

ERISA Beneficiaries, Spousal Rights, and QDROs: Protecting Your Retirement Legacy

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This presentation has been created based on all laws, regulations, and administrative materials as of November 16, 2023.



Legal framework

- Employee Retirement Income Security Act of 1974, as amended
- Puerto Rico Internal Revenue Code of 2011, as amended
- United States Internal Revenue Code of 1986, as amended
- The Puerto Rico Trust Act of 2012
- U.S. and P.R. Supreme Courts decisions
- Government Agencies
 - The Puerto Rico Treasury Department
 - The US Department of Labor
 - The US Internal Revenue Service



Qualified Domestic Relations Orders (“QDROs”)



Legal Background

The QDRO exemption to the anti-assignment and anti-alienation rules in ERISA applies to all plans in Puerto Rico, whether dual qualified or Puerto Rico only qualified. QDRO is one of the limited exceptions. Common QDRO problems, answers, deadlines, etc. are the same in Puerto Rico as in the United States. Practical difference is that proceedings in local courts are regularly held in Spanish.



Legal Background (cont.)

QDRO rules can be found in:

- ERISA Section 206(d)(3)
- Internal Revenue Code Section 414(p)



What is a QDRO?

A “domestic relations order” that creates or recognizes the existence of an “alternate payee’s” right to receive or assigns to an alternate payee the right to receive, all or a portion of the benefits payable with respect to a participant under a plan, which includes certain information and meets certain statutory requirements.



What is a Domestic Relations Order (“DRO”)?

Judgment, decree, or order

- Issued by a court, or any state agency or instrumentality
- Made pursuant to a state domestic relations law
- Can be included as part of a divorce decree or court approved property settlement, or issued as a separate order



What is a Domestic Relations Order (“DRO”)? (cont.)

Relates to the provision of:

- Child support
- Marital property rights

Can assign rights under more than one plan of the same or different employers.



What is a Domestic Relations Order (“DRO”)? (cont.)

- No requirement that both parties to a marital proceeding sign, endorse, or approve an order. On the other hand, parties’ signatures do not make the settlement a DRO.
- There is no need for the plan to be brought into state court or made a party to a domestic relations proceeding for an order issued in that proceeding to be a DRO or QDRO.
- Plans are not required to determine validity of QDRO under local state law.
- Plans **ARE NOT PERMITTED** to follow terms of DROs unless they are QDROS.



Who determines whether a DRO is a QDRO?

- The plan.
- The U.S. DOL takes the view that a state court (or other state agency or instrumentality with the authority to issue DROs) does not have jurisdiction to determine whether an issued DRO constitutes a QDRO. In the view of the DOL, jurisdiction to challenge a plan administrator's decision about the qualified status of an order lies exclusively in federal court.



Who can be an “Alternate Payee”?

- Spouse
- Former Spouse
- Child
- Dependent of participant
- If alternate payee is a minor or legally incompetent, the order can require payment to someone with legal responsibility.



What information must a DRO contain to qualify as a QDRO under ERISA

QDROs must contain the following information:

- The name and last known mailing address of the participant and each alternate payee
- The name of each plan to which the order applies
- The dollar amount or percentage (or the method of determining the amount or percentage) of the benefit to be paid to the alternate payee
- The number of payments to be made to the alternate payee or period to which the order applies
- Special consideration for social security numbers



Are there other requirements that a DRO must meet to be a QDRO?

There are certain provisions that a QDRO cannot contain:

- The order must not require a plan to provide an alternate payee with any type or form of benefit, or any option, not otherwise provided under the plan
- The order must not require a plan to provide for increased benefits (determined on the basis of actuarial value)
- The order must not require a plan to pay benefits to an alternate payee that are required to be paid to another alternate payee under another order previously determined to be a QDRO
- The order must not require a plan to pay benefits to an alternate payee in the form of QJSA for the lives of the alternate payee and his or her subsequent spouse



May a QDRO be part of the divorce decree or property settlement?

There is nothing in ERISA or the U.S. Internal Revenue Code that requires that a QDRO be issued as a separate judgement, decree, or order. Accordingly, a QDRO may be included as part of a divorce decree or court-approved property settlement, or issued as a separate order, without affecting its qualified status.

The order must otherwise satisfy the requirements described above to be a QDRO.

A DRO that provides child support or recognizes marital property rights may be a QDRO, without regard to the existence of a divorce proceeding.



Plan administration when dealing with QDROs

Concepts to consider:

- QDRO procedures in writing / model orders
- Provide information to parties of balances
- Suspend payments/restrict loans and distributions
- May charge reasonable expenses against participant's account in the case of DC plans
- Appeal procedures / interpleader
- Outsourcing



Plan administration when dealing with QDROs (cont.)

General Outline of QDRO Process

- Administrator receives DRO/freeze of accounts
- Administrator notifies participant and alternate payee of receipt of order
- Administrator provides copy of procedures to alternate payee and participant
- Administrator determines whether DRO is a QDRO
- Notice of QDRO determination and offer final period for comments.
- Follow QDRO if qualified.



