

Required Spousal Annuities Under Qualified Retirement Plans

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I. Introduction

A qualified retirement plan must generally provide a lifetime annuity to an employee's surviving spouse, unless the employee and spouse agree to waive the annuity. If they waive the annuity, payment of plan benefits depends on other available plan options. This article discusses the spousal annuity requirements and the tax consequences of receiving or waiving a spousal annuity. The article views the requirements primarily from the perspective of employees and their spouses. For convenience, brief definitions of some of the more common terms used in this article are set forth in the appendix (although most readers will already be familiar with the terms).

II. Spousal Annuity Requirements

Spousal annuity requirements apply to qualified plans generally — but with some exceptions.¹ Under one major exception, the requirements generally do not apply to plans of governments, churches, or tax-exempt associations of churches.² Nor do the requirements generally apply to an employee in a profit-sharing or stock bonus plan if certain conditions are satisfied (discussed in more detail below).³ Some other minor exceptions may also be applicable. For example, the spousal annuity requirements generally do not apply to plans allowing only employee contributions, nor do they apply to the extent a plan provides for the payment of cash in lieu of an annuity worth \$5,000 or less.⁴

If spousal annuity requirements apply, an employee's entire interest in a plan is generally subject to those

requirements. Thus, for such a plan, spousal annuity requirements will apply to funds rolled over to the plan whether or not the funds were subject to those requirements in the transferring plan or IRA.⁵ The requirements will also apply to designated Roth accounts in the plan.⁶ However, the requirements generally do not apply to accrued benefits in an employee stock ownership plan that the employee may take in the form of employer securities or their cash value, if the conditions discussed below are satisfied.⁷

A plan subject to spousal annuity requirements must make provisions for two different types of annuities: (1) a qualified joint and survivor annuity (QJSA) and (2) a qualified preretirement survivor annuity (QPSA).⁸ A QJSA is the applicable form if an annuity starts before the employee's death. A QPSA is the applicable form if the annuity starts after the employee's death.⁹ For either type of annuity, a plan may be able to satisfy its obligation by directly paying the annuity or by purchasing and distributing an annuity contract payable by a third party.¹⁰ However, if the plan distributes a purchased annuity contract, the contract must itself continue to qualify as a QJSA or QPSA.¹¹

A. Qualified Joint and Survivor Annuity

A QJSA is an annuity payable to an employee for the employee's lifetime and, after the employee's death, to his spouse for the spouse's lifetime.¹² An employee may request payment of a QJSA at the employee's earliest retirement age, defined as the earliest date the employee may elect to receive any distribution. For example, the earliest retirement age may be the date of an in-service distribution, the date of the employee's separation from service, the date of the employee's death, or an early retirement date — if the plan allows distributions on those dates.¹³

The amount of the annuity payments to a surviving spouse under a QJSA may range from 50 percent to 100 percent of the amount of the payments to the employee during the joint lives of the employee and spouse.¹⁴ The exact percentage is determined by the terms of the plan.

1. QJSA requirements regarding value, marriage, and so on. A QJSA must be "actuarially equivalent" to a lifetime

¹Section 401(a)(11); 29 U.S.C. section 1055(a) and (b); reg. section 1.401(a)-20, Q&A 3.

²Sections 401(a) (last sentence), 411(e)(1), 414(d), 414(e); 29 U.S.C. sections 1002(32) and (33), 1003(b)(1) and (2). However, churches may irrevocably elect spousal annuity coverage (and some other requirements normally not applicable). Sections 411(e)(1), 410(d); reg. section 1.410(d)-1(a).

³See text accompanying notes 144 through 156 *infra*.

⁴Sections 401(a) (last sentence), 411(e)(1)(C) and (D), 417(e)(1); 29 U.S.C. section 1055(g).

⁵Reg. section 1.401(a)-20, Q&A 11.

⁶Reg. section 1.401(k)-1(f)(4)(i).

⁷See text accompanying notes 157 through 159 *infra*.

⁸Section 417(b), (c); 29 U.S.C. section 1055(d), (e).

⁹Section 401(a)(11)(A); 29 U.S.C. section 1055(a).

¹⁰Reg. section 1.401(a)-20, Q&A 1.

¹¹Reg. sections 1.401(a)-20, Q&A 2, 1.417(e)-1(e).

¹²Section 417(b); 29 U.S.C. section 1055(d).

¹³Reg. section 1.401(a)-20, Q&A 17.

¹⁴Section 417(b)(1); 29 U.S.C. section 1055(d)(1).

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annuity payable to the employee alone. Thus, the QJSA must have a present value that is at least equal to the present value of a single life annuity available to the employee.¹⁵ If the plan does not offer a single life annuity to a married employee, the plan presumably must make the comparison to a single life annuity available if the employee were unmarried. In any event, the present values must be determined using consistent actuarial factors.¹⁶

The actuarial equivalence requirement does not impose a ceiling on the value of a QJSA. The regulations require only that the QJSA for a married employee be at least as valuable as any alternative form of plan benefit. Thus, a QJSA may be more valuable than alternative forms of benefit,¹⁷ and the code expressly recognizes that employers may further increase the relative value of a QJSA by subsidizing it.¹⁸

A plan may provide that QJSA benefits are available to a surviving spouse only if (1) the employee has been married for at least one year before the employee's death or divorce and (2) the marriage period includes the annuity starting date.¹⁹ If QJSA payments have begun but the employee's marriage terminates before satisfaction of the one-year period, the plan may terminate the spouse's survivor benefits. However, the plan may not retroactively correct QJSA payments already made to the employee.²⁰ Nevertheless, the plan would presumably recompute any later payments based solely on the life expectancy of the employee.

The current QJSA rules generally apply to an employee only if the employee had at least one hour of service, or one hour of paid leave, after August 22, 1984.²¹ However, similar spousal benefit rules applied to employees retiring in earlier years.²² Special effective date rules apply to plans under collective bargaining agreements.²³

2. When a plan must commence QJSA payments. Unless a plan provides for an earlier commencement of a QJSA, the plan must generally begin paying the QJSA by the 60th day after *all* the following conditions are satisfied:

- the employee has completed 10 years of participation in the plan;²⁴
- the employee has reached age 65, or the plan's normal retirement age if earlier;²⁵ and
- the employee has terminated service with the employer sponsoring the plan.²⁶

A plan may nevertheless require an employee to file a claim for benefits before receiving payments.²⁷ Conversely, a plan may allow an employee to elect in writing to delay further the commencement of payments, if the delay would not cause the benefits passing at death to become more than "incidental" to the payment of retirement benefits.²⁸ Fortunately, however, this incidental benefit rule does not apply to a QJSA that otherwise satisfies minimum distribution requirements, discussed in some detail below.²⁹

Despite the payout requirements, a plan generally may not commence payments under a QJSA without the written consent of the employee as long as the plan benefit is what the regulations call "immediately distributable."³⁰ Somewhat counterintuitively, the plan may commence payment of the QJSA without consent when the benefit ceases being immediately distributable. That status ceases when the employee attains the later of age 62 or the plan's normal retirement age (but not later than age 65 for an employee with at least five years participation in the plan).³¹ In no event, however, is the consent of the employee's spouse required for the commencement of payments under a QJSA.³²

If a plan provides early retirement benefits, a separated employee who satisfies all the requirements except the age requirement is entitled to a QJSA when he or she reaches the early retirement age. However, the plan need provide only a QJSA benefit that is equal to the normal retirement benefit actuarially reduced for early payment.³³ Fortunately, the 10 percent penalty on early distributions does not apply to those QJSA payments.³⁴

Nevertheless, the tax law imposes an overriding requirement that a qualified plan begin paying a QJSA (or other minimum benefit) by a specified date regardless of the wishes of the employer or employee and regardless of the terms of the plan.³⁵ As discussed in more detail below,³⁶ the beginning date is normally April 1 of the

²⁷Reg. section 1.401(a)-14(a).

²⁸Reg. section 1.401(a)-14(b).

²⁹Reg. section 1.401(a)(9)-6, Q&A 2(b).

³⁰Reg. sections 1.411(a)-(11)(c)(7), 1.417(e)-1(b)(1). Consent is generally not valid unless made within 180 days of the commencement of payments and unless no significant detriment is imposed for failure to consent. Reg. section 1.411(a)(11)(c)(2)(i), (ii). Although the regulations make frequent reference to a 90-day period, Congress has instructed the IRS to substitute a 180-day period. P.L. 109-280, section 1102(a)(1)(B). Consent is not required if the nonforfeitable accrued benefit does not exceed \$5,000 (excluding rollover contributions if the plan so provides). Section 411(a)(11)(A) and (D).

³¹Section 411(a)(8); reg. section 1.417(e)-1(b)(1).

³²Reg. section 1.417(e)-1(b)(1), (c).

³³Section 401(a)(14); 29 U.S.C. section 1056(a).

³⁴Section 72(t)(2)(A)(iv), (3)(B); *Siano v. United States*, 948 F. Supp. 479, Doc 96-27030, 96 TNT 194-4 (W.D. Pa. 1996).

³⁵Reg. sections 1.401(a)(9)-8, Q&A 4, 1.411(a)-11(c)(7). Nor is employee or spousal consent required if the plan must make distributions to avoid violating section 415 or section 411(b). See reg. section 1.401(a)-20, Q&A 23.

³⁶See text accompanying notes 221 through 225 *infra*.

¹⁵Section 417(b)(2); 29 U.S.C. section 1055(d)(2).

¹⁶Reg. section 1.401(a)-11(b)(2), 1.401(a)(4)-12.

¹⁷Reg. section 1.401(a)-20, Q&A 16.

¹⁸Section 417(a)(5); 29 U.S.C. section 1055(c)(5).

¹⁹Section 417(d); 29 U.S.C. section 1055(f); reg. section 1.401(a)-20, Q&A 25(b)(2).

²⁰Reg. section 1.401(a)-20, Q&A 25(b)(2).

²¹Reg. section 1.401(a)-20, Q&A 39, Q&A 41.

²²Section 401(a)(11) (1983); reg. section 1.401(a)-20, Q&A 45.

²³Reg. section 1.401(a)-20, Q&A 40.

²⁴Section 401(a)(14)(B); 29 U.S.C. section 1056(a)(2).

²⁵Section 401(a)(14)(A); 29 U.S.C. section 1056(a)(1).

²⁶Section 401(a)(14)(C); 29 U.S.C. section 1056(a)(3).

year following (1) the calendar year the employee reaches age 70½ or (2) the calendar year the employee retires, if later.

The rules governing the timing of commencement of a QJSA (or other properly elected benefit) tend to overlap in a somewhat confusing way. The immediately following discussion integrates and summarizes the rules in a more understandable way for some of the more common types of situations. Each situation assumes that the employee has accumulated at least 10 years of service with the employer and has not waived the QJSA.

a. Retirement at a plan's normal retirement age. If an employee retires at a plan's normal retirement age, and if that age is less than 62, the plan may not commence payment of a QJSA without the consent of the employee until the employee reaches age 62.³⁷ If an employee retires at a plan's normal retirement age, and if that age is 62 or more, the plan must immediately commence payment of the QJSA unless the terms of the plan allow the retiring employee to elect a further deferral.³⁸ In any event, however, a deferred QJSA for a retired employee must commence by April 1 of the calendar year following the year the employee reaches age 70½.³⁹

b. Retirement at a plan's early retirement age. If an employee retires at a plan's early retirement age, the plan will ordinarily commence payment of an actuarially reduced QJSA. However, the plan must have employee consent to make payments if the employee has not yet reached the later of age 62 or normal retirement age (unless the employee is 65 or older).⁴⁰ When consent is no longer required, the plan must commence payment unless the terms of the plan allow the employee to elect a further deferral.⁴¹ However, the QJSA (or other benefit) must commence by April 1 of the calendar year following the year the employee reaches age 70½.⁴²

c. Separation before reaching early or normal retirement age. If an employee separates from service before a plan's early retirement age, the employee is ordinarily entitled to an actuarially reduced QJSA when he or she reaches early retirement age. If a plan has no provision for early retirement and an employee separates from service before normal retirement age, the employee is ordinarily entitled to a QJSA when he or she reaches the earlier of normal retirement age or age 65.⁴³ The actual commencement of a QJSA granted at early retirement age or a QJSA granted at normal retirement age is then subject to the same timing and consent rules discussed in the two immediately preceding paragraphs.⁴⁴

3. How QJSA payments are taxed. A portion of each QJSA payment may be nontaxable. The nontaxable por-

tion is generally equal to the employee's investment in the annuity as of the annuity starting date divided by the number of anticipated annuity payments.⁴⁵ The employee's investment in a QJSA is generally the employee's after-tax contributions to the cost of the annuity.⁴⁶ The number of anticipated payments depends on whether the plan makes the payments monthly, quarterly, semiannually, annually, and so on. For a QJSA providing monthly payments, the employee determines the number of anticipated payments from the following table by reference to the combined ages of the employee and his spouse.⁴⁷

If the combined ages of the employee and spouse are:	The anticipated number of payments is:
Not more than 110	410
More than 110 but not more than 120	360
More than 120 but not more than 130	310
More than 130 but not more than 140	260
More than 140	210

Thus, the nontaxable portion of each monthly annuity payment is equal to the employee's investment in the annuity divided by the number of anticipated payments found in the above table.

Example 1. Assume an employee has an investment of \$100,000 in a QJSA. Assume that the employee retires at age 62 on the annuity starting date and that the employee's spouse is age 57 on that date. Assume further that the QJSA pays \$3,000 per month for the lifetimes of the employee and surviving spouse. Then, \$277.78 of each monthly payment is not taxable. The employee computes the nontaxable amount by dividing the \$100,000 investment by the 360 payments found in the above table for annuitants with a combined age of 119 (the sum of the employee's age of 62 and the spouse's age of 57). Thus, if the annuity payment is \$3,000 per month, \$2,722.22 of each payment is taxable to the employee or surviving spouse (the \$3,000 payment less the nontaxable portion of \$277.78).

