TAX TRENDS AND DEVELOPMENTS

Changing Beneficiary Designations

By Joseph W. Cunningham, JD, CPA

Two recent Court of Appeals decisions on disposition of (1) 401(k) account and (2) life insurance proceeds in disputes between decedents' estates and former spouses who were the named beneficiaries. *Patrick Estate v. Freedman,* Mich App No. 324438 (2/11/16); *Lett Estate v. Henson*, Mich App No. 326657 (3/17/16).

Facts - *Patrick Estate v Freedman* (Unpublished)

- During their marriage, H designated W beneficiary of his 401(k) plan account.
- In their 2007 consent judgment of divorce (JOD), it was provided that W be designated beneficiary for the amount assigned to her if H died before her share was segregated into an account for her.
- The JOD also provided – "Except as otherwise provided herein, any rights of either party as beneficiary in any policy or contract of life, endowment or annuity insurance of the other, as beneficiary, are hereby extinguished."
- And further – "Except as otherwise stated herein, each party shall retain exclusively any retirement benefits to which they are or shall become entitled to due to their employment, and any claim thereto by the other as beneficiary or otherwise is extinguished."
- H died in 2014 without having changed the beneficiary designation.
- At W's request, the plan administrator distributed the proceeds of H's 401(k) account to her.
- H's estate filed a complaint claiming that she was not entitled to the 401(k) account.
- The trial court ruled that while it was proper for the plan to distribute the 401(k) account proceeds to W, the beneficiary on record, but, under the terms of the JOD, she did not have the right to retain them.
- W appealed.

Court of Appeals Decision

- The Court noted the U.S. Supreme Court case of *Egelhoff v Egelhoff,* 532 US 141 (2001), which held that under the Employee Retirement Income Security Act (ERISA) a plan administrator must pay plan benefits to the named beneficiary.
- But, the Court cited two previous similar cases in which Michigan appellate courts held that, essentially, if a spouse's rights to the other's benefits are expressly extinguished in a divorce document, that such spouse does not have the right to retain funds received from a plan notwithstanding the beneficiary designation was not changed post-judgment. *Thomas v City of Detroit Retirement System,* 246 Mich App 155 (2001) and *Sweebe v Sweebe,* 474 Mich 151 (2006).

- Thus, the Court upheld the trial court's ruling.

Facts - Lett Estate v Henson (Published)

- During marriage, W was designated beneficiary of H's $120,000 group term life insurance policy provided by his employer.
- Their divorce judgment (JOD) provided that rights either had in the other's policy or contract of insurance was canceled.
- After their divorce, H removed W as beneficiary of the policy.
- As part of their divorce settlement, H was obligated to pay W $28,500 and to maintain insurance of not less than $28,500 to secure the obligation in the event of his death.
- W initiated contempt proceedings against H on his default on the $28,500 obligation, including the failure to provide the required insurance coverage.
- In connection with curing his default in these proceedings, H named W beneficiary of the $120,000 policy.
- H paid off the $28,500 obligation before he died in 2014, but had not changed the beneficiary designation.
- The $120,000 death benefit was paid to W, again, as named the beneficiary.
- H's estate filed suit claiming that H had satisfied his divorce obligations and, hence, in view of the express terms of the JOD, pursuant to MCL 552.101(3), W was not entitled to retain the proceeds.
- The probate court ruled on behalf of the estate.
- W appealed.

Court of Appeals Decision

- The Court reversed the probate ruling, finding for W, stating that MCL 552.101(3) – which includes the requirement that all divorce judgments provide for disposition of rights to insurance policies – did not apply to H's post-judgment beneficiary designation.
- The Court also noted the 1970 Michigan Supreme Court case, *Starbuck v City Bank & Trust Co.*, 384 Mich 295 (1970), in which the Court stated that MCL 552.101(3) "does not prohibit the husband or the divorce judgment itself from retaining or renaming the wife as the primary beneficiary. It simply requires an affirmative action on the part of the court or husband to retain the wife as the primary beneficiary."

Comments on the Cases

- In *Patrick Estate v Freedman,* it is made clear that it is vital to appropriately provide for disposition of rights to and in any insurance policy or retirement benefit. This should include a constructive trust provision, such as the following used in *Patrick Estate v Freedman*, but, of course, adapted to specifics of a particular case:

  "If due to omission or commission by either party, on the death or disability of either party, prior to implementation and satisfaction of the entire terms of this Judgment, the other party does not receive an asset or other benefit that he or she was intended to receive under the terms of this Judgment, then the person or entity that receives or holds that asset or benefit shall do so in a constructive trust for the benefit of the party who was the intended recipient of that asset or benefit under this Judgment. The parties intend that this clause be binding on their estates, heirs, and assigns."

- But, because ERISA requires an insurance company or plan administrator to pay proceeds to the beneficiary on record, it is also vital to change beneficiary designations post-divorce. This will avoid proceedings necessary to have the funds paid to the decedent's intended recipient. This should be on a lawyer's checklist of follow-up items provided to clients after a divorce.

About the Author

Joe Cunningham *has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy though his practice is statewide.*