year rule (IRS Notice 2007-7)
- Later of December 31 of year deceased participant would have reached age 70½, or the December 31 of the year after the year the participant died
  - Last date for spouse to begin death benefit installments/annuity if participant dies before the RBD



# Spouse Beneficiary Rules

## QP Differentiated from IRA Rules

*Surviving spouse may:*

1. Roll deceased spouse's IRA into his/her own IRA
2. Make decedent's IRA his/her own IRA, or assume IRA
3. NOT make decedent's QP into his/her own QP account
4. Leave **in decedent's IRA** or decedent's QP until year decedent would have attained 70½
  - e.g., surviving spouse >70½; deceased spouse <70½
5. Rollover deceased spouse's QP assets:
  - To his/her own IRA, or To an inherited IRA; or
  - To QP of a working surviving spouse, if surviving spouse's plan accepts rollovers
6. Take payments from QP as beneficiary, if QP permits
7. Convert to a his/her own Roth IRA or to an inherited Roth IRA

# Spouse Definition

- *State law defines marriage.* (e.g. is there a common-law marriage?)
- IRS in Rev. Rul. 2013-72 defines spouse as any legal marriage anywhere for federal tax purposes
- Same-sex marriages recognized by two Supreme Court cases
  - *Obergefell v. Hodges, June 26, 2015, No. 14-556*
    - The Fourteenth Amendment requires a State to license a marriage between two people of the same sex and to recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-State.
  - *United States v. Windsor, June 26, 2013, No. 12-307*
    - Struck down Section 3 of DOMA because it violated the Equal Protection provisions of the Constitution, thus providing that same sex couples properly married would be recognized for Federal Regulatory purposes.

# Stretch IRA



Method of Prolonging Distributions to Beneficiary's Beneficiary

## Without Stretch IRA

- QP participant dies at 85
- At 84, surviving spouse beneficiary continues plan distributions
- Surviving spouse dies two years later at age 86
- Her son, named as her beneficiary, has only her remaining schedule of 7.1 years left

## With Stretch IRA

- QP participant dies at 85
- At 84, surviving spouse beneficiary rolls into an IRA, son is beneficiary
- Surviving spouse dies two years later, age 86
- Son, sets up single life expectancy payout schedule from inherited IRA, using his age 50, and has 34.2 years of payouts (versus 7.1)

“Stretch IRA” is a marketing term. There is no “Stretch IRA” definition in the Internal Revenue Code

# Non-Spouse Beneficiary Direct Rollover to Inherited IRA

- Inherited IRA is subject to beneficiary taking RMD distributions:
  - Five-year rule: if death prior to RBD, or
  - Life expectancy payout rule: life expectancy payments must be started by the end of the year after the year of death
- If the plan doesn't offer the life expectancy or the five-year rule (before RBD), the beneficiary can roll to an inherited IRA and utilize those rules in the inherited IRA. (Notice 2007-7)
  - Must be directly rolled from decedent QP to inherited IRA
  - Must be done within appropriate timeframes to establish beneficiary distribution



# Inherited IRAs Part of Bankruptcy Estate

- Supreme Court ruled\*: inherited IRAs do not qualify as “retirement funds”
- SC cited three characteristics of inherited IRAs that show that they are not retirement funds. Specifically, individuals with inherited IRAs:
  1. May never contribute additional money
  2. Are required to receive distributions from these accounts regardless of their proximity to retirement
  3. May withdraw the entire account balance at any time and use the proceeds for any purpose, without being subject to the 10% early withdrawal penalty

\* The Supreme Court unanimously ruled, 9-0, in *Clark et ux. v. Rameker, Trustee, et al.*, No. 13-299, that inherited IRAs are part of the federal bankruptcy estate.

