ARTICLE 3 DOES THE NON-EMPLOYEE SPOUSE HAVE A COMMUNITY PROPERTY INTEREST IN THE PARTICIPANT’S QUALIFIED PLAN OR IRA BENEFITS THAT IS TRANSFERABLE BY WILL OR INTESTACY?

It is clear that the nonparticipant spouse has a community property interest in the participant’s qualified plan and IRA benefits, to the extent earned during marriage. It is also clear (in most states) that a spouse’s community property interest in the other spouse’s IRA may be transferred by will or intestacy. If ERISA applies, however, state law on this issue may be preempted.¹

The Rules Governing the Division of The Community Property Interest of a Nonparticipant Spouse On Divorce Are Now Provided By ERISA and the IRC. Until 1986, there was controversy in most all of the community property states ² regarding the division on divorce of pension benefits subject to ERISA. §204(b) of the 1984 Retirement Equity Act, P. L. 98-397 amended ERISA (by adding §206(d)(3)) and the Internal Revenue Code (by adding IRC §414(p)) to provide that pension benefits could be awarded in a domestic relations action, if otherwise awardable under state law, despite the federal preemption provision of ERISA §514(a), if certain procedures —spelled out clearly(?) in two and a half pages of fine print— are followed. Thus was born the QDRO, the qualified domestic relations order. State and federal courts will continue to stay busy for the foreseeable future, interpreting §414(p) and wrestling with the proper methodology for valuing pension benefits, but we are not going to concern ourselves overmuch with these issues here. Dividing pension benefits in divorce is now more of a question of applying the law than it is of figuring out what it is.

At the beginning of 1997, the last major unanswered question of law remaining in this area was whether state probate laws affecting a participant’s interest in a plan were preempted, assuming the plan was subject to ERISA. In this area there is no federal law similar to the QDRO procedures. Prior to the Supreme Court decision in Boggs, all we had to go by was the preemption section of ERISA, as variously interpreted by conflicting circuit courts.

The Boggs Case. In the late spring of 1997, the United States Supreme Court, in Boggs v. Boggs, ³ gave us some needed answers. Whether the answers given raise more questions than they solved remains to be seen. After Boggs, we know that if the nonparticipant spouse dies first, the community property interest of the nonparticipant spouse is not transferable to the spouse’s beneficiaries. Further, a state court cannot rectify the situation indirectly by seeking an accounting or restitution or set off of the participant’s other assets not in the plan. This much is clear.

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² Texas, California, New Mexico, Arizona, Louisiana, Washington, Idaho, Nevada, and to a limited extent Oklahoma.

Before discussing the Boggs decision in any length, a few brief remarks regarding the checkered history leading up to the decision are in order. These remarks will be kept very brief, because now that the Supreme Court has spoken, most of what went on in the past leading up to the decision is of academic interest only. However, a quick review of some of the cases preceding Boggs should be enlightening.

3.1 The California Terminable Interest Doctrine.
In California, rights in plan benefits are community property, subject to division on divorce; but traditionally it was held that the nonparticipant's rights disappear at death. This principle has been dubbed the "terminable interest rule," not to be confused with the marital deduction rule having the same name. Several California cases have indicated that the terminable interest doctrine no longer applies, but the California Supreme Court has not directly so held.

California repealed the terminable interest rule by a 1986 amendment to §4800.8 of the California Civil Code (the California Family Law Act). It is clear that this legislative change applies on divorce; it is not clear that it applies at death although there is evidence in the legislative history to suggest that it should.

In Farver v. Department of Retirement Systems, 644 P.2d 1149 (1982), the Supreme Ct. of Washington state held that the terminable interest rule did not apply to a situation where a wife died after a divorce court had ordered a division of retirement benefits but before the benefits had been distributed. Therefore the interest set aside by the divorce court passed to the wife's heirs.

3.2 Valdez v. Ramirez, 574 S.W.2d 748 (Tex. 1978).
Valdez v. Ramirez, 574 S.W.2d 748 (Tex. 1978) was an important Texas case on the question of the nonparticipant spouse's community property rights in qualified plan proceeds; unfortunately, this case did not answer all of the issues. The case held that in the case of benefits payable under the Federal Civil Service Retirement Act, the adult children of a predeceased husband could not recover their father's community property portion of the wife's retirement benefits. In Allard v. Frech, 754 S.W.2d (Tex. 1988), the Texas Supreme Court, not without difficulty, refused to extend this principle to private retirement plans. First, the Valdez case:

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"A settled marital property rule in Texas is that a spouse has a community property interest in that portion of the retirement benefits of the opposite spouse earned during their marriage.

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"It [the gravamen of the Valdez case] calls for a decision of whether the interest of a spouse who died prior to any division or divorce should pass to his heirs under Texas Prob. Code §45, or should be paid to the living and earning spouse in accordance with a joint and survivor option which she had exercised under the Federal Civil Service Retirement Act.

* * * *

"At the outset, it is recognized that under ordinary circumstances, where there is no contract or provision of law to the contrary, §45 of the Texas Prob. Code would govern the distribution of a deceased spouse's interest in the community property as the Court of Civil Appeals has ruled.

"On the other hand, however, there are at least four categories of assets known as nonprobate assets, not subject to disposition by will and not subject to the rules of intestate distribution. Examples are (1) property settled in an inter-vivos trust, where title remains in the trustee notwithstanding the settlor's death; (2) property passing by right of joint survivorship, as in a valid joint bank account; (3) property passing at death pursuant to terms of a contract, such as provided in life insurance policies, and under contributory retirement plans; and (4) property passing by insurance or annuity contracts, created, funded and distributed as directed by federal statutes. In the context of the Texas community property system, the disposition of such nonprobate assets is governed by lifetime transfer rules, not by death time transfer rules of the Probate Code. See Johanson, Revocable Trusts and Community Property: The Substantive Problems, 47 Texas L. Rev. 537 (1969).

"Lily Valdez's retirement benefits were provided for her by her contract of employment as a civil service employee of the United States Government. United States v. Price, 288 F. 2d 448, 450-51 (4th Cir. 1961)."[Emphasis added.]

The Court concluded its analysis by holding that the adult children of the predeceased husband could not recover their father's community property portion of the wife's retirement benefits:

"The issue presented by this case is whether a husband's community interest in his surviving wife's civil service retirement benefits is inheritable upon his death by adult children of his former wife. We hold that it is not."[8]

7Valdez v. Ramirez, 574 S.W.2d 748 (Tex. 1978), at pp. 749-750.

8Valdez, id, p. 749.