If the plan makes annuity payments at intervals other than monthly, the employee must adjust the nontaxable portion of each payment.⁴⁸

Example 2. If the plan made semiannual payments of \$18,000 in the above example (rather than monthly payments of \$3,000), the nontaxable portion of each

³⁷Reg. section 1.417(e)-1(b)(1).

³⁸Section 401(a)(14); 29 U.S.C. section 1056(a); reg. section 1.417(e)-1(b)(1).

³⁹Section 401(a)(9)(C)(i)(I); reg. sections 1.401(a)(9)-2, Q&A 2(a), 1.401(a)(9)-8, Q&A 4, 1.411(a)-11(c)(7).

⁴⁰Section 411(a)(8); reg. section 1.417(e)-1(b)(1).

⁴¹Section 401(a)(14); 29 U.S.C. section 1056(a); reg. section 1.417(e)-1(b)(1).

⁴²See note 39 *supra*.

⁴³Section 401(a)(14); 29 U.S.C. section 1056(a).

⁴⁴See text accompanying notes 37 through 42 *supra*.

⁴⁵Section 72(d)(1). The computation of the nontaxable portion of annuity payments is somewhat different under nonqualified plans and personally purchased annuities. See *Vorris Blankenship, "Retirement Tax Planning With Personally Purchased Annuities," Tax Notes*, Oct. 30, 2006, p. 459, *Doc 2006-20813, 2006 TNT 210-17*.

⁴⁶For a comprehensive discussion of employee investment in qualified plans, see *Blankenship, "Determining Taxpayer Investment in Retirement Plans and IRAs," Journal of Retirement Planning*, Mar.-Apr. 2006, at 17.

⁴⁷Section 72(d)(1)(B)(iv).

⁴⁸Section 72(d)(1)(F); Notice 98-2, 1998-1 C.B. 266, *Doc 97-33671, 97 TNT 242-4*.

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semiannual payment would be \$1,666.68. The employee computes the \$1,666.68 nontaxable amount by multiplying the \$277.78 nontaxable amount determined above for monthly payments by the six months in a semiannual period. The taxable portion of each semiannual annuity payment is \$16,333.32 (the \$18,000 payment less the nontaxable portion of \$1,666.68).

An employee and surviving spouse must use the same method to compute the nontaxable portion of QJSA payments even if the spouse receives lifetime annuity payments of a different amount than the employee. A common example of such a QJSA is a joint and 50 percent survivor annuity, illustrated as follows:

Example 3. Assume an employee has an investment of \$100,000 in a QJSA. Assume the employee receives payments of \$3,000 per month and, after the employee's death, the surviving spouse receives payments of \$1,500 per month. Further assume that the employee retired at age 62 on the annuity starting date and that the employee's spouse is age 57 on that date.

Then, \$277.78 of each monthly payment to the employee or surviving spouse is nontaxable. The employee or spouse computes the nontaxable amount by dividing the \$100,000 investment by the 360 payments provided in the above table for annuitants with a combined age of 119 (the sum of the employee's age of 62 and the spouse's age of 57). Thus, \$2,722.22 of each monthly payment to the employee is taxable (the \$3,000 payment less the nontaxable portion of \$277.78). After the employee's death, \$1,222.22 of each monthly payment to the surviving spouse is taxable (the \$1,500 payment to the spouse less the nontaxable portion of \$277.78).

(Caution: If an employee's QJSA started before January 1, 1998, the employee and surviving spouse must continue to compute the nontaxable amount using the computation method applicable before that date.⁴⁹)

4. Recovered and unrecovered investment in a QJSA. If an employee and his spouse live long enough to receive all the anticipated number of lifetime annuity payments, they will have fully recovered the employee's investment. Thereafter, the employee or spouse must pay tax on the entire amount of each annuity payment.⁵⁰

If the employee and his spouse do not live long enough to receive all the anticipated number of payments, they will not have recovered all the investment. In that case, the unrecovered investment is generally deductible as an itemized deduction on the final tax return of the last of them to die.⁵¹ The personal representative of the last survivor computes the unrecovered investment by subtracting the sum of the nontaxable portions of previous payments from the original investment.⁵²

Nevertheless, the unrecovered investment is not deductible if the plan must still make a minimum number of guaranteed payments.⁵³ Rather, the individual receiving the guaranteed payments may exclude those pay-

ments from taxable income until he or she has recovered the entire remaining investment. Then, he or she must pay tax on the remaining amount of the guaranteed payments.⁵⁴

(Caution: If the annuity started before July 2, 1986, the employee and spouse are not allowed a deduction for unrecovered investment.⁵⁵)

B. Qualified Preretirement Survivor Annuity

If an employee dies before his annuity starting date and the spousal annuity rules apply, a qualified plan must provide the surviving spouse with a QPSA.⁵⁶ A QPSA is an annuity payable to the surviving spouse for his lifetime that satisfies certain other requirements discussed in more detail below. Before a plan participant reaches age 35, the plan must generally provide the participant with an explanation of any QPSA that is not fully subsidized. However, if an employee later becomes a plan participant or a QPSA later ceases to be fully subsidized, the plan must provide an explanation of the QPSA within a reasonable period thereafter.⁵⁷

1. QPSA requirements regarding payments, marriage, and so on. The amount and timing of QPSA payments depend on whether the plan is a defined benefit plan⁵⁸ and whether the employee's death occurs on or before his earliest retirement age.⁵⁹ The earliest retirement age is the earliest date the employee could elect to receive retirement benefits.⁶⁰ Depending then on the type of plan and the employee's earliest retirement age, a surviving spouse's QPSA will fall into one of the following three categories:

a. The qualified plan is a defined benefit plan and the employee's death occurs after the employee's earliest retirement age. The QPSA is determined as if the employee had retired one day before death with a hypothetical QJSA starting immediately. The surviving spouse is then entitled to QPSA payments in an amount ranging from 50 percent to 100 percent of the payments the employee would have received under the hypothetical QJSA if the employee had lived. The exact percentage is determined by the terms of the plan.⁶¹

b. The plan is a defined benefit plan and the employee's death occurs on or before the employee's earliest retirement age. The QPSA is determined as if the employee had not died but had merely separated from service at death (or actual separation if earlier) — surviving thereafter to receive a hypothetical QJSA starting on the employee's earliest retirement date. Then, based on the further assumption that the employee died the day after his earliest retirement date, the surviving spouse receives payments ranging from 50 percent to 100 percent

⁵⁴Section 72(e)(5)(A), (E).

⁵⁵P.L. 99-514, section 1122(h)(2)(B).

⁵⁶Section 401(a)(11)(A)(ii); 29 U.S.C. section 1055(a)(2).

⁵⁷Reg. section 1.401(a)-20, Q&A 35. For the definition of fully subsidized QPSA, see text accompanying note 135 *infra*.

⁵⁸Section 414(i), (j).

⁵⁹Section 417(c); 29 U.S.C. section 1055(d).

⁶⁰See note 13 *supra*.

⁶¹Section 417(c)(1)(A)(i); 29 U.S.C. section 1055(e)(1)(A)(i); reg. section 1.401(a)-20, Q&A 18.

⁴⁹P.L. 105-34, section 1075(a).

⁵⁰Section 72(d)(1)(B)(ii), (b)(2).

⁵¹Sections 72(d)(1)(B)(ii), 72(b)(3)(A), and 67(b)(10).

⁵²Section 72(b)(4).

⁵³Section 72(b)(3)(B).

of the QJSA payments the employee would have received. The exact percentage is determined by the terms of the plan.⁶²

c. The plan is a defined contribution plan. The QPSA is a lifetime annuity for the spouse with a specified minimum present value. The minimum value is an amount that is at least 50 percent of the nonforfeitable balance of the employee's plan account. However, the terms of the plan may provide a QPSA with a value greater than the minimum.⁶³

For defined benefit plans, the hypothetical QJSA must be "actuarially equivalent" to a lifetime annuity payable to the employee alone. The plan applies this requirement by ignoring the employee's death and assuming the employee had a normal life expectancy. (See above for the QJSA discussion of actuarial equivalence.⁶⁴)

Both defined benefit plans and defined contribution plans must treat amounts forfeitable solely because of an employee's death as if they were nonforfeitable for purposes of funding a QPSA.⁶⁵ Thus, a defined contribution plan must offset the cost of a QPSA ratably against amounts forfeitable solely because of an employee's death and nonforfeitable amounts such as employee and section 401(k) contributions.⁶⁶ The employee may designate another beneficiary to receive the remaining amount of the nonforfeitable balance.⁶⁷ However, the remaining forfeitable balance is truly forfeited.

Nevertheless, if a surviving spouse dies before a QPSA starts, a defined benefit plan may provide for forfeiture of funds the plan would have used for the QPSA. However, a defined contribution plan cannot allow such a forfeiture.⁶⁸ In either case, however, any unforfeited funds remaining in the plan will presumably become an asset of the surviving spouse's estate if the spouse is the sole beneficiary under the plan. The disposition of the unforfeited funds is not as clear if the spouse is not the sole beneficiary (for example, if the employee designated up to half the funds in a defined contribution plan for payment to a nonspouse beneficiary rather than for purchase of the spouse's QPSA).

A plan may provide that a QPSA is available only if the employee has been married for at least one year before his death.⁶⁹ Also, the QPSA rules apply only if an employee had at least one hour of service, or one hour of paid leave, after August 22, 1984.⁷⁰ However, some earlier participants in the plan may elect the QPSA rules if they had at least one hour of service in a plan year beginning after January 1, 1976, and before August 23,

1984.⁷¹ Special effective date rules apply to plans under collective bargaining agreements.⁷²

2. When a plan must commence QPSA payments. A defined contribution plan must allow a surviving spouse to start QPSA payments within a reasonable time after the employee's death.⁷³ Somewhat similarly, a defined benefit plan *may* allow a surviving spouse to start QPSA payments after the employee's death. However, the defined benefit plan *must* allow the spouse to start the payments at least by the month the deceased employee would have reached the earliest retirement age.⁷⁴ If the employee dies after the earliest retirement age, the surviving spouse should be able to start the payments within a reasonable time (although the regulations are silent on this point).

However, any qualified plan can begin payment of a QPSA without spousal consent after the date the deceased employee would have reached the later of normal retirement age or age 62. However, the plan need not wait any later than when the employee reaches age 65.⁷⁵ Ultimately, however, the plan *must* begin paying the QPSA by a specified date, regardless of a surviving spouse's wishes or the terms of the plan. The specified date is generally the first full calendar year following the employee's death or, if later, the calendar year the employee would have reached age 70½.⁷⁶

The following two examples illustrate the rules governing commencement of a QPSA. Each example assumes that the employee dies while employed at age 55, that the plan's early retirement age is 58, and that the employee has not waived the QPSA.

Example 1: QPSA payable by a defined benefit plan with a normal retirement age of 65. The plan *may* allow a surviving spouse to elect to begin QPSA payments immediately after the employee's death. In any event, however, the plan *must* allow the spouse to elect to begin the payments no later than the date the deceased employee would have reached the early retirement age of 58.⁷⁷ If the spouse does not start the payments, the plan *can* start them when the deceased employee would have reached age 65 (the later of age 62 or the employee's normal retirement age of 65).⁷⁸ In any event, however, the QPSA payments *must* commence by the end of the calendar year the employee would have reached age 70½ (since that date is later than the end of the calendar year following the employee's death).⁷⁹

Example 2: QPSA payable by a defined contribution plan with a normal retirement age of 60. The plan *must*

⁶²Section 417(c)(1)(A)(ii); 29 U.S.C. section 1055(e)(1)(A)(ii); reg. section 1.401(a)-20, Q&A 18.

⁶³Section 417(c)(2); 29 U.S.C. section 1055(e)(2).

⁶⁴Section 417(c)(1)(A)(i) and (ii), 417(b); 29 U.S.C. section 1055(e)(1)(A)(i) and (ii), 1055(d). See text accompanying notes 15 through 18 *supra*.

⁶⁵Reg. section 1.401(a)-20, Q&A 10(b)(4), Q&A 13.

⁶⁶Reg. section 1.401(a)-20, Q&A 20.

⁶⁷Reg. section 1.401(a)-20, Q&A 4.

⁶⁸Reg. section 1.401(a)-20, Q&A 19.

⁶⁹Section 417(d)(1); 29 U.S.C. section 1055(f)(1); reg. section 1.401(a)-20, Q&A 25(b)(2)(i).

⁷⁰Reg. section 1.401(a)-20, Q&A 39, Q&A 41.

⁷¹Retirement Equity Act of 1984, P.L. 98-397, section 303(e)(2); reg. section 1.401(a)-20, Q&A 45.

⁷²Reg. section 1.401(a)-20, Q&A 40.

⁷³Reg. section 1.401(a)-20, Q&A 37, Q&A 22(b).

⁷⁴Section 417(c)(1)(B); reg. section 1.401(a)-20, Q&A 22(a).

⁷⁵Reg. section 1.417(e)-1(b)(1), (c).

⁷⁶Section 401(a)(9)(B)(iv); reg. section 1.401(a)(9)-6, Q&A 1(c)(1), 1.401(a)(9)-3, Q&A 3(b).

⁷⁷Section 417(c)(1)(B); reg. section 1.401(a)-20, Q&A 37, Q&A 22(a).

⁷⁸Reg. section 1.417(e)-1(b)(1), (c).

