Beneficiary Designations: The Good, the Bad, and the Ugly

Presented by:

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Introduction

- Beneficiary designations are frequently used in retirement plans to determine entitlement to benefits payable upon death of the participant.
- In some cases, beneficiary designations do not accurately reflect the participant's probable intent. This can result in disputes regarding who is entitled to the plan benefits following the death of the participant.
- For example, disputes can commonly arise where:
  - Participants fail to change beneficiary designations to reflect life events (marriage or divorce, disputes between the participant's spouse, ex-spouse, and other potential beneficiaries, etc.)
  - Lost or stale beneficiary designations because of a change in service providers, administrators or other reasons
  - Elected beneficiary designation is impermissible under the terms of the plan

Introduction

- In cases where disputes occur, plan fiduciaries are required to spend time, as well as financial and other resources, to identify the correct beneficiary in order to fulfill their fiduciary duties.
- Plan fiduciaries could also be placed in the unfortunate position of having to pay the same benefit twice — once to the mistaken beneficiary and again to the correct beneficiary after identification and clarification.
- In the case of a double payment, the plan may be forced into legal procedures to recover the erroneous payment, which recovery may be difficult or in some cases impossible
- A related issue is whether costs incurred when the plan fiduciary is required to engage in legal and other dispute resolution proceedings can be charged to the participant's account under the plan.

Estate Planning

- From the participant's point of view, beneficiary designations are an important part of the participant's estate plan.
- Assets governed by beneficiary designations (such as life insurance and retirement accounts) often make up a large portion of a person's estate.
- Assets governed by beneficiary designations are liquid and access to them is expected quickly after death
- Beneficiary designations must be properly tailored to fit the participant's wishes regarding the disposition of his/her estate.
  - May be as simple as naming spouse as primary beneficiary and child as secondary beneficiary, or as complex as naming a trust as beneficiary
- Proper beneficiary designations can also provide income tax deferral for the beneficiary(ies), and avoid probate costs, court costs and other expenses.

Example – Income Tax Deferral

- What happens to required minimum distributions following the death of a participant prior to their "required beginning date"?
- "Required minimum distribution" (RMD) is the minimum amount you must withdraw from your retirement account each year beginning on the RBD.
- "Required beginning date" (RBD) for a qualified plan participant who owns no more than a 5 percent interest in the company sponsoring the plan (including 403(b) plans), is April 1 of the year following the later of: (1) the calendar year in which the participant turns 70½ **or** (2) the participant's retirement from the company.
- "Designated Beneficiary" (as used in the tax code) is an individual who is designated as a beneficiary under the plan. A person's estate is not a "Designated Beneficiary". Some trusts can be a "Designated Beneficiary".

Example – Income Tax Deferral

- If a participant dies before his RBD, and the beneficiary is not a Designated Beneficiary, the RMDs must be paid out over 5 years. Code Sec. 401(a)(9)(B)(ii); Treas. Reg. Sec. 1.401(a)(9)-3(A4).
- If a participant dies before his RMD, and has a Designated Beneficiary, the default rule is that the RMDs will be paid out over the life expectancy of the Designated Beneficiary. Code Sec. 401(a)(9)(B)(iii) & (iv)
- By not having a "Designated Beneficiary", the participant's heir(s) lose the income tax deferral they would have had if the RMDs had been spread over the life expectancy of the beneficiary(ies).
- Instead, all taxes are paid in 5 years, and may also result in more taxes paid if higher RMDs bump the beneficiary into next tax bracket.

Post-Death RMD Rules

Beneficiary	Owner Died Prior to Required Beginning Date	Owner Died After Required Beginning Date
Spouse - Inherited IRA (No rollover)	Spouse may defer required distributions until the year the owner would have reached age 70 1/2. In this year, the RMD is calculated based upon spouse's life expectancy by referencing her attained age for the year of distribution based on the Single Life Table of Treas. Reg. § 1.401(a)(9)-9. For each succeeding year, the surviving spouse references his or her age under the Single Life Table for each particular year.	RMD for year of death must be taken based upon decedent's life expectancy factor under the Uniform Lifetime Table (if not already taken by the decedent during his/her lifetime). Thereafter, the applicable distribution period is longer of: (1) the surviving spouse's life expectancy based on the Single Life Table using the surviving spouse's birthday for each distribution calendar year after the calendar year of the decedent's death up through the calendar year of the spouse's death. For each succeeding year, this process is repeated based on the surviving spouse's attained age in that particular year; or (2) the life expectancy of the deceased spouse under the Single Life Table using the age of the deceased spouse as of his or her birthday in the year of death, whereby in subsequent years, this initial factor is reduced by one for each subsequent year.
Spouse - Rollover	RMDs begin the year the spouse reaches age 70 1/2 (subject to deferral to 4/1 of year following). If the spouse is already age 70 1/2, RMDs begin by December 31st of the year of the rollover. For such years, RMDs based upon spouse's life expectancy factor determined under the Uniform Lifetime Table for each particular year.	RMD must be taken for year of decedent's death based upon decedent's age in year of death under the Uniform Lifetime Table (if not already taken by the decedent during his/her lifetime). Future year RMDs are based upon surviving spouse's life expectancy factor by reference to the Uniform Lifetime Table in each particular year.
Non-Spouse Individual Designated Beneficiary	The first year distribution (year after the year of death) is determined based upon corresponding life expectancy factor for the designated beneficiary's age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this initial factor is reduced by one for each subsequent year.	RMD must be taken for year of decedent's death based upon decedent's age in year of death (if not already taken by the decedent during his/her lifetime). The first year distribution (year after the year of death) is determined based upon corresponding life expectancy factor for the designated beneficiary's (or the owner's, if the owner was younger than the designated beneficiary) age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this initial factor is reduced by one for each subsequent year.