One of the earliest cases recognizing that the nonparticipant spouse had a community property interest in the participant’s plan at death was a 1982 New York Federal District Court case, Employee Savings Plan of Mobil Oil Corp. v. Geer. The case is interesting for a number of reasons, chief among which is the spouse’s legal theory as to why she was entitled to three-quarters of the community benefit rather than half. The decedent—in this case the participant—left half of his pension plan benefits to his wife, and the other half to the children. The wife (who can fairly be described as grasping) maintained that she was entitled (a) first of all to her one-half community property interest, and (b) secondly, to the one-half that would then pass by the husband’s beneficiary designation—“thank you so much”! Of course, under Texas community property law, since the husband died first, his interest would be a nonprobate asset, and in the absence of fraud, he had the power to dispose of the wife’s half. Further, even if he did not have this power, it would certainly be overreaching to leave the wife three-fourths of the benefit. The case did not dispose of the spurious state law claims, but did hold, in denying a motion for summary judgment, that ERISA did not preempt the matter. ERISA preemption in this context could still be an issue in the future, because here the participant predeceased the nonparticipant spouse, rather than the other way around as in Boggs. (It might be observed that the state interest in enforcing marital property laws is perhaps less pressing—to the extent it conflicts with ERISA—after the participant has died than it is during the participant’s retirement years.)

3.4 MacLean V. Ford Motor Co., 831 F.2d 723 (7th Cir. 1987).

This case involved the testamentary rights of a participant in a plan to direct, by will, where his death benefits were to go. The court took for granted that state law conferred upon the decedent the power to do this, but found that Federal preemption prevented state law from controlling. Accordingly, the decedent’s death benefits under the Ford Motor Company plan, passed in accordance with the terms of the plan, rather than in accordance with the state testamentary transfer act.

3.5 Allard V. Frech, 754 S.W.2d 111 (Tex. 1988).

In Allard v. Frech, 735 S.W.2d 311 (Tex. App.-Fort Worth 1987, aff’d 754 S.W.2d 111 (Tex. 1988)), the Fort Worth Court of Appeals held that half of the husband's General Dynamics pension passed under the wife's will to a trust for the benefit of the couple's adult children. This decision was affirmed by the Texas Supreme Court.

Mr. Allard had retired under the General Dynamics plan. His benefit was in pay status at the time of his wife's death. He had elected to receive a life annuity with a ten year certain payout. In Valdez, the surviving participant wife had elected a joint and survivor annuity which would have inured to the benefit of the husband had he survived the wife. The Court of Appeals in Allard noted that the annuity in Valdez was a valid joint and survivorship community asset, and was therefore a non-probate asset (even though it was

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probably unilaterally elected). Because an annuity distribution was not elected in Allard, Valdez was distinguished. This distinction was not, however, the basis of the affirmation by the Texas Supreme Court.

The Texas Supreme Court case basically held that the distinguishing feature in Allard was that Allard involved a private pension, whereas Valdez was governed by the Federal Civil Service Retirement Act:

"[Valdez] was primarily based on the preemption of Texas community property law by the requirements of the Federal Civil Service Act which provided for the payment of retirement benefits only to the employee, or in the case of the employee's death, to the surviving spouse and the employee's minor children, incapacitated or student children. We held that it would be contrary to the entire contract, policy, and plan of the Federal Retirement Act for nearly one-half of Mrs. Valdez's monthly payments to be taken from her and awarded to her deceased husband's adult children."11

It does not appear from a reading of the opinion that federal preemption under ERISA §514(a) was timely raised.

### 3.6 Ablamis v. Roper, 937 F.2d 1450 (9th Cir. 1991)-Contra To ALLARD AND BOGGS.

The next significant case to wrestle prominently with the issue arose in the Ninth Circuit, Ablamis v. Roper.12 The 9th Circuit has squarely held that in a fact pattern virtually identical to Allard the California community property interest of the predeceasing nonparticipant spouse in the participant’s plan was not a probate asset because ERISA preempted state law. Finally—it was only a matter of time—, the Fifth Circuit was faced with the question.13 The Fifth Circuit reached a conclusion contrary to the Ninth. This case was Boggs v. Boggs, a case that made its way eventually to the United States Supreme Court where the Fifth Circuit was reversed in 1997.


A Federal District Court confronting Louisiana community property laws reached the same conclusion as in Ablamis under almost identical facts: The interest of the nonparticipant did not pass to the decedent’s children because of federal preemption.14

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10 Although a joint tenancy with survivorship rights was not (at that time) ordinarily permissible in community property, this was held to be a matter controlled by Federal law, under the principles of Free v. Bland, 369 U.S. 663, 82 S. Ct. 1089, 8 L.Ed.2d 180 (1962). Note that the Constitution and Texas Probate Code §46 have been recently amended to allow survivorship agreements with respect to community property.

11 Allard v. Frech, 754 S.W.2d 111 (Tex. 1988).

12 Ablamis v. Roper, 937 F.2d 1450 (9th Cir. 1991).

13 Sandra Jean Dale Boggs vs. Thomas F. Boggs, Harry P. Boggs and David B. Boggs, 82 F.3d 90 (5th Cir. 1996).

Further, the court held that the children could not avoid the consequences of preemption by having their claim satisfied out of other assets of equivalent value.

3.8 **Boggs v. Boggs.**

3.8(a) **The Boggs Facts.**
This case was originally decided by applying Louisiana law, since the decedent and his wives lived and (with the exception of wife two who is still living) died in Louisiana. The decedent, Isaac Boggs, was an employee of South Central Bell from 1949 until he retired in 1985. Isaac Boggs was married to Dorothy Boggs when he began employment until Dorothy’s death in 1979. Three children were born of this marriage. Dorothy’s will gave her husband a usufruct interest (similar to a life estate) in two-thirds of her estate, with the remainder to go to her three sons. Mr. Boggs married Sandra Boggs in 1980, and died in 1989. In 1985, Mr. Boggs received a distribution of a portion of his retirement plan benefits, which he rolled over to an IRA. The opinion does not indicate whether this portion of the plan was subject to the joint and survivor annuity rules. If it was, then Sandra must have waived her rights, or the proceeds could not have been rolled over into an IRA. Of course, the IRA, presumably, would not have been subject to ERISA or to the joint and survivor annuity rules, in any event. Another portion of the Bell plan was distributed in the form of AT&T stock and a life insurance policy naming Sandra as the beneficiary. Finally, Isaac was receiving a joint and survivor annuity, to which Sandra succeeded at the time of his death.

3.8(b) **The District Court Finding.**
This originated in Federal District Court, which held that ERISA does not preempt the community property rights of the predeceased nonparticipant spouse. It was appealed to the 5th Circuit, where it was affirmed. It was then appealed to the U.S. Supreme Court, where it was reversed.