# Timing of Payment



- Death benefit must be available to surviving spouse within a reasonable period of time (within 90 days of death is deemed reasonable)
- Code Section 401(a)(9) establishes maximum period depending on whether payments had begun, generally:
  - At least as rapidly after RBD, or
  - Five-years after year of death or life expectancy before RBD, or
  - Spousal beneficiary rules

# Beneficiary Payouts

## Rules, Documents and Procedures

- Retirement Laws and Regulations (covered earlier)
  - ERISA Definition of Beneficiary
  - ERISA Spousal Consent Rules
  - Internal Revenue Code section 401(a)(9)
  - RMD Treasury Regulations 1.401(a)(9) of April 17, 2002
- Governing Documents and Procedures
  - Properly Completed Beneficiary Designation Form
  - Plan Document Provisions
  - Plan Procedures

# Plan Document Provisions





# Plan Document Provisions

- Plan document provisions impacting beneficiary payments:
  - Definition of when RBD occurs
  - Availability of 5-year rule or life expectancy payments
    - Alternatively available in inherited IRA
  - Payment options such as lump sum, installment payments, annuity
    - Plan may limit beneficiary to lump sum
  - One-year marriage rule
  - QJSA provisions, QPSA provisions
  - Definition of beneficiary, and Default Beneficiary Provisions
  - Vesting at Death

# Forms of Payment

- Plan document controls
- Plan may provide for lump sum death benefit only (typically defined contribution plan)
  - For death benefits
  - For Required Minimum Distribution (at 70-1/2)
- RBD definition can lead to: “Waiver” of RMD at age 70½

# Beneficiary Designation

## Plan Document Default Provisions

- Plan document controls who is the beneficiary if:
  - No designation on file
  - Invalid beneficiary designation on file
  - No designated beneficiaries survive
  - All beneficiaries waive right to receive benefits (more on this later)

# Beneficiary Designation Default Provisions *(cont'd)*

- Various ways to specify, for example:
  - If there is no beneficiary form or an invalid beneficiary form then the Beneficiary of such person shall be his surviving Spouse or, if none, his issue\* *per stirpes* or, if no issue, the Participant's surviving parents in equal shares, or if no surviving parents, then to the Participant's estate.
  - Plan may define shares of each beneficiary (equal or other)

\* Issue is defined as children which is defined as biological or adopted.

- Not step-children, unless document specifically includes

# Beneficiary Designation Default Provisions - *(cont'd)*

- Indicate how to handle if not all in class survive
  - Per capita (per head – allocate among survivors)
  - Per stirpes (per issue – children take in lieu)

# Per capita

- Per capita means per head
- With this method, the benefits are paid only to beneficiary(s) alive when the participant dies.
- For example
  - Two primary beneficiaries; 50% each; per capita
    - One beneficiary predeceases the participant
  - When the participant dies,
    - the surviving beneficiary gets 100%.

# Per stirpes

- Per stirpes (aka per issue)
- Example:
  - Two primary beneficiaries, 50% each.
    - One beneficiary predeceases the participant.
  - When the participant dies,
    - 50% will go to the surviving beneficiary, and
    - 50% will go to the issue, i.e. the children, of the beneficiary who died before the participant.



# Per stirpes or Per Capita

## Sample Beneficiary Designation Form Language

Beneficiary designation form sample language for choosing per stirpes or per capita for each beneficiary:

- In the event this Beneficiary predeceases me, this designation is
  - Per capita (no survivorship rights)
  - Per stirpes (default)



# Vesting at Death

- Death while employed – optional provision, commonly provided in DC plan
- After termination, and prior to distribution and prior to 5-year break when forfeit
  - Not required to 100% vest
  - Many plans do
  - Check plan document

## Document Language example:

- A Participant who dies prior to attainment of Normal Retirement Age but before termination of employment will become fully vested, regardless of any vesting schedule which otherwise might apply.

# Beneficiary Forms: Contents and Process

# Beneficiary Designation Process

Plan document or administrative procedures generally specify a process:

- Document or administrative procedures often have a requirement for participant to deliver a valid beneficiary form to the plan administrator for it to be effective
  - Common process for the plan administrator to review and accept the designation IF it is clear who is to be paid; and
  - Provide acknowledgement of acceptance or, if necessary, have participant provide clear beneficiary designation
- Last designation on file with plan administrator controls
- Avoids fraud and problems administering payment after death

# Beneficiary Designation Process (cont'd)

- Electronic or paper designation form
  - Internet beneficiary designation common with daily-valued plans
    - Participant e-signature via a login and PIN generally permitted
    - Spousal consent for naming other beneficiary is commonly a paper beneficiary designation
      - Witnessing of e-signature of spousal consent by Notary or plan representative is permissible under IRS electronic consent regulations; however, electronic witnessing procedure has not been easy to accommodate.