Post-Death RMD Rules

Beneficiary	Owner Died Prior to Required Beginning Date	Owner Died After Required Beginning Date
Multiple Individual Beneficiaries	As long as the account is segregated into separate accounts no later than December 31st of the year following the year of death, each beneficiary may independently calculate RMDs. Thus, with respect to each beneficiary, the first year distribution (year after the year of death) is determined based upon corresponding life expectancy factor for the beneficiary's age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this initial factor is reduced by one for each subsequent year.	RMD must be taken for year of decedent's death based upon decedents age in year of death (if not already taken by the decedent during his/her lifetime). Thereafter, as long as the account is segregated into separate accounts no later than December 31st of the year following the year of death, each beneficiary may independently calculate RMDs. Thus, with respect to each beneficiary, the first year distribution is determined based upon corresponding life expectancy factor for the beneficiary's age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this initial factor is reduced by one for each subsequent year.
Designated Beneficiary Trust	The first year distribution (year after the year of death) is determined based upon corresponding life expectancy factor for the oldest trust beneficiary's age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this initial factor is reduced by one. If the trust is designed to create "one pot" for the benefit of multiple beneficiaries, RMDs are based upon the oldest trust beneficiary's life expectancy.	RMD must be taken for year of decedent's death based upon decedents age in year of death (if not already taken by the decedent during his/her lifetime). The first year distribution is determined based upon corresponding life expectancy factor for the oldest trust beneficiary's age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this factor is reduced by one for each subsequent year. If the trust is designed to create "one pot" for the benefit of multiple beneficiaries, RMDs are based upon the oldest trust beneficiary's life expectancy.
Non Designated Beneficiary Trust /Charity/Estate	Entire balance must be distributed no later than December 31st of the year containing the fifth anniversary of the decedent's death.	RMD must be taken for year of decedent's death based upon decedents age in year of death based on the Uniform Lifetime Table (if not already taken by the decedent during his/her lifetime). For succeeding years, determine initial factor by referencing the owner's age in year of death in the Single Life Table. The initial factor is then reduced by one for each subsequent year.

Example 1: Adherence to Procedure

- Improper beneficiary designations can (and often do) result in disputes regarding who is entitled to the plan benefits following the death of the participant.
- *Ruiz v. Publix Super Markets, Inc*., 248 F. Supp. 3d 1294 (M.D. Fla. 2017).
- Ms. Rizo was a long-time employee of Publix and participated in the company's employee stock ownership plan (ESOP) and 401(k) plan.
- Both plans' summary plan descriptions (SPD) provided specific instructions as to how a participant designates a beneficiary:
  - "It is important to remember to change your beneficiary designation when the situation calls for it. . . . If you wish to change your beneficiary(ies), please obtain a Beneficiary Designation Card from your work location's Publix Communication Center and complete, sign and submit it to the Retirement Department, Publix Corporate Office, Lakeland, Florida. Your change of beneficiary designation is not valid under the Plan until the Retirement Department receives and processes the properly completed Beneficiary Designation Card."
- The SPD also provided these instructions:
  - "Remember that a Beneficiary Designation Card is a legal document. It should not contain mark outs, erasures or correction fluid. It should be typed or printed in ink, and you must sign and date the card. Your beneficiary designation is not valid under the Plan until the Retirement Department receives and process the properly completed Beneficiary Designation Card."