The Boggs district court took comfort in the U.S. Supreme Court’s dismissal, for want of a substantial federal question, of the appeal in Carpenters Pension Trust Fund v. Campa, where the U.S. Supreme Court let stand a California State court holding that ERISA did not preclude states from dividing pension benefits in divorce. Of course, there is a long line of cases decided prior to the advent in 1984

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16**Sandra Jean Dale Boggs vs. Thomas F. Boggs, Harry P. Boggs and David B. Boggs**, 82 F.3d 90 (5th Cir. 1996).


of the QDRO procedures under IRC §414(p), that reached various conclusions regarding the preemption issue in divorce cases.\textsuperscript{19} These cases were largely inconclusive and the confusion they generated was in part responsible for the enactment of IRC §414(p) as a part of REA.\textsuperscript{20} (My own opinion is that the state interest in family property is not as significant where the spouse has died and the participant is still living.)

\textit{Boggs} was directly contrary to \textit{Ablamis} and \textit{Meek}. Therefore it is surprisingly that \textit{Meek} (out of the West District of the same state) was not cited. Moreover, \textit{Ablamis} was not directly cited either, though the court did frequently cite a law review case note on \textit{Ablamis}—“\textit{Ablamis v. Roper: Preemption of the Nonemployee Spouse’s Community Property Rights in ERISA Pension Plans, 49 Wash. & Lee L. Rev. 1085 (1992)}.”

3.8(c) The Fifth Circuit Decision.
The 5th Circuit, like the majority of the Supreme Court, made no real distinction between any of the benefit forms described the facts of the case recited above. This may have been appropriate, since when Dorothy Boggs died in 1979, Isaac’s benefits were not in pay status. So, the form that the benefit payments actually took may have been irrelevant to the analysis of whether the Boggs children had rights in the benefits to begin with.

It is important to note that, unlike \textit{Ablamis},\textsuperscript{21} this was not an action brought against the plan itself. Rather, the action was in the nature of an accounting against Sandra. One consequence of this posture was that it allowed the Boggs children to contend that the court lacked jurisdiction to decide the case. The court dispensed with this argument summarily. However, the Fifth Circuit did conclude that the children were entitled to the benefits in which their mother had a state law community interest, despite the preemption and the anti-alienation provisions of ERISA.

The court could not avoid giving lip service to the well established principal that “ERISA was enacted to protect the interests of the beneficiaries of employee benefit plans,”\textsuperscript{22} and that “any state law which ‘relates to’ an ERISA qualified employee benefits plan is preempted,” stating further that, “a state law ‘relates to’ an ERISA plan ‘in the normal sense of the phrase, if it has connection with or reference to such a plan’.” However, the court also noted “‘that Congress does not intend to preempt areas of traditional state regulation.’”\textsuperscript{23}

\textsuperscript{19}E.g., \textit{Stone v. Stone}, 632 F. 2d 740 (9th Cir. 1980).


\textsuperscript{21}\textit{Ablamis v. Roper}, 937 F.2d 1450 (9th Cir. 1991).


The court also recognized that principals of federalism must be considered and that “domestic relations has long been the domain of the states,” concluding that—

A state community property system that affects what a plan participant does with his benefits after they are received does not impermissibly intrude on the mandates ERISA imposes on plan administrators. The controversy in this case is between successive spouses and their heirs. The focus of this case is not the relationship between the administrator of this ERISA plan and its beneficiary.

* * * *

Nothing is sought from the plan or its fiduciary. No duty will be imposed on the plan or the administrator. Benefits will continue to be paid to the beneficiary in the manner provided in the plan. A spouse’s accounting obligation under community property law affects employee benefit plans “in too tenuous, remote, or peripheral a manner to warrant a finding that the law ‘relates to’ the plan.” Our decision relates not to the plan but to the disposition of the proceeds only after payment to the designated beneficiary.

(One can hardly resist a chuckle at the court’s Alice in Wonderland like statement that taking half of a person’s survivorship benefits —provided by federal law— affects those benefits “in too tenuous, remote, or peripheral a manner to warrant a finding that the law ‘relates to’ the plan.”

The fact that the children in Boggs were proceeding against the spouse rather than the plan, does make the violation of the anti-alienation somewhat less obvious on the face of things. Note that the plan would probably be disqualified if it paid anyone other than the participant or his named beneficiary.

The court also dismissed Sandra’s argument that IRC §408(g), enacted as part of ERISA, specifically provides that “this section shall be applied without regard to any community property laws.”

The court realized that the Ninth Circuit had previously determined that ERISA preempted California community property laws in a case similar to Boggs, but the court felt that the Ninth Circuit placed “too much emphasis on a broad interpretation of the spendthrift provision” of ERISA.

Boggs was appealed to the U.S. Supreme Court, where it was reversed.


25IRC §401(a)(13).

26Cf., IRC §402(g)(6).

27Ablamis v. Roper, 937 F.2d 1450 (9th Cir. 1991).
3.8(d) **Is Boggs Important?**
As recited in the facts of the Supreme Court opinion, “The nine community property States have some 80 million residents, with perhaps $1 trillion [that’s with a “t”] in retirement plans.”

3.8(e) **The Supreme Court Decision.**
Five of the nine judges squarely held that Dorothy Boggs had no power to transfer at death her interest in her husband’s undistributed benefits under a pension plan subject to ERISA. To the extent state law would have provided a contrary result, it is preempted. Further, citing *Free v. Bland*, the state of Louisiana could not make an end run around the federal rule by seeking an accounting from Isaac Boggs’ beneficiary, his new wife Sandra.

*Free v. Bland* involved the right of a surviving spouse to succeed to an interest under a U.S. Savings bond held in joint tenancy with right of survivorship. At the time the case was decided, Texas law did not recognize joint and survivorship provisions between husband and wife in community property. The Supreme Court held that Texas law was preempted in this regard in the case of survivorship rights in United States Savings Bonds. **Further —and this is the point—, the effect of granting survivorship rights could not be circumvented by ordering that the community be reimbursed out of the owner’s separate estate.**

Notwithstanding this [survivorship] provision, the State [Texas] awarded full title to the co-owner but required him to account for half of the value of the bonds to the decedent’s estate. Viewed realistically, the State has rendered the award of title meaningless. Making the bonds security for the payment confirms the accuracy of this view. If the State can frustrate the parties’ attempt to use the bonds’ survivorship provision through the simple expedient of requiring the survivor to reimburse the estate of the deceased co-owner as matter of law, the State has interfered directly with a legitimate exercise of the power of the Federal Government to borrow money.

3.8(e)(1) **The Seven to Two Decision.**
Two of the otherwise dissenting judges (Rehnquist and Ginsburg) agreed with the five majority Justices to the extent that Sandra (the second wife) had rights guaranteed under ERISA as a result of the Retirement Equity Act (REA). Therefore, they joined in Part III of the majority opinion, the part concerned solely with the surviving spouse’s REA rights:

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Even a plan participant cannot defeat a nonparticipant surviving spouse's statutory entitlement to an annuity. It would be odd, to say the least, if Congress permitted a predeceasing nonparticipant spouse to do so. Nothing in the language of ERISA supports concluding that Congress made such an inexplicable decision.

