



A **BIG MISTAKE** OBSERVED

-THE 401K BENEFICIARY TRAP-

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I have often said that attaining financial well-being is as much a function of doing the right things as it is avoiding the wrong things. Think about it. You do nearly everything right year after year, accumulate a healthy nest egg, pay down debt, and inevitably arrive on freedom's doorstep.

But then, one single **BIG MISTAKE** completely wrecks the party, throwing you back 10-15 years. Maybe it's investing in your idiot brother's "can't fail" business idea. Or perhaps a charismatic leader convinces you the world is ending on December

20th next year, and the only sensible way to prepare is by eliminating all equity positions and load up on gold coins – which has always made complete sense to me. I mean, what would a starving post-apocalyptic survivor want more than clean water and food? Why, gold bullion of course!

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I recently experienced a real-life *BIG MISTAKE-moment* with an attorney client. He called, not as a client, but instead seeking my opinion on a case he was working on. Here's the scoop:

- 20 years ago, an unmarried man had a 401k and named his only son as beneficiary
- Last year, the man remarried and DID NOT change the beneficiary because he wanted his son to inherit the account. He even went so far as to explain this to his new bride. She was fine with the arrangement. She understood the money existed before her and that the man wished to provide for his only child.
- This past summer, the man died after **eight months** of marriage.
- At the time of his death the value of the 401k was \$200,000.

NOW, WHO GETS THE 401K?

ANSWER: The new wife. **Period.**

You see, 401k plans are governed by the 1974 ERISA Law. This makes all ERISA retirement plans subject to certain Federal regulations, such as the inability to disinherit a spouse. *This is true even if you have executed a prenuptial agreement that specifically addresses retirement accounts.* The only way to give your 401k to someone other than your spouse, is to have the current spouse sign a “spousal waiver” which typically must be notarized. You can get this form from the 401k’s plan administrator. Other than that, there’s no way out.

By the way, a spouse who does sign a waiver can withdraw that consent if the other spouse later names a different beneficiary, unless the signing spouse expressly gave up that right. (IRC§ 417(a)(2))

To further clarify, ERISA plans – also referred to as *Qualified Plans* – include 401ks, cash balance plans, defined-benefit (aka: pension), profit-sharing plans, deferred-compensation plans, and certain non-governmental 403b plans. Generally, Government employee plans are NOT subject to the ERISA guidelines.

Remember the new wife in our story? Well, she suddenly had a change of heart, and apparently a lapse in memory. After her husband of five minutes died, she now has no recollection of agreeing that the son should get the money. And, guess what? She is on solid legal ground. The son has no recourse. And just like that, the ramifications of the man’s BIG MISTAKE commence, albeit postmortem. Tragically, it would have taken 3 minutes to sign a simple form in route to protect his son’s inheritance.

WHAT ABOUT IRAs?

IRAs are governed by state law. If you don’t live in a community property state, you are free to name whoever the heck you want (if you’re reading this, you likely don’t live in a community property state, as most of these states are in the Western part of the country). Therefore, it’s typically much easier to navigate beneficiary issues with IRAs. So, the short answer is that **you can pretty much name whoever you want as the beneficiary of your IRA.**

Keep in mind, that most states won’t allow someone to completely disinherit a spouse of all property (this means *ALL* property – not just the IRA) without written consent. Therefore, the

surviving spouse can always go to court and claim whatever share of the total property that state law gives them. So, in theory, it's quite possible to disinherit a spouse on an IRA only to have them get a portion of the money in the end. This would be plausible if the IRA constitutes a large portion of the deceased spouse's property because the state's law may take IRA funds into account when determining how much the survivor can claim.

The surviving spouse can always go to court and claim whatever share of the total property that state law gives them.

Now, it's time to pull all those retirement accounts and look over your beneficiary designations. Are the right people listed? Have you gotten necessary consent where needed? Don't let this be a "BIG MISTAKE" moment for you and your family. If you're unsure about whether the right people are listed and/or whether your current designations are in line with your estate plan, you should seek the counsel of an *estate* planning attorney. Or give our office a call and we'll be happy to review everything with you.

Hope you enjoyed the "light" reading!

Sincerely,



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