Example 1 continued

- In October 2008, Ms. Rizo properly named her niece and nephew as her beneficiaries for both the ESOP and the 401(k) Plan.
- In 2011, Ms. Rizo no longer worked for Publix and was diagnosed with cancer. She called the employer and asked about updating her beneficiary designations.
- The company's representative told her that she could write a letter including her name, SSN, the names of her new beneficiaries, and their SSNs **or** she could submit new completed Beneficiary Designation Cards.
- Ms. Rizo submitted a letter including all of the required information and naming her good friend, Arlene, as her sole beneficiary. She also submitted new Beneficiary Designation Cards. Instead of dating and signing the cards, she simply wrote "As stated in letter."
- Ms. Rizo died the day after the letter and cards were mailed to Publix.

Example 1 continued

- Both Plans paid death benefits to Ms. Rizo's niece and nephew, in accordance with the original 2008 designations.
- When Arlene filed a claim for the benefits, the Plans denied the claim because properly completed Beneficiary Designation Cards had not been filed naming her as the sole beneficiary.
- Arlene sued the Plan, claiming that the letter identifying her as the beneficiary was sufficient to entitle her to the death benefits.
- The court rejected Arlene's claim, and concluded that the niece and nephew were the correct beneficiaries.
- Relying on a 2009 Supreme Court case, the court concluded that it does not matter if a participant "substantially complies" with beneficiary designation procedures and that a beneficiary designation will not be changed unless the plan's specific requirements are precisely followed.
- Ms. Rizo did not strictly follow the plan's beneficiary designation procedures, and therefore her attempt to make Arlene her beneficiary was ineffective.

Example 2: Broad Plan Document

- Other courts may rule differently, and, in fact, other courts have examined whether the participant “substantially complied” with the terms of a plan to change a beneficiary designation.
- *Becker v. Carmen Stephanie Mays-Williams*, 168 F. Supp. 3d 1325, 1326 (W.D. Wash. 2016), aff'd sub nom. *Becker v. Mays-Williams*, 712 F. App'x 682 (9th Cir. 2018).
- Mr. Williams was a long-term Xerox employee who participated in two company retirement plans. Both plans contained language requiring participants to designate beneficiaries, but neither required a written, signed document for unmarried participants. In addition, the SPDs stated that participants could visit the benefits web site "or call the Xerox Benefits Center…to complete or change [his] beneficiary designation at any time.”
- In 2002, Mr. Williams designated his then-wife as his beneficiary. Following his divorce in 2006, Mr. Williams called at least three times to change his beneficiary from his ex-wife to his son from a prior marriage as his new beneficiary. After each call, Mr. Williams was sent beneficiary designation forms.
- The forms were returned to Xerox but were not complete. Each time, Xerox notified Mr. Williams that the forms were invalid because they were not signed and/or dated.
- Following Mr. Williams’ death in 2011, his ex-wife and son both submitted claims.

Example 2 continued

- The district court granted summary judgment in favor of the ex-wife. The son appealed.
- On appeal, the 9th Circuit reversed the summary judgment and remanded the case to the district court for trial, noting that a reasonable trier of fact could determine that Mr. Williams had intended to designate his son as his beneficiary and that his phone calls constituted "substantial compliance" with the plans' governing documents.
- After trial, court determined that Mr. Williams did not substantially comply with the terms of the plan, even though three calls were made to Xerox to change the beneficiary designation, because the identity of the caller was not proven, Mr. Williams repeatedly failed to return properly a completed beneficiary designation form, Mr. Williams and his ex-wife had an "ongoing positive relationship" while him and his son did not, and Mr. Williams would not have preferred one child over his eight other children in selecting beneficiary.

Best Practices: Plan Document

- Definition of beneficiary
- Clear requirements for designating a beneficiary
  - Process for review and acceptance, if any
  - Procedure for change of beneficiary
- Default beneficiary procedure
- Automatic revocation on divorce
- Strong Firestone language providing Plan Administrator with authority to interpret the terms of the Plan
- Statement that Plan's records are conclusive
- Reserve discretion to reject certain designations
- Include beneficiary designation procedures and other information in the SPD

Best Practices: Election Form

- Straightforward with clear instructions
- Ample space for primary and contingent beneficiaries
  - Name, address, SSN, birthdate, relationship, and allocation %
  - Statement that participant may attach an additional page if necessary
- Participant should be required to sign and date
- Consider including the following:
  - Designation revokes all prior designations
  - Divorce automatically revokes designation to ex-spouse
  - Process for dividing benefit among beneficiaries if no allocation is included
  - Right to revoke/change prior to death (or retirement in Defined Benefit plan)
  - Plan document governs in event of discrepancy between plan and election form
  - Primary beneficiaries paid first and if none survive, to contingent beneficiaries
  - Default beneficiary language
  - Participant agreement to inform plan administrator of information changes
- Application to multiple plans
- Review forms regularly