Point well taken! It is probable that the only reason the other two Justices (Breyer and O’Connor) did not join in Part III is that, under the facts, there was enough money involved so that Sandra (Wife number two) could have received her full undiminished annuity under REA, even if forced to give up Dorothy’s portion out of the remainder. It would be astonishing if state community property law could effectively place a surviving spouse in an overall worse position than that minimally mandated by REA, without being preempted. In order to give effect to state law in this context, one must be able to say (presumably with a straight face) that even if state law deprives a surviving spouse of Congressionally mandated guaranteed benefits, the law does not “relate” to the plan that guaranteed those benefits.

3.8(e)(2) The Five to Four Decision.

In the words of the Court:

Beyond seeking a portion of the survivor's annuity, respondents claim a percentage of: the monthly annuity payments made to Isaac Boggs during his retirement; the IRA; and the ESOP shares of AT&T stock. As before, the claim is based on Dorothy Boggs' attempted testamentary transfer to the sons of her community interest in Isaac's undistributed pension plan benefits. Respondents argue further--and somewhat inconsistently--that their claim again concerns only what a plan participant or beneficiary may do once plan funds are distributed, without imposing any obligations on the plan itself. Both parties agree that the ERISA benefits at issue here were paid after Dorothy's death, and thus this case does not present the question whether ERISA would permit a nonparticipant spouse to obtain a devisable community property interest in benefits paid out during the existence of the community between the participant and that spouse.

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We conclude the sons have no claim under ERISA to a share of the retirement benefits. To begin with, the sons are neither participants nor beneficiaries.

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Dorothy's 1980 testamentary transfer, which is the source of respondents' claimed ownership interest, is a prohibited "assignment or alienation."
As was true with survivors' annuities, it would be inimical to ERISA's purposes to permit testamentary recipients to acquire a competing interest in undistributed pension benefits, which are intended to provide a stream of income to participants and their beneficiaries.

Respondents contend it is anomalous and unfair that a divorced spouse, as a result of a QDRO, will have more control over a portion of his or her spouse's pension benefits than a predeceasing spouse. Congress thought otherwise. The QDRO provisions, as well as the surviving spouse annuity provisions, reinforce the conclusion that ERISA is concerned with providing for the living. The QDRO provisions protect those persons who, often as a result of divorce, might not receive the benefits they otherwise would have had available during their retirement as a means of income. In the case of a predeceased spouse, this concern is not implicated. The fairness of the distinction might be debated, but Congress has decided to favor the living over the dead and we must respect its policy.

The axis around which ERISA's protections revolve is the concepts of participant and beneficiary. When Congress has chosen to depart from this framework, it has done so in a careful and limited manner. Respondents' claims, if allowed to succeed, would depart from this framework, upsetting the deliberate balance central to ERISA. It does not matter that respondents have sought to enforce their rights only after the retirement benefits have been distributed since their asserted rights are based on the theory that they had an interest in the undistributed pension plan benefits. Their state-law claims are pre-empted. The judgment of the Fifth Circuit is Reversed. [Emphasis added.]

3.8(e)(3) The Undoubted Law.
Five to four decision or not, we must assume that Boggs is now the law, and that if a plan is governed by ERISA, and if the nonparticipant spouse dies first, the community property interest of the nonparticipant spouse is not transferable to the spouse’s beneficiaries. Further, a state court cannot rectify the situation indirectly by seeking an accounting or restitution or set off of the participant’s other assets not in the plan. This much is clear.
3.9 Unresolved Problems in the Law Post Boggs.

3.9(a) Is the Nonparticipant’s Interest to be Included as Part of the Nonparticipant’s Estate If it Cannot Be Transferred?

If the predeceasing nonparticipant spouse has no testamentary power to transfer his or her interest, should that interest be included in the spouse’s estate. According to PLR 8943006 Service apparently thinks that the value of a spouse’s community property interest in a plan is includable in the spouse’s gross estate under §2039(a) even if the spouse cannot dispose of the interest by testamentary disposition, but had a beneficial interest in the plan prior to death. 32

PLR 8943006, citing Allard, 33 but relying on Ablamis 34 (Boggs had yet to be decided) and apparently misinterpreting Louisiana law, held:

It appears that no interest in W and H’s pension benefits in the present case could have passed under W’s will or otherwise to W’s children. Thus, W’s community interest in the pension benefits passed to H by operation of law pursuant to the provisions of the joint and survivor annuity described in the plan.

The PLR concluded that—

[T]he value of W’s community property interest in the plan is includable in her gross estate under section 2039(a) of the Code.

However, I believe the Service failed to pay adequate attention to §2039(b). Even if §2039(a) would on its face cause inclusion, there is §2039(b) to consider:

“(b) AMOUNT INCLUDABLE-Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent’s employer or former employer to the purchase price of such contract or agreement (whether or not to an employee’s trust for fund forming part of a pension, annuity, retirement, bonus or profit-sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.”

The problem with treating the predeceased nonemployee’s community property interest as includable under §2039 is that although it might be said that under §2039(a) the employee is a beneficiary who will receive an interest under the plan by reason of surviving the nonparticipant (assuming the interest cannot be disposed of by the nonparticipant), the amount includable is limited under

32 PLR 8943006.

33 Allard v. Frech, 754 S.W.2d 111 (Tex. 1988).

34 Ablamis v. Roper, 937 F.2d 1450 (9th Cir. 1991).
§2039(b) to the proportionate value of the interest contributed by the decedent (in this case the decedent is the “nonemployee spouse”) or by the decedent’s employer. The decedent, in this case the nonemployee spouse, contributed nothing to the plan (at least not directly), and, for that matter, neither did the employee spouse (arguably). Why do I say the decedent contributed nothing? Because the decedent is not the employee. Why do I go further and suggest that the employee contributed nothing? Because technically it is the employer that makes the contribution, not the employee (ordinarily). It is the last sentence of 2039(b) that attributes contributions of the “decedent’s” employer to the decedent.

If §2039 does not apply, what section does? §2041? **Not if the nonemployee has no power of disposition.** Under the Boggs case, the nonemployee has no such power if the interest is under a plan subject to ERISA!

§2033? Whether or not the spouse can dispose of the interest by testamentary disposition, the Service has held that the interest is includable under §2033. (Alternatively, §2041 would suffice to bar any argument.) But under Boggs, as already mentioned, the spouse lacks this power. Moreover, if §2033 were sufficient to cause inclusion in the case of a nonemployee, it would presumably never have been necessary to enact §2039 to cover the employee’s interest, now would it. It is because it is the employer, rather than the employee, that owns and operates and contributes to the plan that Congress felt compelled to enact §2039 in the first place; otherwise, §2033 would presumably have sufficed.