⁷⁹Section 401(a)(9)(B)(iv); reg. section 1.401(a)(9)-6, Q&A 1(c)(1), 1.401(a)(9)-3, Q&A 3(b).

allow the surviving spouse to elect to begin the QPSA payments immediately, regardless of the date the plan would have allowed the deceased employee to retire.⁸⁰ If the spouse does not start the payments, the plan *can* start them when the deceased employee would have reached age 62 (the later of age 62 or the employee's normal retirement age of 60).⁸¹ In any event, however, the QPSA payments *must* commence by the end of the calendar year the employee would have reached age 70½ (since that date is later than the end of the calendar year following the employee's death).⁸²

3. How QPSA payments are taxed. A portion of each QPSA payment may be nontaxable. The nontaxable portion is generally equal to the investment in the QPSA as of the annuity starting date, divided by the number of anticipated annuity payments.⁸³ The investment in the QPSA generally equals the deceased employee's after-tax contributions toward the cost of the annuity.⁸⁴ For a QPSA providing monthly payments, the surviving spouse determines the number of anticipated payments from the following table by reference to the spouse's age.⁸⁵

If the spouse's age on the annuity starting date is:	The number of anticipated payments is:
Not more than 55	360
More than 55 but not more than 60	310
More than 60 but not more than 65	260
More than 65 but not more than 70	210
More than 70	160

Thus, the nontaxable portion of each monthly annuity payment is equal to the investment in the QPSA divided by the number of expected payments in the above table. If the plan makes annuity payments at intervals other than monthly, the surviving spouse must adjust the nontaxable portion of each payment accordingly.⁸⁶

If a surviving spouse lives long enough to recover all the investment in a QPSA, later payments to the spouse are entirely taxable.⁸⁷ If the surviving spouse does not live long enough to recover all the investment, the unrecovered investment is generally deductible as an itemized deduction on the spouse's final tax return.⁸⁸ Nevertheless, if the QJSA must still make a number of guaranteed payments, the individual receiving the payments may exclude them from taxable income until he

has recovered the remaining investment. Then, he must pay tax on the remaining amount of the guaranteed payments.⁸⁹

(Caution: If a QPSA started before November 19, 1996, the surviving spouse must continue to use the method for determining the nontaxable portion that was applicable before that date.⁹⁰ If the annuity started before July 2, 1986, the tax law does not allow a deduction for unrecovered investment.⁹¹)

C. Annuity Starting Date for a QJSA or QPSA

The annuity starting date for a QJSA or a QPSA is the first day of the first period an annuity amount is payable. For example, if the first annuity amount is payable for the month of July, but payment is not due until July 31, the annuity starting date is the first day of July.⁹² The same definition of annuity starting date normally applies for an acceleration of benefits due to preretirement disability. However, disability payments do not trigger the annuity starting date if they do not alter the benefits that the employee is otherwise entitled to receive at his normal or early retirement date.⁹³

In no event are QJSA or QPSA benefits forfeitable after the annuity starting date.⁹⁴ In fact, after the annuity starting date, the plan or the issuer of the annuity may not even cash out an annuity worth more than \$5,000 without the written consent of both the employee and the spouse (or only the spouse, after the employee's death).⁹⁵

D. Waiver of a QJSA or QPSA

An employee may generally waive a QPSA with spousal consent after the earlier of the first day of the plan year the employee reaches age 35 or the date the employee separates from service. A plan may also allow an employee to waive a QPSA before the year the employee reaches age 35. However, a new waiver is required during or after the year the employee reaches age 35.⁹⁶

An employee may generally waive a QJSA with spousal consent only during the 180-day period immediately preceding the annuity starting date. For this purpose, the annuity starting date generally does not occur until the plan is obligated to start the annuity (for example, on the normal retirement date). Thus, if an employee taking early retirement may choose when to start his annuity, the annuity starting date for purposes of identifying the

⁸⁰Reg. section 1.401(a)-20, Q&A 37, Q&A 22(b).

⁸¹Reg. section 1.417(e)-1(b)(1), (c).

⁸²Section 401(a)(9)(B)(iv); reg. section 1.401(a)(9)-6, Q&A 1(c)(1), 1.401(a)(9)-3, Q&A 3(b).

⁸³Section 72(d)(1).

⁸⁴See Blankenship, note 46 *supra*.

⁸⁵Section 72(d)(1)(B)(iv).

⁸⁶Section 72(d)(1)(F); Notice 98-2, note 48 *supra*.

⁸⁷Section 72(d)(1)(B)(ii), (b)(2).

⁸⁸Sections 72(d)(1)(B)(ii), 72(b)(3)(A), 67(b)(10).

⁸⁹Section 72(b)(3)(B); section 72(e)(5)(A), (E).

⁹⁰P.L. 104-188, section 1403(a).

⁹¹P.L. 99-514, section 1122(h)(2)(B).

⁹²Section 417(f)(2)(A); 29 U.S.C. section 1055(h)(2)(A); reg. section 1.401(a)-20, Q&A 10(b)(1). The regulations allow a reasonable administrative delay of the first payment to provide time to calculate the benefit. Reg. section 1.401(a)-20, Q&A 10(b)(3).

⁹³Section 417(f)(2)(B); 29 U.S.C. section 1055(h)(2)(B); reg. section 1.401(a)-20, Q&A 10(c).

⁹⁴Reg. section 1.401(a)-20, Q&A 10(b)(4).

⁹⁵Section 417(e)(1), (2). If a plan or issuer cashes out a QJSA or QPSA, the plan or issuer must determine the annuity's minimum current value by applying the rules provided in section 417(e)(3).

⁹⁶Section 417(a)(1)(A)(i), (a)(6); 29 U.S.C. section 1055(c)(1)(A)(i), (e)(7); reg. section 1.401(a)-20, Q&A 33(b).

waiver period is generally the earlier of the date the employee chooses or the normal retirement date.⁹⁷

1. Extended waiver period for QJSA. If a plan fails to provide an employee with a written explanation of the QJSA within the first 150 days of the 180-day waiver period, the plan must allow waiver of the QJSA during an extended period that ends at least 30 days after provision of the explanation.⁹⁸ In that case, the plan may also allow the employee to choose an annuity starting date that precedes the employee's selection of a form of benefit but follows receipt of the written explanation. However, actual distributions must commence (absent administrative delays) within 180 days after the employee's receipt of the written explanation.⁹⁹ Alternatively, the employee may elect to reduce the extended waiver period of 30 or more days to a period of only 7 days if the employee wants the plan to begin payments as soon as possible.¹⁰⁰

Due to administrative error or other circumstance, a defined benefit plan may not have provided an employee with a written explanation of the QJSA until after his normal annuity starting date (for example, after normal retirement). In that event, in addition to providing the usual extended waiver period of 30 days or more,¹⁰¹ the defined benefit plan may allow the employee to select a new annuity starting date that actually precedes receipt of the written explanation (a "retroactive annuity starting date").¹⁰² In no event, however, may the retroactive starting date be earlier than the original normal starting date.¹⁰³ The retroactive starting date is also subject to some other conditions set forth in the regulations and the plan.¹⁰⁴ By contrast, the regulations do not allow a defined contribution plan to provide such a retroactive starting date.¹⁰⁵

2. Spousal consent required. Any QJSA or QPSA waiver or seven-day election by an employee requires spousal consent. The spouse's consent may be a limited consent, a general consent, or a limited general consent.¹⁰⁶ A limited consent generally specifies the beneficiary who will receive the waived benefit and, for a QJSA but not a QPSA, the alternative form of payment selected. A general consent expressly permits the employee to choose any beneficiaries and any form of benefit payment. A limited general consent may limit the employee's choice to certain forms of payment or beneficiaries (for example,

beneficiaries limited to children or grandchildren).¹⁰⁷ Nevertheless, the designation of a beneficiary may be superfluous if, under the payment option selected, no benefit remains at the death of the employee (for example, if the option selected is a lump sum payment of the entire benefit to the employee).

Regardless of the form of the consent, it must be in writing, it must acknowledge aspects of the consent that are adverse to the spouse, and a plan representative or notary public must witness it.¹⁰⁸ Thus, a court has held invalid a consent not notarized or witnessed, even though the spouse admitted signing it.¹⁰⁹ However, a court will generally presume a notarization is valid in the absence of clear and convincing evidence to the contrary.¹¹⁰ In fact, two state courts have held valid a consent that a spouse admitted signing, even though the spouse claimed not to have been present during notarization.¹¹¹ Conversely, a district court held invalid a signed and notarized consent after finding that the spouse was not present during notarization and that, despite her signature, she did not intend to give up her spousal rights.¹¹²

The regulations clearly state that a consent provided in an antenuptial agreement or similar premarital agreement is not valid.¹¹³ Nevertheless, the Second Circuit, in holding an antenuptial consent invalid because it did not satisfy the formalities required by the code, pointedly declined to decide whether such an agreement could ever constitute a valid consent.¹¹⁴ The fact is, however, that only one court, in a questionable decision, has actually held that a provision in an antenuptial agreement may constitute a valid consent.¹¹⁵

An employee may revoke a previous waiver of a QJSA during the 180-day period immediately before the annuity starting date¹¹⁶ and a QPSA at any time during the employee's lifetime.¹¹⁷ However, the employee may not revoke the waiver and choose payment options or beneficiaries other than a QJSA or QPSA without obtaining

⁹⁷*Shields v. Reader's Digest Assoc., Inc.*, 331 F.3d 536 (6th Cir. 2003).

⁹⁸Section 417(a)(7)(A)(i); 29 U.S.C. section 1055(c)(8)(A)(i); reg. section 1.417(e)-1(b)(3)(ii)(A).

⁹⁹Reg. section 1.417(e)-1(b)(3)(iii), (iv), (viii). Although the regulations make frequent reference to a 90-day period, Congress has instructed the IRS to substitute a 180-day period. P.L. 109-280, section 1102(a)(1)(B).

¹⁰⁰Section 417(a)(7)(B); 29 U.S.C. section 1055(c)(8)(B); reg. section 1.417(e)-1(b)(3)(ii)(D).

¹⁰¹Reg. section 1.417(e)-1(b)(3)(vi).

¹⁰²Reg. section 1.417(e)-1(b)(3)(iv)(A), (B).

¹⁰³Reg. section 1.417(e)-1(b)(3)(iv)(B).

¹⁰⁴See generally reg. section 1.417(e)-1(b)(3)(iv) through (vii).

¹⁰⁵Reg. section 1.417(e)-1(b)(3)(iv)(A).

¹⁰⁶The IRS provided sample spousal consent language in Notice 97-10, 1997-1 C.B. 370, *Doc 97-221*, 96 TNT 253-10.

¹⁰⁷Section 417(a)(2)(A)(ii); 29 U.S.C. section 1055(c)(2)(A)(ii); reg. section 1.401(a)-20, Q&A 31.

¹⁰⁸Section 417(a)(2)(A)(iii); 29 U.S.C. section 1055(c)(2)(A)(iii).

¹⁰⁹*Lasche v. Lasche*, 111 F.3d 863 (11th Cir. 1997).

¹¹⁰*Butler v. Encyclopedia Britannica, Inc.*, 41 F.3d 285, *Doc 94-10608*, 94 TNT 234-12 (7th Cir. 1994).

¹¹¹*Herrero v. Cummins Mid-America*, 930 S.W.2d 18 (Mo. Ct. App. 1996); *Thompson v. Stull*, 856 N.E.2d 1252 (Ind. Ct. App. 2006).

¹¹²*Alfieri v. Guild Times Pension Plan*, 446 F. Supp.2d 99 (E.D. N.Y. 2006).

¹¹³Reg. section 1.401(a)-20, Q&A 28.

¹¹⁴*Hurwitz v. Sher*, 982 F.2d 778 (2d Cir. 1992), *cert. denied*, 508 U.S. 912 (1993). Similarly, *Nat'l Auto. Dealers & Assoc. Ret. Trusts v. Arbeitman*, 89 F.3d 496 (8th Cir. 1996); *Hagwood v. Newton*, 282 F.3d 285 (4th Cir. 2002).

¹¹⁵*In re Estate of Hopkins*, 574 N.E.2d 230 (Ill. App. Ct. 1991). For a discussion of the errors in *Hopkins*, see *Hurwitz*, note 114 *supra*, at 783.

¹¹⁶Section 417(a)(1)(A)(ii), (6)(A); 29 U.S.C. section 1055(c)(1)(A)(ii), (7)(A).

¹¹⁷Section 417(a)(1)(A)(ii), (a)(6); 29 U.S.C. section 1055(c)(1)(A)(ii), (c)(7).

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spousal consent. Whether the spouse may revoke his consent to a waiver depends on the terms of the plan.¹¹⁸

Fortunately, spousal consent to a waiver of a QJSA or QPSA does not constitute a gift subject to gift tax.¹¹⁹

3. Optional forms of benefit after waiver of a QJSA. After an employee's waiver of a QJSA, most plans allow the employee to choose from an array of alternative forms of retirement benefit (if the employee's choice is consistent with spousal consent).¹²⁰ Those alternative forms often include a lump sum payment and various types of annuities. For a defined contribution plan, those alternative forms of benefit are generally of equal value, since the plan necessarily funds each such form using the balance in the employee's separate account.¹²¹

However, for defined benefit plans, different optional forms of benefit may be of different value. Perhaps for that reason, the code and regulations impose some restrictions on value. Generally, the present value of any optional form of benefit under a defined benefit plan must at least equal the present value of what the plan designates as its normal form of benefit (the accrued benefit). If a plan should designate an annuity for the life of the employee (single life annuity) as the normal form of benefit, the present value of any optional form of benefit could not be less than the present value of the single life annuity.¹²² Thus, for example, the amount of an optional lump sum distribution could not be less than the present value of the single life annuity.

