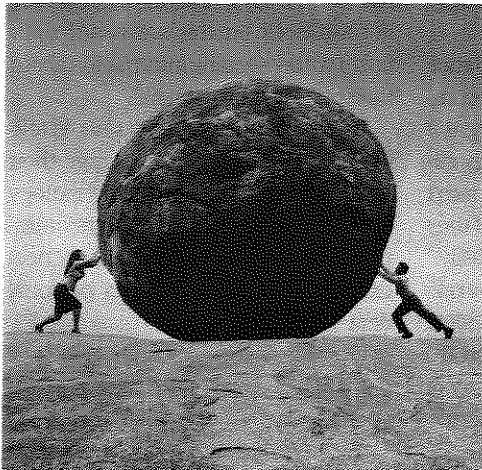


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Beneficiary Battles

Consider converting a 401(k) to an IRA before a second marriage if the new spouse isn't the desired heir.

By Ed Slott

Imagine his children's surprise: Despite having previously named his three kids as beneficiaries of his 401(k) plan, a deceased man's workplace retirement savings would not be part of their inheritance. Instead, they would pass to his new wife.

Typically when dealing with retirement plans, the beneficiary form trumps all. But in this case, the beneficiary form was trumped — by federal ERISA rules.

A U.S. District Court in Louisiana ruled a few months ago that, under the terms of the participant's plan, a spouse's right to plan assets is vested immediately upon marriage (*Cajun Industries vs. Robert Kidder et al.*). Since no spousal waiver had been obtained, the default plan beneficiary was the participant's spouse, even though she was not the named beneficiary. In this particular case, the spouse inherited the 401(k) after just six weeks of marriage.

The decisive factor was that the man had not obtained a spou-

sal waiver after getting remarried. That means if your client wants to name someone other than his or her spouse as the beneficiary of an ERISA-regulated retirement plan such as a 401(k), it's not enough to only fill out a beneficiary form.

NO FAMILY TIES

Leonard Kidder originally named his wife, Betty Kidder, as sole beneficiary of his Cajun Industries 401(k) plan. But after her death, Kidder updated his beneficiaries, naming his three children.

So far, Kidder was making all the right moves — exactly what he should have done if he wanted his kids to get the money.

In late 2008, just six weeks after Beth Bennet Kidder became his wife, Leonard Kidder died. During that brief period, no waiver of spousal rights was granted for Leonard's 401(k) assets. Following his death, a dispute arose between Beth Bennet Kidder and Leonard Kidder's three children, with each side claiming

they were the rightful beneficiary of Leonard Kidder's 401(k) plan.

Kidder's children claimed that, as the named beneficiaries on the most up-to-date beneficiary form, they were entitled to the money. But Beth Bennet Kidder claimed that, as Leonard's wife — and without having waived any of her rights — she was entitled to the money, regardless of what the beneficiary form said.

To make her point, Beth Bennet Kidder pointed to a section of Cajun Industries' 401(k) plan documents, which states in part: "The participant's spouse will be the beneficiary of the participant's entire vested interest in the plan unless an election is made to waive the spouse as a beneficiary."

Kidder's children countered by claiming that the use of the word "spouse" should mean a spouse married for at least one year. They cited the Employee Retirement Income Security Act of 1974, which governs 401(k) plans and does not mandate

that a participant receive spousal consent for distributions to someone other than a spouse during the first year of their marriage.

THE VERDICT

The court apparently had little difficulty in determining that Beth Bennet Kidder was the rightful beneficiary of the retirement plan. The judges noted that the plan's language was "clear and unambiguous" in declaring that, unless a spousal waiver was executed, a deceased participant's vested interest would belong to the spouse.

The court also addressed the ERISA issue raised by Kidder's children, saying that although the law allows for plans to waive spousal

So what about clients who are married, have 401(k) accounts and want to leave their retirement money to a beneficiary other than their spouse? Can they simply roll the savings into an IRA and name a new beneficiary without their spouse knowing — essentially disinheriting them in the process?

The answer is no. Distributions from 401(k)s and other ERISA-regulated plans, including direct rollovers to IRAs, still require consent of a spouse.

But once consent is given and the money is in an IRA, account holders are free to update their beneficiary forms however they please. (Visit irs.gov and search for notice 97-10, which provides sample language

subject to ERISA rules.