If the spouse lacks the power to transfer the interest, it is arguable that the interest is not includable in the estate, as a matter of Constitutional law, since the estate tax is an excise tax on the power to transfer property. If it were a direct tax, other than an income tax, it would be prohibited by the Constitution unless apportioned in accordance with the census:

“No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.”

3.9(b) **If the Nonparticipant’s Spouse’s Interest Is INCLUDABLE in the Estate, Does it Qualify For the Marital Deduction?**

It is clear that a marital deduction will not be available if the interest is a nondeductible “terminable interest.” What is a terminable interest? A "terminable interest” in property is:

“An interest which will terminate or fail on the lapse of time or on the occurrence or the failure to occur of some contingency. Life estates, terms

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37 U.S. Constitution, Article I, Sec. 9.
for years, annuities, patents, and copyrights are, therefore, terminable interest.”

A property interest which constitutes a terminable interest is non-deductible if:

“(i) another interest in the same property passed from the decedent to some other person for less than an adequate and full consideration in money or money’s worth, and

(ii) by reason of its passing, the other person or his heirs or assigns may possess or enjoy any part of the property after the termination or failure of the spouse's interest.”

Under a qualified plan, an interest that passes from the nonparticipant spouse to the participant will terminate or fail if the participant remarries, since, under that “contingency,” the new spouse would have REA survivorship rights. The interest that would pass to the new spouse would pass for less than full consideration and by reason of its passing the new spouse may “enjoy any part of the property after the termination or failure of the spouse's interest.” I am tempted to say at this point, “Draw your own conclusions!” but before doing so, consider IRC §2056(b)(7)(C).

Does 2056(b)(7)(C) Apply to the Nonparticipant's Interest “Passing” to the Participant? IRC §2056(b)(7)(C) does not require that all of the income be payable to the surviving spouse in order to obtain a marital deduction under the QTIP (qualified terminable interest property trust) rules, but only requires that no payments can be made to the surviving spouse so long as the spouse is living. 2056(b)(7)(C), prior to its amendment by the 1997 Taxpayer Relief Act provided:

(C) Treatment of survivor annuities.--In the case of an annuity included in the gross estate of the decedent under section 2039 where only the surviving spouse has the right to receive payments before the death of such surviving spouse--

(i) the interest of such surviving spouse shall be treated as a qualifying income interest for life, and

(ii) the executor shall be treated as having made an election under this subsection with respect to such annuity unless the executor otherwise elects on the return of tax imposed by section 2001.

An election under clause (ii), once made, shall be irrevocable.

Was this section meant to apply to the nonparticipant? I don’t see why not, and neither does the IRS. The only problem with §2056(C) is that it

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38 Treas. Reg. §20.2056(b)-1(b).

39 Treas. Reg. §20.2056(b)-1(c)(i).
requires that the interest be includable under §2039, which is of dubious application in view of §2039(b) as argued above. Since the Service apparently does not read §2039(b) as restrictively as I do, perhaps there is salvation by grace of 2056(C); and indeed, PLR 8943006 followed up on the conclusion that the nonparticipant’s interest was includable in the nonparticipant’s estate (despite the absence of a power of testamentary transfer) with a finding that the marital deduction was applicable under §2056(C). First the Service disposed of the “passing” issue as follows:

Section 2056(a) of the Code allows a deduction from the gross estate in an amount equal to the value of any interest in property which passes from the decedent to his or her surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate. Pursuant to section 2056(c)(5) an interest in property shall be considered as passing to a person if such interest was, at the time of decedent's death, held by such person and the decedent in joint ownership with right of survivorship. SEE ALSO sections 20.2056(e)-1(a)(1) and (6) of the Estate Tax Regulations for the rules applicable in determining the person to whom any property interest "passed from the decedent". Section 20.2056(e)-2(a) of the regulations provides that the rules in section 20.2056(e)-1 are also generally applicable for purposes of determining the property interests which "passed from the decedent to his surviving spouse".

Now on to the heart of the matter:

Section 2056(b)(7)(C) was added to the Code by the Technical and Miscellaneous Revenue Act of 1988 and applies generally with respect to decedents dying after December 31, 1981. Section 2056(b)(7)(C) provides that the interest of a surviving spouse in an annuity shall be treated as a qualifying income interest for life where only the surviving spouse has the right to receive payments before the death of such surviving spouse. The section also provides that the executor shall be treated as having made a QTIP election with respect to such annuity unless the executor otherwise elects on the estate tax return.

It is clear that W's estate would not be entitled to a marital deduction if her community property interest could pass under her will to her children pursuant to the community property and succession laws of Louisiana. On the other hand, a marital deduction is allowable if W's interest passes to H by operation of

40PLR 8943006.

41Another problem, which we will conveniently ignore, is that on the contingency of remarriage followed by divorce, the QDRO rules would permit a subsequent spouse to succeed to the interest of the participant during the participant’s life, but I suppose this would be true of any gift.
law notwithstanding the residuary bequest to the children in W's will.\textsuperscript{42}

The only fly in the ointment here is whether 2039 applies to the nonparticipant, since if it does not, 2056(b)(7)(C) does not either.

The 1997 Taxpayer Relief Act amended §2056(b)(7), by adding the language in italics quoted below, so that it now reads:

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“TREATMENT OF SURVIVOR ANNUITIES.—In the case of an annuity included in the gross estate of the decedent under section 2039 (or, in the case of an interest in an annuity arising under the community property laws of a State, included in the gross estate of the decedent under section 2033) where only the surviving spouse has the right to receive payments before the death of such surviving spouse—

(i) the interest of such surviving spouse shall be treated as a qualifying income interest for life, and

(ii) the executor shall be treated as having made an election under this subsection with respect to such annuity unless the executor otherwise elects on the return of tax imposed by section 2001.”
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The effect of this change is discussed elsewhere in this paper.

\textbf{3.9(c) What is the Interest of the Participant, On the Participant’s Death?}

If PLR 893006 is the law, then we simply have QTIP treatment under 2044. Otherwise, we have an enigma within a mystery. If the participant survives the nonparticipant, we probably have inclusion under §2041, assuming that the participant has the power, at any time, to appoint the interest to himself, herself, or to his or her estate or creditors. That right may come at some point, but won’t exist during lifetime (ordinarily) prior to retirement; and again, if the participant remarries, the right might never exist.

If the participant predeceases the nonparticipant, it would be reasonable to assume that if the participant can appoint the property to creditors or the estate, then 2041 would apply. However, as previously discussed, the participant can, in fact, appoint all sole management community property to creditors or the estate, and (thank goodness) the Service has never raised the 2041 specter—perhaps because if 2041 applied an offsetting 2053 deduction would be available (to which my comment is: not necessarily). In the context of a qualified plan, the participant cannot appoint the nonparticipant’s interest to creditors or the estate, to the extent the surviving spouse has REA rights.