Nevertheless, the code provides an important exception to this present value rule for some defined benefit plans that are cash balance or hybrid plans.¹²³ For distributions after August 17, 2006, such a plan may decline to treat an employee's accrued benefit as equal to the present value of the normal form of benefit. Instead, the plan may treat the accrued benefit as equal to the employee's hypothetical account balance, which is in turn attributable to service credits and hypothetical income. Or the plan may equate the accrued benefit to an accumulated percentage of the employee's final average compensation.¹²⁴ However, to qualify for this exception, the plan must provide for full vesting of an employee's account balance after three years of service.¹²⁵

For distributions before August 18, 2006, cash balance plans were required to compute the accrued benefit as an amount equal to the present value of the normal form of benefit, using specified statutory interest rates. As a consequence, the accrued benefit and thus the value of optional forms of benefit (such as a lump sum distribution) often exceeded the employee's hypothetical account balance.¹²⁶

4. New optional spousal annuity in lieu of QJSA. For plan years beginning in 2008, qualified plans must generally include a "qualified optional survivor annuity" (QOSA) among the benefit options available after a QJSA waiver. As with a QJSA, the QOSA must be payable for the employee's lifetime and, after the employee's death, to his spouse for the spouse's lifetime. However, the amounts of the QOSA and QJSA payments are different.¹²⁷

If the waived QJSA provides a surviving spouse with an annuity payment that is less than 75 percent of the annuity payment to the employee, the QOSA must provide for a payment to the spouse equal to 75 percent of the employee payment. If the QJSA provides the spouse with an annuity payment that is 75 percent or more of the annuity payment to the deceased employee, the QOSA must provide for a payment to the spouse equal to 50 percent of the employee payment.¹²⁸

As with a QJSA, the present value of the expected future annuity payments to the employee and spouse under the QOSA must equal the present value of a lifetime annuity otherwise payable to the employee alone.¹²⁹ A QOSA is also generally taxable to an employee and his spouse in the same way as a QJSA.¹³⁰

Section 417(a)(1)(A)(ii) literally states that an employee waiving *either* a QJSA or a QPSA may elect a QOSA. However, it is highly unlikely that Congress intended a QOSA to replace or modify a QPSA. As noted, a QOSA is similar to a QJSA, but not at all similar to a QPSA. Both a QOSA and a QJSA start during an employee's lifetime and, except for the survivor benefit percentage, the code defines them almost identically.¹³¹ However, a QPSA starts after the employee's death,¹³² has an election period incompatible with a QOSA,¹³³ and, for a defined benefit plan, is determined as a function of a QJSA (and not a QOSA) whether or not the QJSA is waived.¹³⁴

¹¹⁸Reg. section 1.401(a)-20, Q&A 30.

¹¹⁹Section 2503(f).

¹²⁰Section 417(a)(1)(A)(i); 29 U.S.C. section 1055(c)(1)(A)(i).

¹²¹Section 411(a)(7)(A)(ii); reg. section 1.417(e)-1(d)(7).

¹²²Reg. sections 1.417(a)(3)-1(d)(2)(ii), 1.417(e)-1(d)(1), 1.411(a)-11(a)(1), 1.411(a)-11(d), 1.401(a)(11)-(a)(3), Example 1. See also *BBS Associates, Inc. v. Commissioner*, 74 T.C. 1118 (1980), *aff'd*, 661 F.2d 913 (1981) (holding that a plan may designate any form of benefit (including a lump sum) as the normal form of benefit); Notice 82-4, 1982-1 C.B. 356 (acquiescence).

¹²³A cash balance plan is generally a defined benefit plan that bases an employee's normal retirement benefit on a hypothetical account that accumulates hypothetical contributions based on years of service and hypothetical interest accruals. See Notice 2007-6, 2007-3 IRB 272, *Doc 2006-25485*, 2006 TNT 246-9, for a more complete description of cash balance and hybrid plans.

¹²⁴Section 411(a)(13)(A), (C).

¹²⁵Section 411(a)(13); Pension Protection Act of 2006, (P.L. 109-280), section 701(a)(2), (b)(2), (e)(2).

¹²⁶*Lyons v. Georgia Pac. Corp. Salaried Employees Ret. Plan*, 221 F.3d 1235, *Doc 2000-21526*, 2000 TNT 161-8 (11th Cir. 2000), *cert. denied*, 532 U.S. 967 (2001); *Esden v. Bank of Boston*, 229 F.3d 154, *Doc 2000-24516*, 2000 TNT 185-6 (2d Cir. 2000); *Berger v. Xerox Corp. Ret. Income Guar. Plan*, 338 F.3d 755, *Doc 2003-18894*, 2003 TNT 160-12 (7th Cir. 2003); *West v. AK Steel Corp. Ret. Accumulation Pension Plan*, 484 F.3d 395 (6th Cir. 2007).

¹²⁷Section 417(a), (g); 29 U.S.C. section 1055(c), (i).

¹²⁸*Id.*

¹²⁹See text accompanying notes 15 through 18 *supra*.

¹³⁰See text accompanying notes 45 through 55 *supra*.

¹³¹Section 417(b), (g); 29 U.S.C. section 1055(d), (i).

¹³²Section 417(c); 29 U.S.C. section 1055(e).

¹³³Section 417(a)(6); 29 U.S.C. section 1055(c)(6).

¹³⁴Section 417(c)(1); 29 U.S.C. section 1055(e)(1).

5. When waiver is not allowed. Some plans do not allow waiver of a QJSA or QPSA even if an employee has spousal consent. However, in those cases, the plan must fully subsidize the annuity. A plan fully subsidizes a QPSA if the employee does not pay for the QPSA coverage and the plan does not reduce the employee's lifetime benefits to pay for the coverage. Thus, a defined contribution plan always fully subsidizes a QPSA, since the plan must use postdeath funds in the employee's separate account to fund the QPSA without any impact on the employee's lifetime benefits.¹³⁵

A plan fully subsidizes a QJSA if, without incurring additional cost, an employee is certain to receive total QJSA payments during the employee's lifetime that are at least equal to the total payments the employee could have received under another form of plan benefit.¹³⁶ Thus, a plan does not fully subsidize a QJSA if the plan provides an employee a smaller annuity payment under a QJSA than under a single life annuity. Nor does a plan fully subsidize a QJSA if the plan provides an employee with a lump sum option, since total QJSA payments received by an employee suffering an early death could be smaller than the lump sum.¹³⁷

Unfortunately, the regulations do not provide an example of a fully subsidized QJSA. However, it is reasonable to infer from the regulations that the QJSA in the following example is fully subsidized and that the plan may thus prohibit its waiver.

Example. Assume a defined benefit plan provides a normal benefit of \$2,000 per month for the life of an employee who is age 65 (whether or not the employee is married). Assume the plan also provides a QJSA (without charge) for a married employee age 65 that pays \$2,000 per month for the employee's life and \$1,500 per month to his surviving spouse. The plan provides no other forms of benefit or beneficiary options. Under those facts, the plan has fully subsidized the QJSA, since the employee's lifetime payments under the QJSA are at least equal to the employee's lifetime payments under the only other form of benefit (the single life annuity).¹³⁸

Although the regulations are unclear on the point, a QJSA for a married employee likely would fail to qualify as fully subsidized if the plan offers a disqualifying option (for example, a lump sum) to single employees but not to married employees. As explained above, by withdrawing an employee's right to waive a QJSA, a plan effectively eliminates all other benefit options for the employee — but at the cost of full subsidization of the QJSA. It would be perverse if the plan could achieve the

same result *at no cost* simply by selectively eliminating options for married employees but not for other employees.

E. Consent to Use Plan Benefits to Secure a Loan

If a qualified plan is subject to spousal annuity requirements, an employee must obtain spousal consent to use more than \$5,000 of plan benefits as security for a loan. The employee must obtain the consent within the 90-day period preceding the date the security is effective.¹³⁹ Spousal consent is also necessary to renegotiate or revise an existing loan.¹⁴⁰ Spousal consent must be in writing, the consent must acknowledge aspects of the consent that are adverse to the spouse, and a plan representative or a notary public must witness the consent.¹⁴¹ However, spousal consent is not required for the offset of plan assets against a loan in default¹⁴² or under the conditions explained in the next section.

F. Consent if Spouse Unavailable or Incapacitated

If an employee's spouse cannot be located, the employee does not need spousal consent to waive a QJSA or QPSA, to choose other beneficiaries and payment options, or to use plan benefits as security for a loan. Spousal consent is also not required if a court order specifies that an employee is legally separated from his spouse or the spouse has legally abandoned the employee — unless a qualified domestic relations court order (QDRO) provides otherwise. If the spouse is legally incompetent, the spouse's guardian may give consent (even if the employee is the guardian).¹⁴³

G. Exception for Profit-Sharing Plans

The spousal annuity requirements generally will not apply to an employee in a profit-sharing or stock bonus plan¹⁴⁴ if the employee has not elected a life annuity and any nonforfeitable benefit accrued at death is payable to the surviving spouse.¹⁴⁵ The plan must make the payment to the surviving spouse available within 90 days

¹³⁹Section 417(a)(4); 29 U.S.C. section 1055(c)(4); reg. section 1.401(a)-20, Q&A 24(a)(1).

¹⁴⁰Reg. section 1.401(a)-20, Q&A 24(c).

¹⁴¹Section 417(a)(4), (a)(2)(A); 29 U.S.C. section 1055(c)(4), (c)(2)(A); reg. section 1.401(a)-20, Q&A 24(a)(2).

¹⁴²Reg. section 1.401(a)-20, Q&A 24(b).

¹⁴³Sections 417(a)(2)(B), 417(a)(4)(B), 401(a)(11)(B)(iii)(I); 29 U.S.C. section 1055(c)(2)(B), (c)(4)(B), (b)(1)(C)(i); reg. section 1.401(a)-20, Q&A 27; *Bd. of Trs. of the Equity-League Pension Trust Fund v. Royce*, 238 F.3d 177 (2d Cir. 2001).

¹⁴⁴No similar exception exists for defined benefit plans, or for defined contribution plans that are money purchase pension plans. Section 401(a)(11)(B)(i), (ii); 29 U.S.C. section 1055(b)(1)(A), (B); reg. section 1.401(a)-20, Q&A 9. However, the exception is applicable to accumulated deductible employee contributions (DECs) to qualified plans. The regulations treat the accumulated DECs portion of a qualified plan as a separate profit-sharing plan for this purpose. Reg. section 1.401(a)-20, Q&A 14. (An employee may have contributed DECs to a qualified plan during the calendar years 1982 through 1986 and deducted the contribution on the employee's own federal income tax return. Section 72(p)(2)(A); DECs enacted by P.L. 97-34, section 311(a), repealed by P.L. 99-514, section 1101(b)(1).)

¹⁴⁵Section 401(a)(11)(B)(iii); 29 U.S.C. section 1055(b)(1)(C).

¹³⁵Reg. section 1.401(a)-20, Q&A 38(b).

¹³⁶Section 417(a)(5); 29 U.S.C. section 1055(c)(5); reg. section 1.401(a)-20, Q&A 37, Q&A 38.

¹³⁷Reg. section 1.401(a)-20, Q&A 38(a)(2).

¹³⁸See *Green v. Commissioner*, T.C. Memo. 1997-556, Doc 97-34263, 97 TNT 246-16, in which the taxpayer interpreted the plan language as providing a QJSA that was subsidized in the same way as the example in the text of this article. However, the court held to the contrary, interpreting the plan language to provide only an unsubsidized QJSA with a present value equal to the plan's normal benefit of a single life annuity.

after the employee's death or within a reasonable period thereafter. Further, the payment period for the spousal benefit, and postdeath adjustments for gains and losses in the plan, must be at least as favorable as for other types of plan distributions.¹⁴⁶ Finally, the plan must treat amounts forfeitable solely because of the employee's death as if they were nonforfeitable for purposes of providing the spousal benefit.¹⁴⁷

As noted, this exception to spousal annuity requirements does not apply if the employee has elected a life annuity at any time under the plan (without regard to statutory election periods). Further, later revocation of the election will apparently not reinstate the exception. The regulations provide that, once a life annuity has been elected, spousal annuity requirements "will always thereafter apply." That harsh interpretation does not appear to flow readily from the language of the statute.¹⁴⁸ In any event, if the employee's life annuity election is limited to a portion of the plan balance subject to separate accounting, the exception may be available for the remaining plan balance.¹⁴⁹

1. Employee waiver with spousal consent. The profit-sharing or stock bonus exception will apply even though an employee waives the benefit payment to the surviving spouse, if the employee does so with spousal consent.¹⁵⁰ The waiver and consent are generally subject to the same conditions as those applicable to the waiver of a QPSA, except that the employee may waive the spousal payment at any time (without regard to the attainment of age 35). However, the regulation states that the waiver must identify a specific nonspouse beneficiary and thereby implies that the spouse may not provide a general consent or a limited general consent.¹⁵¹ In any event, a plan need not require any spousal consent if the employee and spouse were not married during the entire one-year period ending on the earlier of the annuity starting date or the employee's death.¹⁵²

2. Plan mergers, spinoffs, and similar transfers. The profit-sharing or stock bonus exception is not available if the plan receives funds for the employee's benefit in a merger, spinoff, or similar transfer from a plan subject to spousal annuity requirements. In such a case, the spousal annuity requirements will then normally apply to the employee's entire interest in the recipient plan.¹⁵³ However, if the recipient plan separately accounts for the transferred funds and related income, the exception will be available for the remainder of the plan's funds.¹⁵⁴ For this purpose, a rollover contribution is not a transfer similar to a merger or spinoff.

In a slightly different context, the profit-sharing or stock bonus exception is not available for an employee

whose plan may offset the employee's benefits against benefits payable by another plan subject to spousal annuity requirements.¹⁵⁵

3. Plan distributions and loans to the employee. After satisfying the profit-sharing or stock bonus exception to spousal annuity requirements, an employee may elect any distributions allowed by the plan that are not life annuities (for example, election of a lump sum distribution). Spousal consent is not required for those distributions even though the distributions diminish plan funds otherwise payable to the surviving spouse. Nor is spousal consent required to secure a loan to the employee.¹⁵⁶ Thus, the employee generally has considerable freedom of action regarding use of plan benefits during his lifetime — making somewhat illusory the spousal survivorship benefits required under the exception.

The stricter spousal rules applicable to defined benefit plans and money purchase pension plans are probably a reflection of the traditional focus of those types of plans on family income security. However, for profit-sharing or stock bonus plans, it is apparently sufficient to assume an employee will use lifetime withdrawals for the benefit of both the employee and his spouse. Also, however, the surviving spouse will receive any plan amounts remaining at the employee's death (unless the spouse agrees to a different disposition).