# Beneficiary Designation Process (cont'd)

- Supreme Court Case demonstrating the significance of the plan administrator having procedures and uniformly following those procedures
- Kennedy vs. Plan Admin for DuPont Savings – U.S. Supreme Court, No. 07-636, 01/26/09



# *Kennedy vs. Plan Admin for DuPont Savings* – U.S. Supreme Court

## Background:

- Prior to divorce, participant completed a beneficiary form naming wife as primary beneficiary for his savings and investment plan (SIP) benefits
- Under DuPont's *separate* Pension and Retirement Plan, the decedent had filed a new beneficiary designation after the divorce, naming his daughter as the beneficiary. The daughter was paid this plan's benefit as beneficiary.
- The decedent never filed a new beneficiary designation form under DuPont's savings and investment plan (SIP). Beneficiary form on file with plan administrator named the (now former) spouse as beneficiary.
- Plan paid former-spouse in accordance with the beneficiary designation form filed by the participant.
- Estate sued in an attempt to recover the \$400,000, claiming former spouse had agreed to waive her right to the SIP plan benefits in the divorce agreement.

# *Kennedy vs. Plan Admin for DuPont Savings* – U.S. Supreme Court

- **Plan Administrator Procedures Existed and Were Followed**
- DuPont plan document stated that participant has power to “designate any beneficiary or beneficiaries ... to receive all or part” of the funds upon his death, and to “replace or revoke such designation.”
- Plan requires all authorizations, designations and requests concerning the Plan to be made by employees in the manner prescribed by the plan administrator.
  - And all participants had been informed that this was the procedure.

# *Kennedy vs. Plan Admin for DuPont Savings* – U.S. Supreme Court

*Supreme Court's opinion:*

- *Plan administrator follows its procedures and the plan documents on file, including the beneficiary form filed by the participant with the plan administrator, are what rules.*
- *SCOTUS decision that the plan administrator made the correct call to pay using the beneficiary designation form last filed by the participant. SCOTUS also clarified that there was no anti-alienation violation of benefits.*
  - Former spouse received (even though waived in divorce)
  - 9-0 Decision



# *Kennedy vs. Plan Admin for DuPont Savings – U.S. Supreme Court*

*Supreme Court's opinion:*

- Supreme Court held that waiver is not an assignment*
- Supreme Court held that plan had specific procedures for waiving benefits so plan did not need to look at divorce decree to determine if it was a waiver*
- Supreme Court applied plan document rule, i.e. plan administrators only need to look at plan documents, that is beneficiary designations and underlying plan documents; versus applying the “waiver rule” where courts look at divorce decree to see if ex-spouse waived rights to benefits in divorce.*

# Best Practices

## When to Update Beneficiary Designation

- Any life event:
  - Divorce; Marriage; Remarriage; Birth of Children; When updating estate plan
- After a business merger or acquisition
- After moving the plan to a new recordkeeper or document provider

# Best Practices

## When to Update Beneficiary Designation

### Train employers:

1. To have participants review beneficiary designation forms regularly
  - e.g. every 5 years
2. To understand it is the plan administrator's responsibility to authorize payments to beneficiaries after a participant's death.
  - Thus, it is wise to review and keep the beneficiary designations to be able to determine the beneficiary to be paid and to instruct the trustee to make payments.