Taxation of benefits

Distributions to alternate payees under a QDRO are generally subject to the same local tax rules that apply to distributions to participants, but they are taxable income to the alternate payee, not the participant.

The paying agent for the plan should process distributions to the alternate payee just as it would if the distributions were going to be made instead to the participant, but it would prepare the corresponding PRTD Form 480.7C in the alternate payee's name.

The alternate payee has to include the distributions in gross income to the same extent as the participant would have been required to do so if the same distributions were made to the participant.



Taxation of benefits (cont.)

There is an exception to this general rule in the case of distributions to an alternate payee under a QDRO, be it the participant's spouse, ex-spouse, or dependent, on account of the payment of child support for the participant's minor children. Even though those distributions are made to the alternate payee, they must be reported as taxable income to the participant.

In order for the aforementioned exception to apply, the QDRO must expressly designate the payment to the alternate payee as one made on account of the participant's child support obligations for his or her minor children.

Local tax rules make no distinctions between spousal and non-spousal beneficiaries. They are subject to exactly the same set of rules, including rollover rights.



Beneficiaries - Who will be the recipient of a deceased participant's benefits?



Estate and inheritance

As a general rule, the heirs as established by will or as set forth by the Puerto Rico Civil Code inherit the remaining rights and property of a deceased person after outstanding debt is discounted.

However, Article 71 of the Puerto Rico Trust Act of 2012 provides that all the assets in a retirement plan trust will be exempt from the estate and inheritance provisions of the Puerto Rico Civil Code.

Accordingly, the filing of court proceedings will not be necessary to distribute the plan assets to the beneficiary designated under the terms of the retirement plan.

Thus, a beneficiary designation in a retirement plan determines who will receive the benefits upon the participant's death.



What happens if there is no beneficiary designation, or if the named beneficiary predeceases the participant?

Retirement plans provide a default distribution provision that attempts to predict the distribution method that most people would want.

This default distribution might provide that the account goes to the surviving spouse, or in the absence of a spouse, the participant's children. However, many retirement plans provide that in the event there is no beneficiary designation, then the account is payable to the participant's estate.



Spousal Rights

ERISA and PR law provide certain protections and rights for spouses regarding retirement plan benefits. These rights are intended to protect a spouse's interest in retirement benefits accumulated during the participant's employment.

If the participant is married and dies, federal and local law require for the deceased participant's spouse to be the beneficiary, unless the participant designates someone else with the surviving spouse's consent which shall be granted in compliance with ERISA.

Special case of Keogh Plans.

Spousal Consent

Section 205 of ERISA defines spousal consent as an agreement by the spouse of a married participant to an action by the participant that affects the participant's qualified retirement plan account. Consent is generally given by completing and signing a section of an applicable administrative form and having that consent notarized by a licensed notary or witnessed by a plan representative.

In all types of qualified retirement plans a spouse must give consent if a married participant is changing the designated beneficiary to someone other than the spouse.

However, spousal consent will not be needed if it is established to the satisfaction of a plan representative that the consent required under subparagraph may not be obtained because there is no spouse, because the spouse cannot be located, or because of such other circumstances as the Secretary of the U.S. Treasury may by regulations prescribe.

Any consent by a spouse (or establishment that the consent of a spouse may not be obtained) shall be effective only with respect to such spouse.



Common Pitfalls and Challenges

- Failing to update beneficiary designations after major life events. For example, marriage, divorce, birth, or death of a family member.
- Designating a minor child as a direct beneficiary without establishing a trust. Age and maturity of beneficiaries should be considered.
- Neglecting to review and update beneficiary designations periodically.
- Importance of updating beneficiary designations after a divorce to reflect the participant's current wishes.
- Tax consequences for beneficiaries.



Case Studies and Examples

- A divorced participant dies without designating a beneficiary.
 - Who will be the beneficiary?
- A participant designates a primary beneficiary but fails to designate a contingent beneficiary.
 - Who will be the beneficiary if the primary beneficiary predeceases the participant?
- A participant designated her children as beneficiaries, then got married.
 - Who will be the beneficiary(ies) upon the participant's demise?



Case Studies and Examples (cont.)

- Participant A got married in 2001. Designated his spouse as a beneficiary in his qualified retirement plan after completing the appropriate form. Such designation was never revoked. Then, in 2011 underwent a divorce procedure. As part of the divorce settlement, the court approved for the former spouse to be entitled to 50% of Participant A's account balance in the plan as of the divorce's effective date. Thereafter, Participant A remarried in 2015 but failed to name the new spouse as a beneficiary pursuant to the qualified retirement plan's administrative procedures. Participant A sadly passed away in 2016.
 - Who will be entitled to receive the plan benefits?



Best Practices

- Have updated and clear QDRO procedures in place.
- Reinforce with participants and administrators the importance of beneficiary designation and spousal rights.
- Educate participants about beneficiary designation rules and QDROs.
- Collect and maintain accurate beneficiary designations.
- Assist participants with updating their beneficiary designations.



Questions?



Thank you!

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