H. Exception for Accrued Benefits in an ESOP

Spousal annuity requirements are generally not applicable to accrued benefits in an ESOP¹⁵⁷ that the employee may take in the form of employer securities (or their cash value). However, this exception is available only if the plan itself satisfies certain statutory conditions.¹⁵⁸ Also, the employee must satisfy the conditions discussed above that are applicable to the profit-sharing plan exception. That is, the employee must not have elected a life annuity and any accrued benefit must be payable to the surviving spouse (absent spousal consent for an alternative beneficiary). The primary effect of this provision is to make the profit-sharing exception available for the ESOP portion of a money purchase pension plan.¹⁵⁹

I. Separate Accounts in Defined Benefit Plans

A defined benefit plan must separately account for an employee's *voluntary* contributions and must apply the spousal annuity requirements separately to the separate account. In fact, the plan must separately apply the spousal annuity requirements whether the separate account contains voluntary employee contributions or employer contributions. For QPSA purposes, the regulations treat the separate account as a defined contribution

¹⁴⁶Reg. section 1.401(a)-20, Q&A 32, Q&A 3(b).

¹⁴⁷Reg. section 1.401(a)-20, Q&A 10(b)(4), Q&A 13.

¹⁴⁸Section 401(a)(11)(B)(iii)(II); reg. section 1.401(a)-20, Q&A.

¹⁴⁹Reg. section 1.401(a)-20, Q&A 4.

¹⁵⁰Section 401(a)(11)(B)(iii)(I); 29 U.S.C. section 1055(b)(1)(C)(i).

¹⁵¹Reg. section 1.401(a)-20, Q&A 32, Q&A 33(a), Q&A 27.

¹⁵²Reg. section 1.401(a)-20, Q&A 26.

¹⁵³Section 401(a)(11)(B)(iii)(III).

¹⁵⁴Section 401(a)(11)(B)(iii) (flush language).

¹⁵⁵Reg. section 1.401(a)-20, Q&A 5(a).

¹⁵⁶Reg. section 1.401(a)-20, Q&A 33(a); LTR 200453026, Doc 2005-146, 2004 TNT 251-17.

¹⁵⁷Limited to ESOPs under sections 409(a) and 4975(e)(7).

¹⁵⁸For these statutory conditions, see sections 401(a)(11)(B)(iii)(III), 401(a)(11)(C), 409(h); 29 U.S.C. section 1055(b)(2).

¹⁵⁹Section 401(a)(11)(B)(iii), 401(a)(11)(C)(ii); 29 U.S.C. section 1055(b)(2); reg. section 1.401(a)-20, Q&A 3(c).

plan.¹⁶⁰ In no event, however, do the spousal annuity requirements apply separately to *mandatory* employee contributions. The regulations continue to treat those contributions as a part of the overall defined benefit plan.¹⁶¹

J. Treatment of Death Benefits

The spousal annuity rules apply to all nonforfeitable benefits under defined contribution plans, including insurance proceeds.¹⁶² For defined benefit plans, the spousal benefit rules do not apply to life insurance proceeds that exceed the present value of the employee's predeath nonforfeitable benefits. Nor do they apply to other benefits payable solely because of the employee's death.¹⁶³

K. Payments Under Both a QJSA and a QPSA

A surviving spouse may conceivably receive payments under both a QJSA and a QPSA from the same plan. If a plan subject to spousal annuity requirements distributes to an employee only a portion of the employee's benefits, the distribution must be in the form of a QJSA (in the absence of a waiver with spousal consent). If the employee dies before receiving the remaining benefit, the plan must pay the remainder to the surviving spouse as a QPSA (without a waiver and consent). Thus, the surviving spouse will receive payments under both the QJSA and the QPSA, but without any duplication of benefits.¹⁶⁴

L. Marriage and Divorce

If an employee divorces after a QJSA starts, the employee's spouse on the annuity starting date generally remains entitled to the survivor benefit, even if the spouse later remarries.¹⁶⁵ Similarly, a surviving spouse receiving payments under a QPSA must continue to receive the payments whether or not he or she remarries.¹⁶⁶ If an employee divorces before the annuity starting date, elections made by the employee and his former spouse generally remain in effect until the employee changes them or remarries.¹⁶⁷

Of course, a QDRO issued under divorce or legal separation¹⁶⁸ may require specific allocations of benefits to the employee's spouse, former spouse, children, or other dependents.¹⁶⁹ Also, a QDRO may designate a divorced spouse as the surviving spouse entitled to receive the *survivorship payments* under a QJSA or QPSA.¹⁷⁰ However, such a designation must be ex-

PLICIT,¹⁷¹ and the QDRO may not designate nonspouse beneficiaries, such as children, to receive the survivorship payments.¹⁷²

Except for QDROs, state law relating to qualified plan benefits after a divorce or legal separation is generally preempted by ERISA¹⁷³ and the Supreme Court's decision in *Boggs v. Boggs*.¹⁷⁴ For example, in *Egelhoff v. Egelhoff*,¹⁷⁵ the Supreme Court held that ERISA preempted a state law that would have automatically denied beneficiary status to a divorced spouse under a plan.¹⁷⁶ However, there is a split among the federal circuits on the question whether a divorcing spouse's mere disclaimer of a plan interest is valid if it is not part of a QDRO.¹⁷⁷

State courts that recognize the validity of spousal disclaimers of plan interests have also generally held premarital disclaimers enforceable. Those courts have held that a premarital disclaimer denies the disclaiming spouse any interest in the employee's qualified plan if a later divorce of the spouses occurs before the employee's annuity starting date.¹⁷⁸ Those courts nevertheless generally recognize that, as discussed above, a premarital disclaimer does not constitute a valid consent to a waiver of a QJSA or a QPSA if the disclaiming spouse and the employee are still married on the annuity starting date or at the employee's death.¹⁷⁹

M. Assignment of Interest in a QJSA or QPSA

Qualified plan benefits (including QJSAs and QPSAs) are generally exempt from forfeiture in bankruptcy proceedings.¹⁸⁰ The bankruptcy exemption also generally extends to an alternate payee (for example, a former

¹⁶⁰Reg. section 1.401(a)-20, Q&A 15(a), (b)(1); section 417(c)(2).

¹⁶¹Reg. section 1.401(a)-20, Q&A 15(b)(2).

¹⁶²Reg. section 1.401(a)-20, Q&A 12(b).

¹⁶³Reg. section 1.401(a)-20, Q&A 12(a).

¹⁶⁴Reg. section 1.401(a)-20, Q&A 9.

¹⁶⁵Reg. section 1.401(a)-20, Q&A 25(b)(1), (3).

¹⁶⁶Reg. section 1.401(a)-20, Q&A 25(b)(1).

¹⁶⁷Reg. section 1.401(a)-20, Q&A 25(b)(3).

¹⁶⁸The IRS provided sample QDRO language in Notice 97-11, 1997-1 C.B. 379, Doc 97-222, 96 TNT 253-11.

¹⁶⁹Sections 401(a)(13)(b), 414(p); reg. section 1.401(a)-20, Q&A 25(b)(3).

¹⁷⁰Section 414(p)(5); reg. section 1.401(a)-13(g)(4).

¹⁷¹*Dorn v. Int'l Bhd of Elec. Workers*, 211 F.3d 938 (5th Cir. 2000) (QDRO allocated a portion of employee's lifetime QJSA payments to former spouse, but failed to allocate to the former spouse any portion of the postdeath QJSA payable to the actual surviving spouse).

¹⁷²*Hamilton v. Wash. State Plumbing & Pipefitting Indus. Pension Plan*, 433 F.3d 1091 (9th Cir.), cert. denied, 127 Sup. Ct. 86 (2006).

¹⁷³ERISA provides that it "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." 29 U.S.C. section 1144(a).

¹⁷⁴*Boggs v. Boggs*, 520 U.S. 833 (1997) (relying on general preemption principles rather than ERISA's statutory preemption).

¹⁷⁵*Egelhoff v. Egelhoff*, 532 U.S. 141 (2001).

¹⁷⁶But cf. LTR 9008079 (finding an "implied exception" to ERISA to accommodate a state law denying plan benefits to a beneficiary who murdered the participating employee).

¹⁷⁷*Disclaimer effective: Estate of Altobelli v. IBM*, 77 F.3d 78 (4th Cir. 1996); *Fox Valley & Vicinity Constr. Workers Pension Fund v. Brown*, 897 F.2d 275 (7th Cir. 1990) (en banc), cert. denied, 498 U.S. 820 (1990); *Mohamed v. Kerr*, 53 F.3d 911 (8th Cir.), cert. denied, 516 U.S. 868 (1995). *Disclaimer not effective: McGowan v. NJR Serv. Corp.*, 423 F.3d 241 (3d Cir. 2005), cert. denied, 127 Sup. Ct. 1118 (2007); *Metro. Life Ins. Co. v. Hanslip*, 939 F.2d 904 (10th Cir. 1991); *McMillan v. Parrott*, 913 F.2d 310 (6th Cir. 1990).

¹⁷⁸*Stewart v. Stewart*, 541 S.E.2d 209 (N.C. Ct. App. 2000); *Ryan v. Ryan*, 659 N.E.2d 1088 (Ind. Ct. App. 1995); *Edmonds v. Edmonds*, 710 N.Y.S.2d 765 (N.Y. Sup. Ct. 2000).

¹⁷⁹Id. See also text accompanying notes 113 through 115 *supra*.

¹⁸⁰Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, P.L. 109-8, section 224.

spouse) under a QDRO.¹⁸¹ Also, an employee or spouse generally may not transfer or encumber his benefits (including a QJSA or QPSA),¹⁸² with the following exceptions:

1. Voluntary and revocable assignments totaling no more than 10 percent of future benefits, but only if the assignor is currently receiving benefits under the plan and the assignments are not applied to plan administrative costs.¹⁸³
2. Nondiscriminatory plan loans that bear a reasonable rate of interest and are adequately secured by the employee's benefits in the plan.¹⁸⁴
3. Plan payments to alternative payees under a QDRO.¹⁸⁵
4. Some judgments, orders, decrees, or settlements involving acts of wrongdoing related to the plan.¹⁸⁶
5. A federal tax lien or levy.¹⁸⁷

Under item 5 above, the IRS may collect a federal tax levy against an employee from the employee's QJSA payments. However, the IRS may not collect the levy from the spouse's survivorship interest in the QJSA, since the spouse's survivorship interest is not the property of the employee.¹⁸⁸ Presumably, this recognition of the spouse's property rights would prevent an employee from making any kind of voluntary or involuntary assignment of his spouse's survivorship interests in a QJSA or QPSA.

Any QJSA or QPSA benefits actually transferred under one of the above-listed exceptions (other than a spousal QDRO transfer) will be taxable to the transferor, even if the plan pays the benefits directly to the transferee.¹⁸⁹ Payments to a spouse or former spouse under a QDRO are taxable to the spouse. State community property laws do not change this result.¹⁹⁰

N. QSAs for Unmarried Employees

The foregoing discussion of QSAs and QPSAs deals only with married employees. Strange as it may seem, unmarried employees are also subject to the QJSA rules (but not the QPSA rules).¹⁹¹ The QJSA for a single employee is an annuity for the life of the employee that the employee will automatically receive unless he or she

elects another available form of benefit.¹⁹² Unlike for married employees, the QJSA for a single employee need not be as valuable as other optional forms of benefit.¹⁹³ The primary significance of a QJSA for a single employee is that the plan may not unilaterally pay any other form of benefit without the consent of the employee.¹⁹⁴

O. Values of QSAs and Other Forms of Benefit

The preceding discussion, at various points, mentions different constraints on the relative values of QSAs and other forms of benefit available under a plan. Those constraints may be summarized as follows:

1. The present value of an employee's QJSA must equal or exceed the present value of a single life annuity for the employee.¹⁹⁵
2. For a married employee, the present value of the employee's QJSA must equal or exceed the present value of any other available form of benefit.¹⁹⁶
3. The present value of each optional form of benefit must equal or exceed the present value of the plan's normal form of benefit.¹⁹⁷

Those constraints are normally satisfied automatically for a defined contribution plan, since the alternative forms of benefit are generally of equal value. That is, the plan generally funds each such alternative form of benefit using the fixed balance of the employee's separate account.¹⁹⁸ The same is true for benefits paid after August 17, 2006, by a defined benefit plan that qualifies as a statutory cash balance or hybrid plan.¹⁹⁹ However, the interaction of the constraints is more complex for a defined benefit plan that is not a statutory cash balance or hybrid plan, and can best be understood by example.

Example 1. Assume a married employee retires in 2008 as a participant in a defined benefit plan that is not a cash balance or hybrid plan. Assume the employee's alternative forms of benefit are a QJSA, a QOSA, a single life annuity, or a lump sum payment, each with a present value of \$100,000. Assume that the plan has designated the single life annuity as its normal form of benefit.

Then, it is apparent that the relative values of the alternative forms of benefit satisfy the above constraints. That is, the \$100,000 value of the QJSA is equal to or greater than the \$100,000 value of each of the QOSA, the single life annuity, and the lump sum payment (constraints 1 and 2). Further, the \$100,000 value of each of the QJSA, the QOSA, and the lump sum payment is equal to or greater than the \$100,000 value of the single life annuity, the normal form of benefit (constraint 3).

Example 2. Assume the same facts as in Example 1, except that the present values of the alternative forms of benefit are \$150,000 for the QJSA, \$150,000 for the QOSA, \$125,000 for the lump sum, and \$100,000 for the single life

¹⁸¹*In re Ronald J. Nelson*, 274 B.R. 789 (B.A.P. 8th Cir. 2003), *aff'd*, 322 F.3d 541 (8th Cir. 2003).

¹⁸²Section 401(a)(13); 29 U.S.C. section 1056(d)(1).

¹⁸³Section 401(a)(13)(A); 29 U.S.C. section 1056(d)(2).

¹⁸⁴*Id.*

¹⁸⁵Section 401(a)(13)(B); 29 U.S.C. section 1056(d)(3)(A).