# Contents of Beneficiary Forms

- Names, addresses, SSNs, relationship, percentages
  - Do you ask for cell phone number and e-mail addresses?
  - Number of beneficiaries
- Marital status, including not married
  - Certification of non-married status
- Spouse consent limited to named designation
- Witnessing spousal consent
- Primary versus contingent (secondary) indicated
- Per Stirpes or Per capita indicated
- Payout Method, If Selected by Participant



# Contents of Beneficiary Forms *(cont'd)*

- QPSA Waiver Issue and QPSA Notice
- Reminder of when to update
- Default provisions
- How to file
- QDRO Certification
- Signatures:
  - Participant (May be multiple places)
  - Participant's spouse, if applicable (May be multiple places)
  - Notary or plan representative, as applicable
  - Plan administrator's acceptance

# Contingent (Secondary) Beneficiary

- Contingent (Secondary) beneficiary(s) receives benefits only if all the primary beneficiaries predecease the participant.
  - Often spouse is primary and children are contingent.
  - If primary disclaims *and* there is no other primary, then the contingent receives.
    - More on disclaimers later.

# Choose Beneficiary's Payout Method?

- Beneficiary designation form may have option for participant to decide:
  - That beneficiary will select payout method

OR

- That participant has chosen the payout method for the beneficiary; and beneficiary has no choice.
  - Lump sums
  - Installments (if available in plan)
  - Annuity (if available in plan)

# Beneficiary's Payout Method

## Sample Beneficiary Designation Form Payout Language

Any death benefit due my designated Beneficiary or Beneficiaries shall be payable as follows (select one):

- My Beneficiary(ies) will select his/her own method of payment.
- My Beneficiary(ies) will receive installment payments over a period not to exceed the life expectancy of my Beneficiary or Beneficiaries (only available if your Vested Account Balance exceeds \$5,000).
- My Beneficiary(ies) will receive a Lump Sum payout.
- My Beneficiary(ies) will receive a Life Annuity: [only available in Money Purchase Plans; Profit Sharing and 401(k) plans may only use this option if subject to the Qualified Joint and Survivor Annuity Rules].

– PARTICIPANT'S SIGNATURE: \_\_\_\_\_

– WITNESS'S SIGNATURE: \_\_\_\_\_



# Certification of Marital Status

## Sample Beneficiary Designation Form Language

I understand that if I become married in the future, my Spouse will be my Primary Beneficiary unless I complete a new Designation of Beneficiary Form and my Spouse consents to my designation.

- I hereby certify that I am not now married and that there are no Plan benefits payable to a former Spouse under a prior Qualified Domestic Relations Order.
- I hereby certify that I am not now married; however, there may be a reduction in my benefits as a result of a prior Qualified Domestic Relations Order.
- I am married but I am legally separated. My Spouse will be my primary Beneficiary unless my Spouse consents to the naming of another Beneficiary.

- **PARTICIPANT'S SIGNATURE:** \_\_\_\_\_ **Date:** \_\_\_\_\_  
*The signature of the Participant must be witnessed by a Plan representative or a notary public.*
- **WITNESS:** Notary Public \_\_\_\_\_  
Subscribed and sworn to before me on this \_\_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_.
- **NOTARY'S SIGNATURE:** \_\_\_\_\_
- **PLAN REPRESENTATIVE'S SIGNATURE:** \_\_\_\_\_
- The Plan Representative may not witness his or her own form or the form of any relative.

# Challenging Scenarios



# RMD in Year Of Death

- If participant is receiving RMDs and dies, the RMD for the year of death is calculated and distributed based on the participant's RMD.
- Example
  - A qualified plan participant who is receiving RMDs dies at age 76 before having taken the RMD for the year.
  - RMD for the year must be paid before the beneficiary may roll the amount to an inherited IRA.



# RMD Regulations

- Regulations define beneficiary as only being a person.
- Designating an entity, a charity, or other non-persons, as a beneficiary on the beneficiary designation form is fine.
  - They are just not considered to be a person under the regulations for life expectancy calculation purposes.

# Challenging Scenarios Beyond the Five-year Deadline

- Participant retires in 2009 at age 61.
- In 2012, participant dies.
- In 2019, participant would have attained age 70½ and plan administrator sends RMD notification letter.
- In 2019, beneficiary notifies plan administrator of participant's death in 2012.