If Pension Benefits Subject to ERISA are Distributed During the Lives of Both Spouses, Will the Nonparticipant Spouse Then Have a Testamentary Power of

\textsuperscript{42}PLR 8943006.
Disposition? This is the $64,000\textsuperscript{43} question. My own opinion is that the spouse will have such a power. I suppose that what to me would be a nightmare scenario of ERISA preemption never going away, haunting the recipient for so long as the assets distributed can be traced, could be a good thing, depending on one’s perspective. But it will make estate planning for the medium sized estate much more difficult than it already is.

One assumes that once pension benefits are distributed they are alienable, and can be reached by creditors. On divorce, one also assumes that the QDRO rules need not be complied with respect to plan benefits that have already been distributed, which is helpful, since in that case the QDRO rules could not be complied with and in that context do not make sense.

One could argue that if the beneficiaries of a predeceased nonparticipant spouse step into the spouse’s shoes, and yet, upon ultimate distribution from the plan they are not entitled to the share of the benefits that the predeceased spouse would have been entitled to if living, then it follows, as a matter of very compelling logic, that the fact that the spouse outlived the distribution ought not to be of special relevance. Indeed, the majority opinion in the Boggs case suggests that this could be an issue for future resolution:

Both parties agree that the ERISA benefits at issue here were paid after Dorothy's death, and thus this case does not present the question whether ERISA would permit a nonparticipant spouse to obtain a devisable community property interest in benefits paid out during the existence of the community between the participant and that spouse.

This is a rather ominous comment. One should note at the onset that if, in fact, plan proceeds are always protected against testamentary transfer by the spouse, even after distribution, we will be faced with an accounting nightmare for which most work-a-day participants and their lawyers will be generally unprepared. In such a case, it would matter not whether the interest were placed in a rollover IRA or a passbook savings account or invested in the stock market, it would still be treated as the participant’s separate property, in effect. (Presumably the income on the distribution would be transferable by the nonparticipant spouse without regard to preemption issues.)

My own opinion is that when next faced with this question the Supreme Court will back away from an extension of Boggs, and will give common sense precedence over strict logic. This is, after all, not unknown at the Supreme Court level. Here, a little stretch would be a lot of help. Further, only a little stretch is called for.

There are in fact good legal reasons for making a distinction between those cases where the nonparticipant dies prior to a distribution and those cases where death occurs later. The majority opinion was based largely on the anti-alienation provision of ERISA §206(d), the IRC corollary of which is §401(a)(13). I am not

\textsuperscript{43}Unadjusted for inflation.
aware of any cases holding that the anti-alienation rule survives a distribution of plan assets. One may surely transfer pension plan benefits that have been distributed, as surely as one is prohibited from transferring benefits that have not.

When does a testamentary “transfer” take place? At death, of course. It is reasonable to interpret Boggs as involving an attempted “transfer” at death by Dorothy Boggs of plan assets, a transfer clearly prohibited by ERISA §206(d). However, once the assets are no longer in the plan, the anti-alienation rule would not prohibit the transfer. Therefore, if the nonparticipant spouse makes a testamentary “transfer” of the assets after they have been distributed, there is no longer any ERISA impediment to the alienation, or so I would argue. True, Dorothy’s children made much the same argument by contending that although the transfer at death was admittedly ineffectual at that time, it ought to be given effect after death, when and if the assets are distributed. My response is that this is like arguing that I am entitled to irrevocably assign you my interest in my pension plan now, as long as it is understood that you are to receive those benefits only when distributed by the plan. There is no question whatsoever that any attempt to do this would be ineffectual in addition to being prohibited.

Given the vigorous nature of the dissent in Boggs, and the desirability of limiting it to undistributed pension benefits only, I think it all but certain that at least one additional Justice will join four dissenting Justices that did not agree with Boggs to begin with, and if faced with the question would decide that Boggs only applies to benefits that were undistributed at the time of the nonparticipant’s death. This is simply the most practical solution to the problem, even if a rigorously logical (hidebound?) extension of Boggs would make no distinction as to whether death occurs before or after distribution.

**3.9(d) How Does Boggs Affect Estate Planning?**

I agreed with the result in Boggs, not because I think it a desirable outcome, but because I could not see how one could, in good conscience, argue that state law, if allowed to operate unfettered, would not “relate” to an employee benefit plan when it deprives both the participant and the participant’s (new) spouse of rights specifically granted under the federal law. I say this being mindful of state’s rights concerns, with which I am generally sympathetic; but whatever my personal opinion, I cannot ignore the commerce clause either.

One reason I think that ERISA preemption in this area is unfortunate is that it will interfere with bypass trust planning for all but the very wealthy and the very not so wealthy. Persons with combined estates under $600,000, and persons with combined estates of over $1.2 million exclusive of qualified plan benefits, may not be affected much by Boggs. But the many people in between may be unable to shelter the unified credit exemption equivalent (approximately $600,000) without resorting to the assets in a qualified plan. And if the nonparticipant spouse dies first, Boggs says that these benefits are unavailable for that purpose if subject to ERISA.
3.9(e) Possible Solutions to the Boggs Dilemma.
If the pension plan assets are distributed, the problem goes away—that is, it goes away unless the logic of Boggs is extended to transfers taking place after distribution. If the assets are distributed, they could be rolled into an IRA. IRAs are not subject to ERISA—again, unless the logic of Boggs is unreasonably extended, which it presumably will not be. Life insurance is certainly a viable solution here if the nonparticipant is healthy and not too old.

3.10 Distinguish IRAs, SEPs And Plans Covering Only Owners-IRAS and SEPs are Not ERISA Plans.
Recall that IRAs (and perhaps SEPs) are generally not governed by ERISA. The same is true of plans without common law employees. Therefore, these plans cannot rely on federal preemption as a defense to the application of state property law rules. An IRA is generally nothing more than a form of a bank account that it not subject to tax until withdrawn. Clearly, the spouse of the designated owner of an IRA has the same community property rights that the spouse would have in an insurance policy on the life of an insured “owner,” or would have in a checking or savings account in the name of a surviving spouse. That community property interest is a probate asset, pure and simple. What is more, unlike a qualified plan, the survivor has absolute control over an IRA, just like any other bank account or an insurance policy or any other community property asset over which a spouse has sole control and management. So in this case we do not have the logistical difficulties of getting the decedent spouse’s interest out of the plan and into the hands of the decedent’s beneficiaries.

It has occasionally been successfully argued that a SEP is an employee benefit plan, subject to certain parts of ERISA. If a SEP is an employee benefit plan—and therefore subject to Title I—it would be subject to the preemption but not the antialienation provisions of ERISA. Perhaps the SEP itself could be subject to ERISA, but not the IRA into which the contributions are shunted.