¹⁸⁶Section 401(a)(13)(C); 29 U.S.C. section 1056(d)(4).

¹⁸⁷Section 6321.

¹⁸⁸*Travelers Ins. Co. v. Rattermann*, 77 A.F.T.R.2d 956, 96-1 U.S.T.C. para. 50,143 (S.D. Ohio 1996); *Toledo Plumbers & Pipefitters Ret. Plan & Trust v. United States*, 71 A.F.T.R.2d 4356, 91-2 U.S.T.C. para. 50,343 (N.D. Ohio 1991).

¹⁸⁹*Gallade v. Commissioner*, 106 T.C. 355, Doc 96-15877, 96 TNT 105-9 (1996); *Darby v. Commissioner*, 97 T.C. 51 (1991).

¹⁹⁰Section 402(e)(1)(A); *Seidel v. Commissioner*, T.C. Memo. 2005-67, Doc 2005-6688, 2005 TNT 62-10.

¹⁹¹Section 40(a)(11)(A)(i).

¹⁹²Reg. section 1.401(a)-20, Q&A 25(a).

¹⁹³Reg. section 1.401(a)-20, Q&A 16.

¹⁹⁴*Franklin v. Thornton*, 983 F.2d 939 (9th Cir. 1993).

¹⁹⁵See text accompanying notes 15 through 18 *supra*.

¹⁹⁶See text accompanying note 17 *supra*.

¹⁹⁷See text accompanying note 122 *supra*.

¹⁹⁸Section 411(a)(7)(A)(ii); reg. section 1.417(e)-1(d)(7).

¹⁹⁹See text accompanying notes 123 through 126 *supra*.

annuity. That is, the plan has subsidized the QJSA (but not “fully” subsidized it because of the lump sum option²⁰⁰).

The relative value constraints are still satisfied. The \$150,000 value of the QJSA is equal to or greater than the \$100,000 value of the single life annuity (constraint 1). The \$150,000 value of the QJSA is equal to or greater than the \$150,000 value of the QOSA, the \$125,000 value of the lump sum payment, and the \$100,000 value of the single life annuity (constraint 2). Further, the \$150,000 value of each of the QJSA and QOSA, and the \$125,000 value of the lump sum payment, are equal to or greater than the \$100,000 value of the single life annuity, the normal form of benefit (constraint 3).

Example 3. Assume the same facts as in Example 2, except the retiring employee is unmarried. In that event, the employee’s QJSA is the single life annuity²⁰¹ worth \$100,000 and the QOSA is irrelevant. Then constraint 1 is satisfied because the \$100,000 value of the QJSA is equal to or greater than the \$100,000 value of a single life annuity (in fact, they are the same annuity). Constraint 3 is satisfied because the \$100,000 value of each of the QJSA and the \$125,000 value of the lump sum payment are equal to or greater than the \$100,000 value of the single life annuity, the normal form of benefit. Although constraint 2 is not satisfied because the \$100,000 value of the QJSA is not equal to or greater than the \$125,000 value of the lump sum payment, constraint 2 does not apply to an unmarried employee.²⁰²

III. Distribution of a QJSA or QPSA Contract

If a qualified plan trust distributes a *nontransferable* annuity contract (including a QJSA or QPSA) to an employee or surviving spouse, the distributee normally need not include any portion of the distribution in gross income.²⁰³ However, if the distributed contract is *transferable*, the distributee must include its entire fair market value in gross income without reduction for recovery of investment. The distributee may avoid this harsh result only if he or she converts the contract to a nontransferable annuity within 60 days.²⁰⁴ The conversion will relate back to the date of distribution of the contract.

An annuity contract is transferable if the owner can transfer it to any person other than the issuer. Thus, the contract is transferable if the owner can sell, assign, or

pledge the owner’s interest in the contract to anyone other than the issuer. However, it is not transferable merely because the owner may designate a beneficiary to receive distributions after the owner’s death.²⁰⁵

It is technically unclear whether a transferable QJSA or QPSA may continue to qualify as a QJSA or QPSA after distribution by the plan. The code provides that a transferable annuity contract distributed by a plan is no longer treated as an annuity for purposes of sections 401 through 404 (covering qualified plans and tax-sheltered annuities).²⁰⁶ However, it is section 417 (not sections 401 through 404) that defines a QJSA or a QPSA as an “annuity” with some additional attributes (that do not touch on transferability). It appears, however, that the question is without great significance, since the avoidance of unnecessary tax provides a powerful incentive for the timely conversion of a transferable annuity to a nontransferable annuity.

A. Status of a Distributed QJSA or QPSA

The distribution of a nontransferable annuity contract (including a QJSA or QPSA) will continue to be tax free only if the annuity contract continues to comply with the tax law requirements imposed on the distributing plan.²⁰⁷ Consequently, a later exchange of a distributed annuity contract for another annuity contract will be taxable unless the new contract also complies with those requirements.²⁰⁸

In GCM 39882 (May 27, 1992), an employee received a nontransferable annuity contract tax free on the termination of his employer’s qualified plan. The annuity reflected the tax law requirements imposed on the qualified plan (including the QJSA or QPSA requirements). Later, the taxpayer sought to exchange the distributed annuity for a new nontransferable annuity issued by another insurer. The IRS concluded that, if the new nontransferable annuity contained the same required provisions as the old annuity, the proposed exchange of annuities would be a mere substitution of issuers, would not violate the nontransferable requirement, and would not be taxable.

However, the general counsel memorandum also held that the exchange would become taxable if the new annuity contract did not reflect the same qualified plan requirements (including QJSA or QPSA requirements) as the old annuity contract. That is, the contract would no longer be what the GCM called a “401 annuity contract.” Thus, the annuity would lose the protection of the nontaxable status granted by the regulations to distributions of 401 annuity contracts. Although section 1035 provides for some nontaxable exchanges of annuity contracts, the IRS held that code section not applicable —

²⁰⁰See text accompanying notes 136 and 137 *supra*.

²⁰¹See note 192 *supra*.

²⁰²See note 193 *supra*.

²⁰³Section 401(g); reg. sections 1.401-9(b), 1.402(a)-1(a)(2). For a more comprehensive discussion of annuities and insurance contracts owned or distributed by qualified plan trusts, see Blankenship, “Annuity and Life Insurance Contracts Purchased by Trusts Under Qualified Retirement Plans,” *Journal of Retirement Planning*, July-Aug. 2006, at 11.

²⁰⁴If a plan distributes a transferable annuity contract that the distributee does not convert to a nontransferable annuity contract within 60 days, the regulations provide that the “fair market value of the contract is includible in the distributee’s gross income” (that is, the FMV is not merely taken into account under the annuity rules of section 72). Reg. section 1.402(a)-1(a)(2).

²⁰⁵Reg. section 1.401-9(b)(3).

²⁰⁶Section 401(g).

²⁰⁷See, e.g., reg. sections 1.401(a)-20, Q&A 2, 1.401(a)(31)-1, Q&A 17, 1.402(c)(2), Q&A 10, 31.3405(c)-1, Q&A 4; GCM 39882 (May 27, 1992).

²⁰⁸GCM 39882 (May 27, 1992) (involving exchanges of distributed section 401(a) annuities); Rev. Rul. 90-24, 1990-1 C.B. 97 (involving an exchange of TSAs); LTR 9348051, 93 TNT 247-32 (involving an exchange of section 403(a) annuities).

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presumably because the section does not mandate the continuation of required qualified plan provisions such as the spousal annuity provisions.

B. Characteristics of a Distributed QJSA or QPSA

The regulations confirm the unique status of a 401 annuity contract (including a QJSA or QPSA), referring somewhat awkwardly to such a contract as a "qualified plan distributed annuity contract." The regulations recognize that such a contract retains the tax characteristics of a qualified plan. It does not matter that the plan that originally distributed the contract has since terminated.²⁰⁹ Nor does it matter that a designated Roth account distributed the contract. In the latter event, the contract must also retain designated Roth account characteristics.²¹⁰

The regulations specifically recognize that an employee or surviving spouse may roll over a distribution received from the issuer of a 401 annuity contract to another plan or IRA tax free — if the distribution otherwise satisfies the definition of an eligible rollover distribution.²¹¹ The issuer of the 401 annuity contract (including a QJSA or QPSA) must also provide the employee with an election to make a trustee-to-trustee rollover that is comparable to the election a qualified plan must offer.²¹²

A rollover of an eligible distribution from a 401 annuity contract to an IRA will have the effect of eliminating spousal annuity requirements. However, a rollover of such a distribution to any other type of eligible plan will eliminate spousal annuity requirements only if the recipient plan is not itself required to comply with those requirements.²¹³ In either event, however, the tax law does not generally allow an issuer to make without spousal consent an eligible rollover distribution from a 401 annuity contract that is a QJSA.²¹⁴ If a spouse declines to consent to the distribution from a QJSA, the employee's only alternative is to exchange the QJSA for a new QJSA in the manner suggested by the above discussion of GCM 39882.

IV. Minimum Distribution Requirements

A qualified plan generally must begin making minimum distributions to an employee or to his beneficiary as of a specified date.²¹⁵ If a plan fails to make required minimum distributions, the affected employee or benefi-

ciary must ordinarily pay a penalty tax equal to 50 percent of the undistributed amount, in addition to any regular tax.²¹⁶ The IRS may waive the penalty only when failure to make the minimum distribution was due to reasonable error that the employee or beneficiary is taking reasonable steps to correct.²¹⁷

A. Minimum Distributions for QJSAs and QPSAs

Minimum distribution requirements apply to QJSAs and QPSAs. As with other annuities, a QJSA or QPSA will ordinarily satisfy those requirements if the periodic payment interval does not exceed one year and the annuity period and payment amount does not change (except in limited circumstances).²¹⁸ Also, for a QPSA, a surviving spouse must receive his first annuity payment before the end of the first full calendar year following the employee's death or, if later, the calendar year the employee would have reached age 70½.²¹⁹ For a QJSA, an employee must receive his first annuity payment on or before the employee's "required beginning date."²²⁰

The required beginning date for a QJSA is normally April 1 of the year following the calendar year the employee reaches age 70½.²²¹ However, if the employee retires after age 70½, the required beginning date is generally April 1 of the year following the calendar year of retirement.²²² Nevertheless, the plan may by its terms eliminate this retirement alternative altogether (reverting to age 70½ in all events).²²³ Also, the retirement alternative does not apply if the employee is directly or indirectly a 5 percent owner of the employer.²²⁴ If a QJSA starts before an employee's normal required beginning date, the tax law treats the annuity starting date as if it were the required beginning date.²²⁵

B. Payments Guaranteed for a Fixed Term

A QJSA or QPSA may guarantee annuity payments for a fixed term, even though both the employee and beneficiary die before expiration of the fixed term.²²⁶ For a QJSA, the term of the guaranteed payments generally may not exceed a period determined from the Uniform

²¹⁶Section 4974(a).

²¹⁷Section 4974(d).

²¹⁸Section 401(a)(9)(A)(ii); reg. section 1.401(a)(9)-6, Q&A 1(a); 1.401(a)(9)-5, Q&A 1(e).

²¹⁹Section 401(a)(9)(B)(iv); reg. section 1.401(a)(9)-6, Q&A 1(c)(1), 1.401(a)(9)-3, Q&A 3(b).

²²⁰Section 401(a)(9)(A)(ii); reg. section 1.401(a)(9)-6, Q&A 1(c)(1).

²²¹Section 401(a)(9)(C)(i)(I); reg. section 1.401(a)(9)-2, Q&A 2(a).

²²²Section 401(a)(9)(C)(i)(II).

²²³Reg. section 1.401(a)(9)-2, Q&A 2(e).

²²⁴Section 401(a)(9)(C)(ii), (iv). The definition of a 5 percent owner is complex; it may be found at section 416(i)(1)(B).

²²⁵Reg. section 1.401(a)(9)-6, Q&A 10(a).

²²⁶In Rev. Rul. 81-9, 1981-1 C.B. 178 (Situation 8), the IRS acknowledged that QJSAs could provide for guaranteed payments. At that time, the statutory definition of QJSAs was substantially identical to their current statutory definition. Compare section 401(a)(11) (1983) to section 417(b) (2007).

²⁰⁹Reg. sections 1.402(c)-2, Q&A 10, 1.417(e)-1(e). Plant shutdown benefits that are retirement-type benefits and not ancillary benefits are also subject to the spousal annuity requirements. GCM 39869 (May 20, 1992).

²¹⁰Reg. section 1.402A-1, Q&A 14.

²¹¹Reg. section 1.402(c)-2, Q&A 10.

²¹²Reg. section 1.401(a)(31)-1, Q&A 17.

²¹³Reg. section 1.401(a)-20, Q&A 11; LTR 200453026.

²¹⁴Section 417(e)(1), (2); reg. section 1.417(e)-1(b)(2).

²¹⁵Section 401(a)(9). For a comprehensive explanation of required minimum distribution rules, see Blankenship, "Maximizing Tax Deferral for Funds in Tax-Favored Retirement Plans and IRAs," 3 CCH *Financial and Estate Planning Reporter* para. 32,871 (2006), or *Journal of Retirement Planning*, Jan.-Feb. 2006, at 15.

Lifetime Table²²⁷ based on the age attained by the employee in the calendar year that includes the annuity starting date. However, if a QJSA starts earlier than the normal required beginning date, the plan may determine the maximum guaranteed period by adjusting the period shown in the table for an individual age 70. That is, the plan may increase the maximum period shown for an individual age 70 by the difference between age 70 and the age the employee attains in the calendar year that includes the annuity starting date.²²⁸

Example. Assume an employee is age 65 on her birthday in the calendar year that includes the starting date of a QJSA. Then, the plan may satisfy minimum distribution rules by guaranteeing payments over a period no longer than 32.4 years. The plan determines this limitation by adding the 5-year difference between age 70 and age 65 (when the annuity actually begins) to the 27.4-year period in the Uniform Lifetime Table for an individual age 70.