# Challenging Scenarios

## Beyond the Five-year Deadline continued

- What happens now that the 5 year deadline for the beneficiary to take the decedent's money out of the plan has passed?
  - Specifically, as of the sixth year, the RMD regulations require the 50% penalty –for not taking an RMD – to be applied
- It is time for the distribution to the beneficiary. It is not eligible for rollover.
- Penalty and taxation is for the beneficiary to discuss with his or her accountant or attorney. This is not the plan administrator's decision.
  - For example, if the beneficiary was unaware of the money's existence, and corrects the scenario upon discovering it, they may wish to discuss with their attorney or CPA the "reasonable cause" exception of Code Section 4974(d).
    - Waiver details on IRS Form 5329 and the Instructions for Form 5329)

# Challenging Scenarios

## Multiple Primary Beneficiaries

- For Single Life Expectancy Calculations:
  - Oldest beneficiary is used for life expectancy for all beneficiaries, or
  - Split into a separate account for each beneficiary by Sept. 30 after year of death and use each beneficiaries own age for life expectancy
- If one of primary beneficiaries pre-deceased participant, check whether per stirpes or per capita
  - If per stirpes, locating the deceased beneficiaries “issue”

# Challenging Scenarios

## Trust as Beneficiary

- Trust agreement should be referenced with first and signature page provided
- The underlying beneficiaries can be treated as designated beneficiaries if:
  - Trust is irrevocable on death
  - Trust is valid under state law
  - Beneficiaries identifiable from trust agreement provided to plan administrator
  - Plan administrator provided with copy of applicable sections of the trust by October 31 of the year after the year of death



# Payment to Minor Beneficiary

- Plan can specify how payment is made to minor
  - If not specified then guardian determined under state law
- Taxable to minor

## Example

- Beneficiary is six-year old son of participant
- Participant dies and her mother is named the six-year old's guardian (i.e. minor's grandmother is the guardian).
- Payments made to grandmother as guardian of the minor after appropriate paperwork and ID.
- Minor's Social Security number used for tax purposes.

# Estate as Beneficiary

- Estate can be specified as beneficiary or be a default
- Requires the executor to provide
  - Letters Testamentary or Letters of Administration
- Plan issues check payable to the Estate
  - Estate Executor/Administrator deposits check in estate account and pays estate in accordance with decedent's instructions, generally, as specified in a will.



# Charity Beneficiary

- Charity can be named as beneficiary
  - Death benefit before RBD – 5-year rule
  - After RBD:
    - Lump sum (if plan provides)
    - Over single life expectancy based on participant's age in year of death (reduced by 1 year each year until paid)

# Challenging Scenarios

## Payee Disclaimer

### Requirements under IRC §2518

- Irrevocable and Unqualified refusal to accept property
- Beneficiary hasn't accepted any payout
- Must be in writing
- 9 months after later of:
  - Age 21
  - Date of transfer
- Passes without discretion of the disclaimant



# Challenging Scenarios

## Nonresident Alien Beneficiary

### Nonresident Alien Without Social Security Number

- Use IRS Form W-8 BEN
- ITIN requirement
- Withholding per treaty rate (30% typical)
  - See IRS Publication 515 for treaty rates
- Report on IRS Form 1042/1042-S



# Challenging Scenarios

## Divorce and Remarriage Example

- Participant has spousal consent naming his four children as the beneficiaries
- Participant divorces
- Participant remarries, but does not complete a new beneficiary designation
- The participant dies
  
- New spouse never consented to naming of participant's children as beneficiary → new spouse gets the money.

# Revoking Spousal Beneficiary Designation After Divorce

- If the beneficiary form named the spouse, best practice is for the participant to change the beneficiary form after the divorce
- Language in some plan documents state that after a divorce, the ex-spouse is no longer the beneficiary, and, if the participant wishes the ex-spouse to be the primary beneficiary, he/she must complete a new beneficiary form after the divorce.
- Requires administrator to determine if a divorce occurred before paying out.
  - Check your plan document.

# Revoking Spousal Designation After a Divorce: Sample Plan Document Language

“If a Participant completes or has completed a Beneficiary designation in which the Participant designates his or her Spouse as the Beneficiary and the Participant and the Participant’s Spouse are legally divorced subsequent to the date of such designation, the designation of such Spouse as a Beneficiary hereunder will be deemed null and void unless the Participant, subsequent to the legal divorce, reaffirms the designation by completing a new Beneficiary designation form.”