Best Practices: Obtaining Designations

- Include in Plan welcome packets
- Discuss during plan orientation, if any
- Obtain from every participant!
- If rules change, obtain new forms
- Periodically request new forms
  - At a minimum, encourage participants to review and, where appropriate, update beneficiary designations
- Regularly audit records to ensure 100% of participants have a designation on file

Best Practices: Acceptance & Recordkeeping

- Review election form on receipt for completeness, understanding, compliance with Plan terms, and legibility
  - CONSISTENCY is key
- Maintain forms for at least 6 years following participant's death
- Coordinate with QDRO records
- Update file when beneficiaries change

Best Practices: Education

- Educate participants (and staff) on:
  - Completing and updating election forms
  - Plan provisions
  - Default rules
  - Procedure for initial election and changing beneficiary
  - Importance of reviewing and updating designations
  - Administrative policies and procedures

Best Practices: Resolving Disputes

- Use of the plan's claim procedures to resolve payment disputes
  - If Plan's claim procedure is limited to beneficiaries or participants, include statement that plan is treating claimant as a beneficiary, but is not relinquishing its right to challenge his or her status
  - Freeze participant's account while dispute is pending, if permitted by Plan
- Interpleader action when there is a serious payment dispute

Best Practices: Trouble Cases

- Smell test
- Capacity of participant
  - Dementia
- Make reasonable determinations based on all facts and circumstances known to you
- Consider asking payee to sign an acknowledgment that he or she is the appropriate recipient and that he or she agrees to repay the plan in the event of improper distribution
- Powers of Attorney (POA)
  - Check for specific authorization to change beneficiary designations and reference to TN POA statute.

Best Practices: Final Notes

- Do NOT give tax advice – encourage participants to engage their own tax advisor
- Documentation is your friend
- When in doubt, call the lawyer

A Little About Your Presenters

Bill Mason received his law degree from Harvard Law School in 1974, and has been practicing more than 40 years, most of that time in employment and employee benefits for employers. Bill joined Kennerly Montgomery in 2009. He serves on the Board of Directors for the Legacy Parks Foundation and the Education Subcommittee for the United Way of Greater Knoxville. He is the past Chair of the Hillcrest Healthcare Board of Directors. In 2016, the US Treasury Department appointed him as the IRS Taxpayer Advocacy Panel (TAP) representative for Tennessee.

As a leader of Kennerly Montgomery's employee benefits practice, **Kathy Aslinger** assists clients in maneuvering through the complex world of employee benefit plan design and implementation, benefit considerations in mergers and acquisitions, audits, fiduciary liability issues, DOL and IRS compliance, HIPAA, COBRA, ERISA and state law obligations, and Affordable Care Act compliance. Kathy has been practicing law for almost 20 years and has been with Kennerly Montgomery since 2010. In addition, Kathy serves on the Board of Directors for Uplands Village, a continuing care retirement community in Pleasant Hill, Tennessee.

As a member of the Firms' employee benefits practice, **Ashley Trotto** aims to condense and simplify the complicated and ultra-technical world of employee benefits into understandable, plain English advice for her clients. Ashley is dedicated to building long-standing, trusted relationships with her clients and understands that a single point of contact for timely resolution of employment-related issues is key. To that end, Ashley also spends her time helping clients navigate the prickly, and often unforgiving, landscape of the FLSA, HIPAA, COBRA, FMLA, ADA, and other employment-related legislation as well as everyday employment issues, like creation and application of employer policies and employee training. Ashley serves on the Board of Directors for the Smoky Mountain Animal Care Foundation and is the energy behind the Firm's on-going kindergarten book project at Christenberry Elementary.

A Little About Your Presenters

Marshall Peterson has practiced law for over 30 years. His practice area has always been trusts & estates. That means he helps clients protect their assets, and ultimately distribute them in the most efficient manner among loved ones, and personally important causes. Marshall joined Kennerly Montgomery in 2018. He is president of Legal Aid East Tennessee where he has served on the board for many years. He previously served on the board of Tennessee Park & Greenways. The Tennessee Supreme Court appointed Marshall to be a hearing officer on panels that evaluate claims of ethical violations for Tennessee lawyers.

Michael Crowder enjoys problem-solving for his clients' special situations and teaming up with his clients to formulate a unique estate plan that meets their needs and desires. He always aims to craft his clients' wills and trusts in a way that ensures their assets are best utilized during their life and then effectively passed along at death, taxes are minimized, protection from creditors is maximized, and, most importantly, loved ones are provided for. Michael received his law degree from the University of Tennessee, College of Law and his undergraduate degree in Religion from Princeton University, where he studied the history of early Christianity and also played offensive line on the football team. Michael and his wonderful wife, Katey, have one son, Henry. When he's not with his clients, you can usually find Michael with his family working on a new project for their 90-year-old house in north Knoxville.

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