If an employee dies before the required beginning date, a QPSA will satisfy minimum distribution requirements only if the guarantee period is no longer than the life expectancy of the surviving spouse.²²⁹ The plan finds the spouse's life expectancy in the Single Life Table,²³⁰ based on the age attained by the spouse in the calendar year containing the annuity starting date.²³¹

C. Increasing Payments Generally Prohibited

Minimum distribution requirements are generally not satisfied for a QJSA or QPSA if the amount of the periodic payment increases during the term of the annuity — except as follows:²³²

1. Exceptions to prohibited increases. The regulations do permit the following types of increases:

- a. An annual percentage increase not exceeding the increase in a cost-of-living index issued by the U.S. Bureau of Labor Statistics (including indices based on population segments or geographic areas).²³³
- b. An annual percentage increase equal to the lesser of a fixed percentage or the increase in a cost-of-living index described in a above. (Any excess of the cost-of-living increase over the fixed percentage may be carried over and used to increase payments in some later years.)²³⁴
- c. Percentage increases determined at specified times (or ages) by reference to cumulative increases in a cost-of-living index described in items a or b above.²³⁵

²²⁷Reg. sections 1.401(a)(9)-6, Q&A 3(a), 1.401(a)(9)-9, Q&A 2, Uniform Lifetime Table.

²²⁸Reg. section 1.401(a)(9)-6, Q&A 10(b).

²²⁹Reg. section 1.401(a)(9)-6, Q&A 3(b).

²³⁰Reg. section 1.401(a)(9)-9, Q&A 1, Single Life Table.

²³¹Reg. section 1.401(a)(9)-5, Q&A 5(b), 5(c)(2).

²³²Reg. section 1.401(a)(9)-6, Q&A 1(a).

²³³Reg. section 1.401(a)(9)-6, Q&A 14(a)(1), (b)(2).

²³⁴Reg. section 1.401(a)(9)-6, Q&A 14(a)(1), (b)(3).

²³⁵Reg. section 1.401(a)(9)-6, Q&A 14(a)(2).

- d. Increased benefits resulting from a plan amendment.²³⁶

2. Additional exceptions for purchased annuities. For QJSAs or QPSAs purchased by a plan, the regulations allow some additional types of payment increases. However, these increases are available only if total expected payments under the annuity exceed the amount of benefits used to purchase the annuity.²³⁷ The plan or annuitant determines the expected payments by reference to the single life table or joint and last survivor table, taking into account any guaranteed payments.²³⁸ If the preceding condition is satisfied, the regulations allow the following additional types of increases for a purchased annuity:

- a. a flat percentage increase applied each year;²³⁹
- b. dividends due to annual actuarial gains paid in the year following the year of the gains or as an additional annuity amount over the remaining annuity period;²⁴⁰ and
- c. an acceleration of payments that decreases the total amount paid under the annuity.²⁴¹

3. Additional exceptions for defined benefit plans. If a QJSA or QPSA payable by a defined benefit plan is not one described under the immediately preceding caption, the regulations allow the following additional types of payment increases:²⁴²

- a. A flat percentage increase of less than 5 percent a year.²⁴³
- b. Dividend payments due to annual actuarial gains from investment experience, computed by using an assumed interest rate of at least 3 percent. However, item a above must be inapplicable, and the plan must pay the dividends in the year following the year of the gains or as an additional annuity amount over the remaining annuity period.²⁴⁴

4. Changing the annuity payment period. The minimum distribution regulations allow a change in the annuity payment period in connection with any of the allowed payment increases described above.²⁴⁵ However, any changes to the annuity payment period should be consistent with QJSA or QPSA requirements.

D. Requirements for Distributed Annuity Contracts

As discussed above, a qualified plan may purchase and distribute a QJSA or QPSA contract. The mere distribution of the contract will not itself satisfy any

²³⁶Reg. section 1.401(a)(9)-6, Q&A 14(a)(4).

²³⁷Reg. section 1.401(a)(9)-6, Q&A 14(c), (e)(1).

²³⁸Reg. section 1.401(a)(9)-6, Q&A 14(e)(3), 1.401(a)(9)-9, Q&A 1, Single Life Table, Q&A 3, Joint and Last Survivor Table.

²³⁹Reg. section 1.401(a)(9)-6, Q&A 14(c)(1).

²⁴⁰Reg. section 1.401(a)(9)-6, Q&A 14(c)(3).

²⁴¹Reg. section 1.401(a)(9)-6, Q&A 14(c)(4), (e)(4).

²⁴²Reg. section 1.401(a)(9)-6, Q&A 14(d).

²⁴³Reg. section 1.401(a)(9)-6, Q&A 14(d)(1).

²⁴⁴Reg. section 1.401(a)(9)-6, Q&A 14(d)(3).

²⁴⁵Reg. section 1.401(a)(9)-6, Q&A 13(a).

minimum distribution requirements.²⁴⁶ Rather, distributions under the contract must satisfy those requirements.²⁴⁷ However, if the issuer stops payments because it is in delinquency proceedings, the tax law suspends minimum distribution requirements. The employee treats the unpaid annuity amounts as unvested.²⁴⁸ When the unpaid amounts become available, the issuer must pay them either before the end of the following calendar year or as an additional annuity beginning with the first payment interval ending in the following calendar year.²⁴⁹

E. Distribution Requirements for Rollovers

With spousal consent, an employee may roll over the benefit represented by a QJSA to another qualified plan, tax-sheltered annuities (TSAs), or IRA. A surviving spouse may similarly roll over the benefit represented by a QJSA or QPSA. In either event, the funds rolled over become subject to the minimum distribution requirements applicable to the recipient plan or IRA.²⁵⁰ Thus, for example, an employee may be able to delay the commencement of distributions by rolling over amounts from a plan in which age 70½ triggers minimum distributions to a plan in which minimum distributions are triggered by reaching the later of age 70½ or retirement.²⁵¹

It does not matter that minimum distributions have already begun in the distributing plan but are not yet required to begin in the recipient plan or IRA. The IRS views the distributing plan and the recipient plan (or IRA) as entirely separate for this purpose.²⁵² As a corollary, then, the different forms of distribution under the recipient plan or IRA should also be available with respect to the rolled-over amounts.²⁵³ Thus, an employee or surviving spouse rolling over plan amounts should, with any required consent, be able to take distributions in the form of *nonannuity* payments that satisfy minimum distribution requirements (rather than as a QJSA or QPSA).

V. Spousal Annuity Requirements for TSAs

TSAs, governed by section 403(b), may be established by tax-exempt educational, charitable, scientific, literary, sports, or religious organizations; public school systems; or the Uniformed Services University of the Health Sciences. The code authorizes three distinct types of TSAs: purchased retirement annuities,²⁵⁴ custodial accounts investing only in regulated mutual funds,²⁵⁵ and

“retirement income accounts,” available only to churches and related organizations.²⁵⁶

A. Identifying TSAs Subject to Requirements

Although failure to comply with spousal annuity requirements will not disqualify a TSA for tax purposes, the Labor Code nevertheless generally imposes the requirements on TSAs.²⁵⁷ Failure of an employer to comply with those requirements may trigger substantial enforcement action and monetary penalties.²⁵⁸ Strangely enough, though, it is still the tax regulations applicable to spousal annuities of qualified plans that govern spousal annuities provided by TSAs under the Labor Code.²⁵⁹

In any event, the spousal annuity requirements normally will not apply to a TSA established by a church, a tax-exempt association of churches, or a public school.²⁶⁰ Nor do the requirements generally apply to some other TSAs in which the employer is only minimally involved.²⁶¹ Such a minimal-involvement plan is one that satisfies all the following conditions:

1. Employee participation in the plan is voluntary.²⁶²
2. The only involvement of the employer is to:
 - a. allow sellers of annuity contracts or custodial accounts to present their products to employees;
 - b. request information regarding the products and their sellers;
 - c. summarize information for employees;
 - d. collect, record, and submit amounts under salary reduction agreements;
 - e. hold group annuity contracts of employees in the employer’s name; and
 - f. limit products and sellers to those providing employees with a reasonable choice.²⁶³
3. All rights in the annuity contract or custodial account are enforceable only by employees, beneficiaries, and their representatives.²⁶⁴
4. The employer is entitled to compensation or reimbursement only for reasonable expenses incurred in administering a salary reduction agreement.²⁶⁵

²⁵⁶Section 403(b)(9).

²⁵⁷T.D. 9340, *Doc 2007-17141, 2007 TNT 142-4* (July 23, 2007).

See generally 29 U.S.C. section 1055(a)-(l).

²⁵⁸29 U.S.C. section 1132.

²⁵⁹Reg. section 1.401(a)-20, Q&A 3(d).

²⁶⁰29 U.S.C. sections 1002(32), 1002(33), 1003(b)(1), 1003(b)(2). However, churches may irrevocably elect spousal annuity coverage (and some other requirements normally not applicable). 29 U.S.C. section 1003(b)(2); section 410(d); reg. section 1.410(d)-1(a).

²⁶¹29 C.F.R. section 2510.3-2(f).

²⁶²29 C.F.R. section 2510.3-2(f)(1).

²⁶³29 C.F.R. section 2510.3-2(f)(3).

²⁶⁴29 C.F.R. section 2510.3-2(f)(2).

²⁶⁵29 C.F.R. section 2510.3-2(f)(4).

²⁴⁶Reg. section 1.401(a)(9)-8, Q&A 10.

²⁴⁷Reg. section 1.417(e)-1(e).

²⁴⁸Reg. section 1.401(a)(9)-8, Q&A 8.

²⁴⁹Reg. section 1.401(a)(9)-8, Q&A 8, 1.401(a)(9)-6, Q&A 6, 1.401(a)(9)-5, Q&A 8.

²⁵⁰Rev. Rul. 2004-12, 2004-1 C.B. 478, *Doc 2004-1810, 2004 TNT 20-17*.

²⁵¹LTR 200453026.

²⁵²*Id.*

²⁵³Rev. Rul. 2004-12, note 250 *supra*.

²⁵⁴Section 403(b)(1).

²⁵⁵Section 403(b)(7).

B. Exchanges and Rollovers of TSAs

Similar to the exchange of 401 annuity contracts (discussed above), the exchange of a TSA for a new TSA will not be taxable if the new TSA continues to be subject to the same distribution restrictions (for example, spousal annuity requirements) as the old TSA. The tax law treats the exchange as a mere substitution of annuity issuers.²⁶⁶ Similarly, the treatment of spousal benefits after a *rollover* from a TSA is the same as the treatment of spousal benefits after a rollover from a 401 contract (as discussed above).²⁶⁷

C. Minimum Distribution Requirements

Minimum distribution requirements for QJSAs or QPSAs that are TSAs are essentially the same as the requirements discussed above for qualified plans. However, the required beginning date for those annuities is always April 1 of the year following the calendar year the employee reaches age 70½ or, if later, the calendar year the employee retires from employment with the sponsoring employer.²⁶⁸

Strictly speaking, minimum distribution requirements do not apply to the balance in a TSA at December 31, 1986.²⁶⁹ Nevertheless, the undistributed portion of this balance is subject to the rule that beneficiary benefits be merely “incidental” to retirement benefits.²⁷⁰ This incidental benefit rule is vague and ill-defined and thus difficult to apply. However, an employee may avoid the issue altogether simply by applying the current minimum distribution requirements to a TSA’s entire account balance (that is, to both the pre-1987 and post-1986 balances).²⁷¹

VI. Tax Planning for QJSAs and QPSAs

Tax planning for a QJSA or QPSA mainly revolves around changes in the timing and form of benefit payments. However, such planning may not always be feasible or desirable. For example, regular payments from a QJSA or QPSA may be an economic necessity for a retired employee or surviving spouse. In other cases, an employee or surviving spouse may need or desire a lump sum payment for personal reasons, even if it results in a

higher tax liability. Nevertheless, in many cases, tax planning will be both desirable and feasible.²⁷²

A. Tax Deferral for Employees

If tax deferral is one of the primary objectives of a retiring or separated employee, much will depend on the elections and options offered by his plan. For example, if a plan permits, an employee may be able to defer the start of QJSA payments until minimum distributions must begin, which is normally April 1 of the calendar year following the later of age 70½ or retirement.²⁷³ Spousal consent is not required for such a deferral, as long as the employee does not also attempt to waive the QJSA.

Alternatively, the employee may be able to achieve tax deferral (with spousal consent) by rolling over the entire retirement benefit tax free to another qualified plan or TSA.²⁷⁴ Although a retiring employee generally would have little opportunity to make such a rollover, the rollover may be feasible and desirable if the employee is merely changing employers. Although the recipient plan may also require payment of a QJSA or a QPSA absent spousal consent,²⁷⁵ the plan may nevertheless allow the employee to defer the commencement of distributions and thus taxation until well after age 70½, if the employee continues to work beyond that age.²⁷⁶

Conversely, the employee may prefer the greater personal control afforded by a tax-free rollover to an IRA. Unlike a rollover to a qualified plan or TSA, a rollover to an IRA will generally allow an employee to choose the trustee or custodian of the IRA, control investment decisions, and control the timing and amounts of distributions. Thus, the employee will have the power to defer IRA distributions (and the tax thereon) until April 1 of the calendar year following the year the employee reaches age 70½.²⁷⁷ Although the rollover to the IRA requires spousal consent, the spousal annuity and consent requirements will not thereafter apply to the IRA.²⁷⁸

A transfer of the plan funds to a Roth IRA is taxable. However, income earned by the Roth IRA accumulates tax free thereafter, and qualifying distributions from the Roth IRA are not taxable.²⁷⁹ Whether paying the tax on a transfer of funds to a Roth IRA makes sense depends in part on anticipated changes in the employee’s marginal

²⁶⁶Rev. Rul. 90-24, 1990-1 C.B. 97.

²⁶⁷Reg. section 1.401(a)-20, Q&A 11, Q&A 3(d). See text accompanying notes 213 and 214 *supra*.