- Note that this does not apply to a legal separation and thus the wording in pre-approved plans is for divorce. (Legal separation is still married, so need spousal consent to re-designate.) For more on this, IRS article on 9/13/13: [https://www.irs.gov/pub/irs-tege/eprn\\_2013\\_3.pdf](https://www.irs.gov/pub/irs-tege/eprn_2013_3.pdf)



# Challenging Scenarios Prenuptial Agreement



Typically used to waive pension and 401(k)

Still need spousal consent on beneficiary designation form after the wedding

## Example

- It is the second marriage for both spouses
- Man signs prenuptial agreement permitting second wife's children to be her retirement plan beneficiaries
- A new beneficiary form is not completed.
- Wife dies. ERISA requires surviving spouse to be the beneficiary because there was no spousal consent.

- ***Prenuptial Consent Is Not Spousal Consent***

# Challenging Scenarios

## Lost/Missing/Invalid Beneficiary Form

- Plan document controls. Follow plan document hierarchy of who is named by the plan document as beneficiary. ERISA would require spouse to be beneficiary if the participant is married at the time of death.
- For example:
  - Spouse first per ERISA,
  - if no spouse see plan document for ordering, e.g. children, parents, siblings, estate

# Challenging Scenarios

## Lost/Missing Beneficiary Form Example

- Participant deceased.
- Beneficiary form lost or missing.
- Small firm and employer states that he remembers seeing the beneficiary form in which the children had been named as beneficiary and spouse had consented.
- Unless form can be located, ERISA makes the spouse the beneficiary.
  - Spouse can disclaim, but then document controls who is the beneficiary



# Challenging Scenarios

## Beneficiary in Jail

- Inmate can receive distribution
- Call Jail to determine how to get election forms signed and deliver payment

# Challenging Scenarios

## Younger Spouse Beneficiary Example

- 401(k) participant dies at age 60 in November 2017.
- Surviving spouse, age 51, is sole beneficiary and directly rolls to an inherited IRA in early 2018 and begins lifetime payments based on her single life expectancy, re-calculated annually.
  - There is no 10% penalty as these are beneficiary payments.
- Surviving spouse reaches age 59½ and rolls the inherited IRA into her own IRA and this ceases beneficiary payments.



# Challenging Scenarios

## Qualified Domestic Relations Orders

- Qualified Domestic Relations Order (QDRO) paid before participant's death
- As administrator you want to have certification that any QDRO has either already been paid or is accounted for so it can be paid.



# Challenging Scenarios

## QDRO

- Participant and Spouse divorce
- Former spouse no longer meets the definition of “surviving spouse” under plan terms
- Plan receives DRO requiring former Spouse to be treated as Participant’s surviving spouse for purposes of receiving a death benefit under the plan’s terms only to a surviving spouse
  - Pension Protection Act of 2006 called for Regulations to Address this: DOL Regulations Section 2530.206 Issued in Federal Register of June 10, 2010

# Challenging Scenarios

## Post-death DRO

- Participant and Spouse 1 divorce
- Administrator of Participant's plan receives a DRO
- Administrator finds DRO deficient and determines it is not a QDRO
- Participant dies while actively employed
- A second DRO correcting the defects in the first DRO is submitted to the plan
  - Second DRO ok, even though issued after death
  - Answer would be the same if it was the first DRO that was issued after death
- *Files v. Exxon Mobile Pension Plan, 428 F. 3d (3<sup>rd</sup> Circuit 2005)*
- Pension Protection Act of 2006 called for Regulations to Address this: DOL Regulations Section 2530.206  
Issued in the Federal Register of June 10, 2010



# Challenging Scenarios

## QDRO Marriage/Remarriage

- Automatically makes new spouse the beneficiary
- Doesn't affect QDRO to the former spouse

# Challenging Scenarios

## Interpleader Action

Interpleader action (a civil action) can be brought by the trustee or plan administrator to sort out the rights of parties who are claiming conflicting interests in plan benefits. For example:

- When more than one “spouse” claiming benefits, or
- Disagreement over who is the proper death beneficiary of non-spousal benefits
- Validity of a beneficiary designation
- When things don’t pass the “smell test”, then:
  - Interpleader can be the safest course of action.
    - Expensive process
    - Weigh the cost versus the amount involved in the dispute
    - Pay the benefits to the court and let the court decide the proper beneficiary.