45DOL Reg. §2510.3-2(d) and(f).

46DOL Reg. §2510.3-3(b).


48ERISA §514(a).

49ERISA §201(6).
3.11 Income Taxation On Distribution of Nonparticipant Spouse’s Community Property interest—Who Pays the Income Tax?
For a discussion of how the community property laws operate on income tax issues, be sure to consult Article VII, especially Section D, “Will A Nonprorata Distribution Or Partition Of The Community Property Interest Of The Surviving Spouse And The Community Property Interest Of The Decedent's Estate, Escape Taxable Sale Or Exchange Treatment In Accordance With Principles Applicable During Lifetime?,” and Section P, “Partitions of IRAs And Qualified Plan Interests By Married Couples,” in addition to this Article III.

3.11(a) IRAS

IRC §408(d)(1) provides:
Except as otherwise provided in this subsection [§408(d)], any amount paid or distributed out of an individual retirement plan [IRA] shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.50

§72(a), in turn, provides:

Except as otherwise provided in this chapter [Ch. 1, Normal Taxes, e.g., income taxes], gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.51 [Emphasis added.]

Let us assume that a lifetime assignment would trigger immediate income taxation to the participant

3.11(a)(2) IRC §408(g).
There is almost no law on the question of who is taxed on the income when a distribution is made from a living participant’s IRA to the estate or beneficiaries of predeceased spouse, whose interest was acquired as a result of the community property laws. IRC §408(g) provides, simply.

This section shall be applied without regard to any community property laws.52

Presumably, if IRC §408(g) were literally applied, the participant would have to foot the income tax bill, although an equitable right of recovery might also obtain.

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50IRC §408(d)(1).
51IRC §72(a).
52IRC §408(g).
3.11(a)(3) **PLR 8040101.**

Despite the literal wording of §408(g), the Service has privately ruled that the statement found in IRC §408(g) that the IRA rules “shall be applied without regard to any community property laws,” relates solely to the deduction rules found in IRC §219. In that ruling the IRA owner’s spouse (the nonparticipant spouse) died before the IRA owner. The IRA was a rollover IRA and was community property. The decedent’s estate listed half the IRA as community property includable in the estate. The IRS agreed. Furthermore, the ruling stated that a distribution to the beneficiaries of the decedent’s estate would not result in income taxation to the surviving IRA owner but would be taxable to the distributees.

IRAs are not subject to the QDRO rules. Rather §408(d)(6) simply states that a transfer on an interest in an IRA to a spouse or former spouse incident to divorce is not a taxable transfer, and the transferred interest is treated as an IRA maintained for the spouse. PLR 8040101 held that for purposes of this section, death was to be treated in the same manner as a divorce.

However, where a couple in a community property state divided the husband’s IRA under a private separation agreement entered into during life, the IRS privately ruled that the husband was taxable on the transfer and that §408(d)(6) did not apply. PLR 8040101.

3.11(a)(4) **PLR 199937055.**

PLR 199937050 reaffirmed the Revenue Service’s position that 408(g) “clearly applies only to the deduction provisions under sections 219 and 220 of the Code,” citing the House Committee Report set forth in H.R. Rep. No. 93-779, 93rd Cong., 2nd Sess, 1974-3 C.B. 244, 363.

3.11(b) **Qualified Plans.**

If the interest is in a qualified plan rather than an IRA, the issue of who is taxed on distributed income is more problematic. An analogy to §414(p) similar to the analogy to §408(d)(6) is likely to be misplaced, because there is authority that §414(p) does not apply to probate orders.

In *Karem v. Commissioner*, the Tax Court held that when a participant paid his former wife a portion of his benefits under a qualified plan, pursuant to a divorce decree that was not a QDRO, the husband was taxed on the distribution, not the wife, despite the fact that the proceeds were community property prior to the

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54 §414(p) only applies to qualified plans.

55 PLR 9344027.

divorce.\textsuperscript{57} §402(g)(6), like §408(g), states that the distribution taxation rules are to be applied “without regard to community property laws.” Here, unlike PLR 8040101, the section was literally applied.

*Karem* appears to be contrary to *Powell*,\textsuperscript{58} another (and slightly more recent) Tax Court decision, discussed below. The reason for the difference may have had to do with the facts, and the *Karem* case did have some unique facts. For example, the lump sum distribution took place in a year prior to the entry of the consent judgment ordering the division of the plan proceeds. It does not appear, however, that this fact was deemed significant. The taxpayer’s alternative argument, which was unsuccessful, was that half of the proceeds were community property, and therefore taxable one-half to each spouse, regardless of the qualified status of the court order. This argument, though unsuccessful here, was successful in *Powell*.

According to Powell, the crucial difference between Karem and Powell was that the former was a post REA decision which had to be interpreted in light of IRC §414(p) which “preempted community property laws in respect of post-REA years.”

Query: what is the proper way to report a post-REA distribution of community property from a qualified plan or IRA to a participant who is happily married. The distribution will not be pursuant to a QDRO. If the couple files separately, should each report only half of the distribution, as would be the case if the compensation were current, rather than a form of deferred, compensation?

In Darby,\textsuperscript{59} a case not involving community property, the Tax Court reached the same result as in Karem. Unlike Karem, Darby arose prior to REA and the advent of §414(p) QDROs. Therefore, unlike Karem, it was not so clear that ERISA preempted the effectiveness of the state divorce court order. In a case arising under REA, the statute provides that the alternate payee is taxed on the distribution, if the alternate payee is a spouse, but not otherwise.\textsuperscript{60}

Although the arguments made in Darby tend may be said to support the notion that if a portion of a qualified plan is payable to the heirs of the nonparticipant spouse, the income tax will be owed by the participant rather than by the recipient,\textsuperscript{61} Darby is of doubtful application in community property states, as

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\textsuperscript{57} Robert L. Karem and Hazel W. Karem v. Commissioner, 100 T.C. No. 34 (CCH Dec. 49,091) (1993).

\textsuperscript{58} Rodney Powell, et. al. v. Commissioner, 101 T.C. 32 (1993)


\textsuperscript{60} IRC §414(e)(1)(A).

Powell makes clear. See below. Of course, if ERISA preempts state law in this regard, then this anomaly will not arise.\[62\]

Note that *Karem* and *Darby* can be distinguished from a case involving an IRA because both cases involved a qualified plan. Following the rationale of *Ablamis v. Roper*, 937 F.2d 1450 (9th Cir. 1991), the *Karem* court held that unless the order was a QDRO, it would be ineffective, as a result of ERISA preemption, to divest the participant of his interest in the plan. If so, then it is easy to see why the participants in *Darby* and *Karem* should be taxed on the distribution, since the payments were in the nature of a voluntary assignment. All the more so in *Darby* where the benefit was not community property. In the case of an IRA, neither ERISA nor the QDRO rules are applicable, and so there is no impediment to the unadulterated application of state law.