Wayne Wilson worked for a joint venture of Siemens and GTE until 1992. Two years later, he took a lump-sum distribution from his 401(k) plan and rolled his money into an IRA with Smith Barney. Between 1995 and 1999, Wilson transferred additional money into the IRA as well.

In December 2000, a decade after he began living with a woman named Katherine Chandler, the couple married. Two years later, he transferred about half of the money in his Smith Barney IRA to an IRA at Schwab — telling Schwab he was divorced and naming his four adult children from a previous marriage as the beneficiaries.

To name someone other than a spouse as beneficiary of a 401(k) plan, obtain a spousal waiver and update the beneficiary form.

consent requirements when a participant has been married less than a year, it does not require that they do so. "The court finds no merit in the argument that a uniform construction of the plan requires the term 'spouse' ... to be defined as a spouse married for at least a year," the ruling said.

CHOOSING THE ROLLOVER

IRAs usually offer far greater benefits than employer-sponsored retirement plans. One of those benefits is that, unlike with ERISA plans, a spouse is not required to be the beneficiary of a client's IRA account (some exceptions apply to clients living in community property states).

Instead, an IRA owner may name whomever he or she chooses as beneficiary. A single IRA can even be split into multiple IRAs, each with a separate beneficiary.

clients can use to obtain spousal waiver consent.)

Had Leonard Kidder rolled his 401(k) into an IRA after leaving Cajun Industries and before he remarried, the outcome likely would have been different. After Betty Kidder's death, Leonard could have updated his IRA beneficiary form to list his three children as beneficiaries, just as he did with his 401(k). But in this case, even though he remarried, the children would have remained as the beneficiaries of his account.

THE IRA DIFFERENCE

This was plainly evident last year in *Charles Schwab vs. Chandler*. The U.S. Court of Appeals ruled that a dead man's IRA would pass to his children (the named beneficiaries on his beneficiary form) and not to his new spouse, even though some of the money came originally from a company 401(k) retirement plan

In August 2005, disaster struck: Wilson was caught in a flash flood and died at age 65. Afterward, Chandler claimed she was entitled to the Schwab IRA, even though she was not the named beneficiary.

She asserted that, as Wilson's surviving spouse, she was entitled to the IRA account under ERISA laws and the U.S. Tax Code. The children contested her claim.

In court, Chandler argued that ERISA rules applied to Wilson's IRA savings because they had originated from an ERISA-qualified plan. She added that only self-funded IRAs (contributions made directly to IRAs, and their earnings) are exempt from spousal rights, and that IRA proceeds that come from a retirement plan are still subject to ERISA spousal rights.

But the court rejected her claim, saying the law does not recognize ERISA-granted spousal rights to money maintained in an IRA. Once

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the money left Wilson's 401(k) plan, they were no longer ERISA funds, the court ruled.

The court also found it significant that Wilson left his employer and

rolled the money into his IRA well before he married Chandler. That meant Wilson's Schwab account would go to his children, not to Chandler, who would get nothing.

DOING IT RIGHT

Although the outcomes were clearly different, both cases serve as a clear indication that clients should consider moving ERISA plan money to an IRA before a second marriage when someone other than the soon-to-be spouse is the desired beneficiary. Had Leonard Kidder taken this step, his children would not have been disinherited.

In the *Schwab* case, the children received the money as intended because the plan funds were rolled over to an IRA before Wilson remarried. A surviving spouse has no ERISA-type spousal statutory rights to a deceased spouse's IRA.

If a client wants to name someone other than a spouse as the beneficiary of a 401(k) or other ERISA retirement plan, it is a two-step process. The first step is to obtain a waiver of spousal rights. The second step is to update the necessary beneficiary form.

This second step is as crucial to the outcome as the first. After all, a spousal waiver simply means that a spouse does not have to be the beneficiary of the account. But it does not mean that the spouse cannot be or is not the beneficiary. If a spouse is still listed on the beneficiary form on file when an account owner dies, the spouse can still inherit the money in the account — even if that husband or wife had previously waived spousal rights.

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Ed Slott, a CPA in Rockville Centre, N.Y., is an IRA distribution expert, professional speaker and author of several books on IRAs. He's also created programs to help financial advisors become leaders in the IRA marketplace. For more info, visit his website at irahelp.com.

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