# Interpleader Action

## Telephonic Beneficiary Designation Case

- Plan procedures did not preclude telephonic beneficiary designation change. *Becker v. Williams* 777 F.3d 1035 (9<sup>th</sup> Cir. 2015)
- After divorcing wife, participant designated his son from a prior marriage as beneficiary over the telephone but did not sign and return beneficiary designation form.
- After participant died, ex-wife and son each claimed the death benefits.
- Participant's telephonic conversation with the plan representative -- indicating his desire to revoke former wife and replace with son -- was followed by the plan's mailing of a beneficiary designation form to the participant. The participant had not returned a completed form before he died.

# Interpleader Action Case

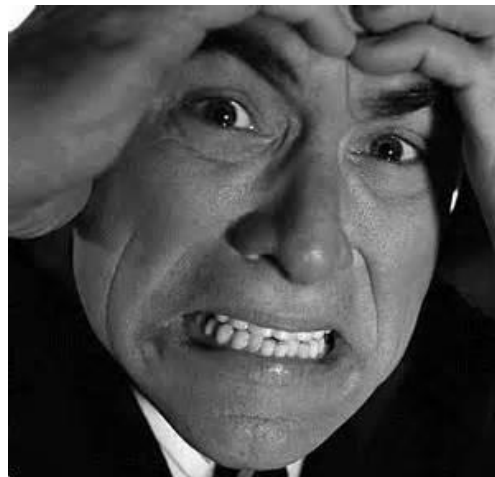
- 9<sup>th</sup> Circuit decided that substantial compliance was satisfied with telephonic change of beneficiary.
  - Noting that the plan administrator impliedly declined to exercise its discretion to determine if telephonic designation of son was valid.
- The 9<sup>th</sup>'s determination was that the participant complied with governing plan documents. SPD instructs unmarried participants to call the employer's office or visit the website to change or complete a beneficiary designation.
  - A reasonable trier of facts could determine that the participant intended to change his beneficiary.
  - Summary judgement in favor of son, reversing lower court.
  - 9<sup>th</sup> Circuit remanded case to lower court for further proceedings:
    - Lower court reversed and honored original beneficiary designation form based on inability to verify if participant, or someone else, had actually called to change the beneficiary; and on the fact that son was estranged from father at that time, while ex-wife maintained good relations with ex-husband.

# Challenging Scenarios

## Slayer Statutes

A slayer is not entitled to benefit from the wrong.

- A slayer is someone who is responsible for felonious and intentional killing of another person
- Most courts hold that ERISA pre-empts state law. ERISA is silent on slayer statutes, so the courts apply (create) a federal common law that is equivalent to a slayer statute.



# Challenging Scenarios

## Simultaneous Death – Who Is the Survivor

- *Uniform Simultaneous Death Act*
  - Adopted by most states
  - Presumption that participant survived in a simultaneous death (not the beneficiary).
- (ERISA is silent on this.) It is likely that federal common-law would recognize a similar principle

# TAX TREATMENT AND REPORTING OF BENEFICIARY PAYOUTS



# Tax Treatment and Reporting of Beneficiary Payouts

- IRS Form 1099-R issued to recipient
- Box 7
  - Code 4 for deceased
  - Code 4G for direct rollover
- Withholding
  - Mandatory 20% for eligible rollover distribution
  - 10% for ineligible for rollover, 10% withholding can be waived



# Tax Treatment

No 10% excise tax on death benefit payments, specifically:

- No 10% IRS excise tax regardless of participant's age at death.
- No 10% excise tax on the beneficiary, regardless of age of beneficiary.
- Each life expectancy payment, lump sum or partial payment, due to death, is exempt from the 10% excise tax.