Finally, in *Rodney Powell, et. al. v. Commissioner*, 101 T.C. 32 (1993) the Tax Court distinguished its earlier decisions—*Darby* and *Karem*, and held that the wife of the participant was a “distributee” under IRC §402(a) and therefore was taxed on a distribution to her of her community property interest in her husband’s retirement plan made pursuant to a pre-REA domestic relations order. Citing a long list of cases, the court reasoned that the anti-alienation rule (ERISA §514(a) and IRC §401(a)(13)) was not intended to preempt state community property law in this regard.

In the author’s opinion, *Powell* is the better reasoned of the three cases, and represents the most thorough exposition of the law on the subject.

If the Service sticks to the position reflected in PLR 8040101 in the case of IRAs, and if ERISA preempts the probate disposition of a participants’ interest in a qualified plan, then the thorny problem discussed above largely dissolves in the case of the prior death of the nonparticipant spouse.

### 3.11(c) Death of the Nonparticipant—Nonqualified Plans.

The Service has privately ruled that under *Lucas v. Earl*\[63\] (the seminal assignment of income case) the participant in a nonqualified plan will be taxed on distributions to a spouse made pursuant to a divorce decree.\[64\] (The QDRO rules of IRC §414(p) do not apply to nonqualified plans.) This ruling did not address community property issues, however.

### 3.11(d) Death of the Nonparticipant (or Participant) as an Assignment of Income.

Does the passing of a nonparticipant’s community property interest in an IRA (or qualified plan if that is possible) to the nonparticipant’s successors in interest

\[62\] *Ablamis v. Roper*, 937 F.2d 1450 (9th Cir. 1991).


\[64\] PLR 9340032.
result in an “assignment” that would trigger immediate taxation, perhaps under §408. This is possible, but doubtful, as a technical matter.

It is true that if the owner of an IRA pledges or borrows against the IRA or engages in a prohibited transaction with it, the account ceases to be an IRA. An assignment or alienation could be construed as a prohibited transaction. Presumably, if a division of an IRA or qualified plan takes place during lifetime, for example by transferring to the nonparticipant the nonparticipant’s community one-half interest, the interest assigned will be taxable, unless the assignment is pursuant to a QDRO in the case of a qualified plan, or pursuant to IRC §408(d)(6) in the case of an IRA, as discussed immediately above.

However, a transfer at death is not a taxable sale or exchange if the beneficiary is entitled to the interest as a matter of right. Consider, for example, the distribution of a decedent’s property to a residuary beneficiary under a will. Absent an IRC §643(e) election, no gain or loss will be recognized on the “transfer.” More to the point, IRC §691(a)(1) is explicit that the recognition of an IRD item is included in gross income “when received.” Therefore the recipient of the “right to” an IRD item will never be taxed upon receipt of the right, unless the transfer of the right is itself a taxable sale or exchange, such as might be the case, for example, if the transfer is in satisfaction of the right to a pecuniary bequest.

“If a right to income in respect of a decedent is transferred by an estate to a specific or residuary legatee, only the specific or residuary legatee must include such income in gross income when received.”

3.12 Who Pays the Premature Distribution Tax On Distribution of The Nonparticipant Spouse’s Community Property interest?
The exception to the 10% premature distribution tax under §72(t)(2)(A)(i), for distributions (prior to age 59&1/2) made on account of death, does not apply here because the death referred to is that of the employee. However, the tax does not apply unless the distribution is includable in gross income. Further, the tax is on amounts received by the taxpayer. Therefore, if the tax applies at all, it is arguable that it is owed by the beneficiary of the nonparticipant spouse’s interest.

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65 IRC §408(e)(2)-(4).
66 IRC §4975(c)(1)(A) & (D).
67 IRC §414(p).
68 PLR 8820086. PLR 8735032. PLR 8929046. PLR 8007024.
69 Treas. Reg. §1.691(a)-4(b)(2).
70 IRC §72(t)(1).
3.13 **Beneficiary Designation Forms For the Nonparticipant.**

Occasionally one will encounter a beneficiary designation for the participant’s spouse to sign, the purpose of which is to dispose of the nonparticipant spouse’s community property interest in the plan or IRA. This is not the rule, but since it is just as likely that the nonparticipant will predecease the participant as it is the other way around, one is entitled to wonder why so much attention is paid to the participant’s beneficiary designation and so little attention is paid to the nonparticipant’s beneficiary designation. Recall that the beneficiary designation signed by the participant, even if consented to by the spouse, only addresses the disposition of benefits on the *participant’s* death.

If the nonparticipant does sign a beneficiary designation, is it effective? After all, the nonparticipant’s interest is ordinarily a probate asset. Can it be made a nonprobate asset simply by signing an unwitnessed piece of paper? What about the statute of wills? Can the formalities required of a will be dispensed with so easily?

If the beneficiary designation is a survivorship agreement in community property, Part 3 of Chapter XI of the Texas Probate Code, §§451-462, may govern. §452 provides that “spouses may agree between themselves that all or part of their community property then existing or to be acquired, becomes the property of the surviving spouse on the death of that spouse” if certain very basic conditions are met. The only substantive requirement is that the agreement be in writing and be signed by both of the spouses.\(^71\) If only one spouse signs the beneficiary designation it would not pass muster. Also, it might be necessary to make it clear that the designation rises to the level of an “agreement.”

If the beneficiary designation is not technically a “survivorship agreement” then §450 of the Probate Code may govern. §450(a) provides:

“(a) Any of the following provisions in an insurance policy, contract of employment, bond, mortgage, promissory note, deposit agreement, employees' trust, retirement account,\(^72\) deferred compensation arrangement, custodial agreement, retirement account, pension plan, trust agreement, conveyance of real or personal property, or any other written instrument effective as a contract, gift, conveyance, or trust is deemed to be nontestamentary, and this code does not invalidate the instrument or any provision:

“(1) that money or other benefits theretofore due to, controlled, or owned by a decedent shall be paid after his death to a person designated by the decedent in either the instrument or a separate writing, including a will, executed at the same time as the instrument or subsequently;

“(2) that any money due or to become due under the instrument shall cease to be payable in event of the death of the promisee or the promisor before payment or demand; or

“(3) that any property which is the subject of the instrument shall pass to a person designated by the decedent in either the instrument or a

\(^{71}\)Tex. Prob. Code §452.

\(^{72}\)Tex. Prob. Code §450(b)(3) provides that “retirement account” includes an IRA and a SEP.
3.14 **Is a Probate Order A QDRO.**

" separate writing, including a will, executed at the same time as the instrument or subsequently.” [Emphasis added.]