²⁶⁸Section 401(a)(9)(C)(i)(I); reg. section 1.403(b)-3, Q&A 1(c)(1).

²⁶⁹Reg. section 1.403(b)-3, Q&A 2(a). The issuer or custodian of the TSA must keep adequate records of the pre-1987 balance, exclusive of earnings on the balance, but reduced by distributions from the balance. Reg. section 1.403(b)-3, Q&A 2(b). Distributions are considered to be made first from the post-1986 balance to the extent of the minimum distribution requirements applicable to the post-1986 balance, then from the pre-1987 balance. Reg. section 1.403(b)-3, Q&A 2(c). The pre-1987 balance may retain its character in a trustee-to-trustee transfer to another TSA. However, a rollover of all or part of the pre-1987 balance will convert the rollover amount to a post-1986 balance. Reg. section 1.403(b)-3, Q&A 2(d).

²⁷⁰Reg. section 1.401-1(b)(1)(i).

²⁷¹Reg. section 1.403(b)-3, Q&A 3.

²⁷²For a broader discussion of tax deferral opportunities, see Blankenship, “Maximizing Tax Deferral for Funds in Tax-Favored Retirement Plans and IRAs,” note 215 *supra*.

²⁷³See text accompanying notes 24 through 36 *supra*.

²⁷⁴The employee may or may not be able to roll over his investment in the distributing plan. See Blankenship, “Retirement Plans and IRAs: Rollovers of Taxpayer Investment,” *Journal of Retirement Planning*, May-June 2006, at 29.

²⁷⁵Reg. section 1.401(a)-20, Q&A 11.

²⁷⁶Rev. Rul. 2004-12, note 250 *supra*; LTR 200453026. See text accompanying notes 221 through 225 *supra*.

²⁷⁷Sections 402(c), 401(a)(9)(A), 401(a)(9)(C)(i)(I); reg. sections 1.401(a)(9)-8, Q&A 4, 1.401(a)(9)-2, Q&A 2(a), 1.408-8, Q&A 3.

²⁷⁸Rev. Rul. 2004-12, note 250 *supra*.

²⁷⁹Section 408A(d). In the past, taxpayers, to transfer funds in a qualified plan to a Roth IRA, have had to roll over the funds to a regular IRA and then convert the regular IRA to a Roth IRA. However, after 2007, a taxpayer may directly transfer funds in a

(Footnote continued on next page.)

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tax rates and the rate of return on investments made by the Roth IRA.²⁸⁰ Perhaps most importantly, however, a Roth IRA is not required to begin minimum distributions until after the death of the employee, thereby allowing income to accumulate tax free during the employee's lifetime.²⁸¹ Again, the rollover to the Roth IRA requires spousal consent, but the spousal annuity and consent requirement will not thereafter apply.²⁸²

B. Tax Deferral for Surviving Spouses

Tax deferral planning for a surviving spouse will differ depending on whether the spouse is entitled to a QJSA or QPSA. If the deceased employee had begun receiving QJSA payments, the plan must continue QJSA payments to the surviving spouse.²⁸³ However, a spouse may be able to defer the start of QPSA payments (if the plan permits) until the date minimum distributions must begin.²⁸⁴ That date is generally the last day of the later of the calendar year following the employee's death or the calendar year the employee would have reached age 70½.²⁸⁵

Otherwise, a spouse entitled to QPSA or QJSA payments may be able to achieve tax deferral by cashing out the annuities and rolling over the entire proceeds tax free to another qualified plan, TSA, IRA, or Roth IRA.²⁸⁶ If the surviving spouse is employed, a rollover to another qualified plan or TSA may be the most feasible and desirable alternative. Such a rollover might extend the period of tax deferral by allowing the spouse to defer distributions until April 1 of the year after the spouse reaches age 70½, or April 1 of the year after the spouse's retirement, if later.²⁸⁷

Nevertheless, the surviving spouse might not have access to an appropriate qualified plan or may prefer the personal control allowed by an IRA. In that case, the spouse may roll over the cash-out proceeds to his own IRA and defer minimum distributions until April 1 of the year following the calendar year the spouse reaches age 70½.²⁸⁸ That will provide a potentially longer tax deferral than under the original qualified plan if the surviving spouse is under age 70½ and will reach age 70½ later than would the deceased employee.

Finally, the surviving spouse could choose to transfer the cash-out proceeds to a Roth IRA owned by the

spouse. Although, as noted above, a transfer of plan funds to a Roth IRA is taxable, income earned by the Roth IRA thereafter accumulates tax free and qualifying distributions from the Roth IRA are not taxable.²⁸⁹ Again, whether paying the tax on a transfer of funds to a Roth IRA makes sense depends in part on anticipated changes in the surviving spouse's marginal tax rates and the rate of return on investments made by the Roth IRA.²⁹⁰ Perhaps most importantly, however, a Roth IRA is not required to begin minimum distributions until after the death of the spouse, thereby allowing income to accumulate tax free during the spouse's lifetime.²⁹¹

(When and after minimum distributions are required to begin, the distributions themselves may assume different permitted payment forms with different ongoing tax deferral consequences (for example, a lump sum payment vs. a life annuity). However, a comparison of the ongoing tax deferrals associated with these different forms of payment is beyond the scope of this article.²⁹²)

C. Planning With the QOSA

With the introduction of QOSAs in 2008, employees and their spouses gain some flexibility in choosing a joint and survivor annuity. A QOSA will allow an employee and spouse to vary the division of a plan benefit between them without changing the overall value of the benefit. On one hand, a QJSA provides that a surviving spouse's annuity payment is fixed at a given percentage of the employee's annuity payment. On the other hand, a QOSA allows the employee and spouse to either raise the percentage to 75 percent or reduce the percentage to 50 percent, depending on the level of the original percentage. Of course, the choice of percentage may depend more on nontax considerations and wishes than on tax considerations. Nevertheless, raising the spouse's percentage to 75 percent from some lesser percentage (thereby decreasing the amount of the employee's payments) clearly enhances tax deferral.²⁹³

D. Dealing With Refusal to Consent

An employee's spouse might unreasonably refuse to consent to waivers of a QJSA and QPSA provided by a profit-sharing or stock bonus plan, even though the annuities are otherwise incompatible with a comprehensive family financial plan. If so, the employee may be able to avoid the spousal consent requirements by making his spouse the beneficiary of any funds held by the plan at the employee's death. Then, during the employee's lifetime, he or she may freely exercise any of the plan's payment options other than life annuity options. Thus, the employee may be able to withdraw all the benefits in the form of an annuity for a term of years, a lump sum, or other non-life-annuity distribution. Also, the employee might be able to roll over the lump sum or other

qualified plan to a Roth IRA without using a regular IRA as an intermediary. Pension Protection Act of 2006, section 824(a), (b), (c).

²⁸⁰See Blankenship, "Conversions of IRAs to Roth IRAs and Roth Recharacterizations," *Journal of Retirement Planning*, Nov.-Dec. 2005, at 11.

²⁸¹Section 408A(c)(5).

²⁸²Rev. Rul. 2004-12, note 250 *supra*.

²⁸³Section 417(b)(1); reg. section 1.417(e)-1(b)(1), (c).

²⁸⁴See text accompanying notes 73 through 75 *supra*.

²⁸⁵Section 401(a)(9)(B)(iv); reg. section 1.401(a)(9)-6, Q&A 1(c)(1), 1.401(a)(9)-3, Q&A 3(b).

²⁸⁶Sections 417(e) and 402(c). See note 274 *supra*.

²⁸⁷Rev. Rul. 2004-12, note 250 *supra*; LTR 200453026. See text accompanying notes 24 through 36 *supra*.

²⁸⁸Sections 402(c), 401(a)(9)(A), 401(a)(9)(C)(i)(I); reg. sections 1.401(a)(9)-8, Q&A 4, 1.401(a)(9)-2, Q&A 2(a), 1.408-8, Q&A 3.

²⁸⁹See note 279 *supra*.

²⁹⁰See Blankenship, note 280 *supra*.

²⁹¹Sections 408A(c)(5).

²⁹²See, however, Blankenship, note 215 *supra*.

²⁹³See text accompanying notes 127 through 134 *supra*.

nonannuity distributions tax free to an IRA that would be free of spousal consent requirements.²⁹⁴

E. Marriage or Divorce Planning

As previously discussed, an antenuptial consent to a waiver of a QJSA or QPSA is unlikely to survive judicial review. Further, a promise in an antenuptial agreement to sign a consent after marriage would likely be unenforceable due to ERISA's policy concerns and its general preemption of state law. However, given the honeymoon effect, the best time to obtain consent to waivers might well be as soon after the wedding as possible, if that should coincide with the allowable waiver period. If the effort to obtain consent is likely to meet resistance, it still might be possible to obtain consent during the marriage by renegotiating some other provision of the antenuptial agreement.²⁹⁵

As soon as possible after a divorce or separation, an employee should make desired changes to the beneficiary designations in his qualified plans. It is highly risky to rely merely on spousal disclaimers of plan interests in divorce settlements or premarital agreements. Of course, most desirably, the employee and divorcing spouse should spell out everything in a QDRO.

Unfortunately, however, a QDRO will not solve all problems. For example, a provision in a QDRO will not allow divorcing spouses to designate their children as the beneficiaries of survivorship benefits under a QJSA or QPSA over the survivorship rights of the employee's future spouse. Perhaps the best they can do is to designate the divorcing spouse as the beneficiary under the QDRO in the expectation their children will thereby benefit. The alternative is to attempt to obtain a future spouse's consent to make the children the beneficiaries.²⁹⁶

As noted above, it is highly unlikely that a disclaimer in an antenuptial agreement could ever constitute consent to a waiver of a QJSA or a QPSA. Also, a later divorce after payments under a QJSA have started will not affect the spouse's survivorship rights under the QJSA. However, a premarital disclaimer may be effective if the spouses should divorce before the employee's annuity starting date. In divorce actions, many state courts look with favor on the enforcement of spousal disclaimers of plan interests, even premarital disclaimers. Thus, it may be easy to convince those courts to enforce a premarital disclaimer (before a QJSA's starting date) by refusing to issue a QDRO for the benefit of the disclaiming spouse.²⁹⁷

F. Planning for the QPSA

If a defined benefit plan provides for forfeiture of funds when a surviving spouse dies before QPSA payments commence, it is of course generally advisable to start the annuity payments as soon as possible. Starting the payments may be even more urgent for a surviving spouse in poor health if the annuity provides for guaranteed payments. In any event, however, a surviving

spouse in poor health should explore a potential cash out of the benefit in the plan in lieu of accepting QPSA payments, regardless of the nature of the plan.²⁹⁸

G. Planning for Distributed QJSAs or QPSAs

If a qualified plan distributes a transferable QJSA or QPSA contract, the employee or surviving spouse must convert the contract to a nontransferable contract within 60 days to avoid paying tax on the entire value of the contract. Further, the value of even a nontransferable contract will become taxable if the contract ceases to comply with the tax law requirements imposed on the distributing plan. However, an employee or surviving spouse may roll over an eligible distribution tax free to an IRA or another qualified plan. A rollover to an IRA of a cashed-out QJSA will have the effect of eliminating spousal annuity requirements. However, if a spouse refuses to consent to a cash out of the QJSA, the employee might be limited to an exchange of the QJSA for a new QJSA in the manner suggested by GCM 39882 (discussed above).²⁹⁹

VII. Conclusion

Spousal annuity requirements serve the valuable function of protecting spousal interests. Although those requirements make tax planning more difficult and complex, substantial tax deferral planning is available and the many pitfalls are usually avoidable. There is little doubt, however, that cooperative spouses make planning much easier.

Appendix:

Brief Definitions of Some Common Terms

Cash balance plan. A defined benefit plan that bases an employee's normal retirement benefit on a hypothetical account that accumulates hypothetical contributions based on service and hypothetical interest accruals.

Defined benefit plan. A qualified plan that is not a defined contribution plan. Defined benefit plans generally guarantee participants fixed benefits at retirement determined without regard to contributions to the plan.

Defined contribution plan. A qualified plan that provides for individual employee accounts and for employee benefits based solely on contributions to the accounts, income, expenses, gains and losses allocable to the accounts, and allocable forfeitures of accounts of other employees (when applicable). Defined contribution plans include profit-sharing plans, stock bonus plans, and money purchase pension plans.

ESOP. An employee stock ownership plan. An ESOP is a defined contribution plan designed to invest in stock of the employer. It must satisfy specific statutory requirements.

Money purchase pension plan. A defined contribution plan that provides for a set level of required employer contributions, generally as a specified percentage of participants' compensation, and for the distribution of benefits in the form of an annuity.

²⁹⁴See text accompanying notes 144 through 156 *supra*.

²⁹⁵See text accompanying notes 113 through 115 *supra*.

²⁹⁶See text accompanying notes 165 through 172 *supra*.

²⁹⁷See text accompanying notes 178 and 179 *supra*.

²⁹⁸See text accompanying note 68 *supra*.

²⁹⁹See text accompanying notes 203 through 214 *supra*.

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Profit-sharing plan. A defined contribution plan under which the annual contributions by the employer are generally within the employer's sole discretion (whether or not the employer has profits or is a nonprofit organization).

QDRO. A qualified domestic relations order. A QDRO is generally a judgment, decree, or order of a state court normally issued in connection with divorce or legal separation that satisfies specific statutory requirements. A QDRO establishes or recognizes the right of a spouse, former spouse, child, or other dependent to receive specified benefits from a qualified plan.

Qualified church plan. A qualified plan established by a church, or by a convention or association of churches.

Qualified government plan. A qualified plan established by a federal, state, or local government, or by any of their subdivisions, agencies, or instrumentalities.

Qualified plan. An employer retirement plan that satisfies the requirements of section 401(a) or section 403(a).

Stock bonus plan. A profit-sharing plan in which benefits are distributable in stock of the employer sponsoring the plan.

TSA. A tax-sheltered annuity or other arrangement that satisfies the requirements of section 403(b).

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