# Tax Treatment

Special Tax Treatment for Participant passed to beneficiary:

- Net Unrealized Appreciation (on employer stock)
- 10 year averaging if participant born prior to 1936 and not rolled over to IRA
- Capital gains on pre-1974
- IRS Publication 575 has more details on these.

# For Review of Some Key Points: Sample Document Language



# Sample Plan Document

## Beneficiary Designation Section

- ***Designation Of Beneficiary***
- (a) For purposes of the Plan, a Beneficiary is the person or persons designated as such in accordance with Code Section 401(a)(9) and the Regulations thereunder by the Participant or by the Participant's surviving Spouse if the Participant's surviving Spouse is entitled to receive distributions under the Plan. Such a designation by the Participant's surviving Spouse, however, shall relate solely to the distributions to be made under the Plan after the death of both the Participant and the surviving Spouse. A Beneficiary designation shall be communicated to the Plan Administrator on a form or other type of communication acceptable to the Plan Administrator for use in connection with the Plan, signed by the designating person, and subject to the last sentence of this subparagraph (a), filed with the Plan Administrator in accordance with this paragraph not later than thirty (30) days after the designating person's death. The form may name individuals, trusts or estates to take upon the contingency of survival and may specify or limit the manner of distribution thereto. In the event a Participant or the Participant's surviving Spouse, as the case may be, fails to properly designate a Beneficiary (including, as improper, a designation to which the Participant's surviving Spouse did not properly consent) or in the event that no properly designated Beneficiary survives the Participant or the Participant's surviving Spouse, as applicable, then the Beneficiary of such person shall be his surviving Spouse or, if none, his issue *per stirpes* or, if no issue, the Participant's surviving parents in equal shares, or if no surviving parents, then to the Participant's estate.
- The Beneficiary designation last accepted by the Plan Administrator during the designating person's lifetime before such distribution is to commence shall be controlling and, whether or not fully dispositive of the vested portion of the account of the Participant involved, thereupon shall revoke all such forms previously filed by that person.

# Sample Plan Document

## Beneficiary Designation Section

- (b) Notwithstanding subparagraph (a), the designation by a married Participant of any Beneficiary other than the Participant's Spouse, or the change of any such Beneficiary to a new Beneficiary other than the Participant's Spouse, shall not be valid unless made in writing and consented to by the Participant's Spouse. The Spouse's consent to such designation must be made in the manner described in this paragraph.
- 
- (c) Any Beneficiary designation made and in effect under a Qualified Plan immediately prior to that Plan's amendment and continuation in the form of this Plan shall be deemed to be a valid Beneficiary designation filed under this Plan to the extent consistent with this Plan. If such Beneficiary designation was made with respect to a Qualified Plan that permitted the Participant to designate without spousal consent a Beneficiary to receive 50% of the Participant's account balance in the event of the Participant's death, with respect to such Beneficiary designation under this Plan, this paragraph shall be applied by application of 50% of the vested portion of the Participant's account toward the purchase of a Qualified Pre-Retirement Survivor Annuity and the balance of the Participant's account shall be paid to the Designated Beneficiary pursuant to the provisions of Article VIII. In such event, the amount of Voluntary After-tax Contributions applied to the purchase of the annuity shall be in the same proportion as the Voluntary After-tax Contributions bear to the entire Participant's account.

# Sample Plan Document

## Beneficiary Designation Section

- (d) In the absence of a Beneficiary designation or other directive from the deceased Participant to the contrary, any Beneficiary may name his or her own Beneficiary to receive any benefits which may be payable in the event of the Beneficiary's death prior to the receipt of all the Participant's death benefits to which the Beneficiary was entitled.
- 
- (e) Notwithstanding any provision in this section, any Beneficiary named hereunder will be considered a contingent Beneficiary until the death of the Participant (or Beneficiary, as the case may be), and until such time will have no rights granted to Beneficiaries under the Plan.
- 
- (f) Designated Beneficiary will also include a non-spouse Designated Beneficiary. For this purpose, a non-spouse Designated Beneficiary means a Designated Beneficiary other than (i) a Surviving Spouse or (ii) a Spouse or former Spouse who is an Alternate Payee under a Qualified Domestic Relations Order
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# Questions?

