Community Property Interests in Individual Retirement Accounts

Lee Hargrave

Repository Citation
Available at: https://digitalcommons.law.lsu.edu/lalrev/vol55/iss3/2

This Article is brought to you for free and open access by the Law Reviews and Journals at LSU Law Digital Commons. It has been accepted for inclusion in Louisiana Law Review by an authorized editor of LSU Law Digital Commons. For more information, please contact kayla.reed@law.lsu.edu.
Community Property Interests in Individual Retirement Accounts

Lee Hargrave*

A married person’s interest in an Individual Retirement Account (IRA) is subject to the general Louisiana community property and successions laws except to the extent federal law provides otherwise or more specific state legislation applies. Important exceptions include federal income tax provisions that limit tax benefits to qualified IRA’s and that specify, in 26 U.S.C. § 408(g): “This section shall be applied without regard to any community property laws.” Also, Louisiana Revised Statutes 9:2449 provides IRA benefits “shall be paid as provided in the individual retirement account agreement to the designated beneficiary of the account.”

The inquiry is complicated by the Louisiana Trust Code,1 for an IRA is not a simple tax-exempt bank account or investment account. To qualify for favorable tax treatment, the funds must be placed in trust with a trustee, who must abide by a number of limitations provided for in 26 U.S.C. § 408. The trust itself is governed by state trust law, under which the trustee must manage and distribute the assets according to the trust agreement.2

A. Power to Contract and Fund an IRA

Federal tax laws give favorable treatment to IRA’s3 that meet a number of conditions. One condition requires deposits in the IRA to be in a “trust . . . for the exclusive benefit of an individual or his beneficiaries.”4 A married person can establish the trust contract with the trustee without the consent of the other spouse under general rules of contractual capacity. Marriage does not lessen either spouse’s general capacity to contract,5 and the matrimonial regimes legislation governs property of the spouses6 rather than contractual capacity.

Once the trust is established, a spouse acting alone can transfer funds to the trustee. No state law requires the consent of the other spouse to make such a transfer. Normally, funds can be deposited in an IRA trust account only if they

Copyright 1995, by LOUISIANA LAW REVIEW.
* Wex S. Malone Professor of Law, Louisiana State University.
2. La. R.S. 9:1731 (1991): “A trust, as the term is used in this Code, is the relationship resulting from the transfer of title to property to a person to be administered by him as a fiduciary for the benefit of another.”
4. Id. § 408(a) (1988).
are earnings of the taxpayer. Under Louisiana Civil Code article 2338, such earnings of a married person are community property in the absence of a matrimonial agreement providing otherwise. They are corporeal movables (or their equivalent), and each spouse acting alone can alienate such funds without the consent of the other spouse, unless the transfer is a donation of community property to a third person.

The transfer of funds to a trustee of an IRA is probably not a donation to a third person. It is not a case in which the donor "divests himself, at present and irrecovably, of the thing given, in favor of the donee who accepts it." The normal IRA is revocable. The trustee is not a donee, but a fiduciary. It is not a present transfer to the beneficiary. The intent of the transferor is normally not to make a gift to the trustee, but to obtain tax savings and to accumulate investment income free of income tax in anticipation of repayment at retirement when one is in a lower tax bracket. To the extent a beneficiary is named to receive funds if the transferor does not survive, it is not a transfer of the funds to the named beneficiary. Such a designation would appear to be analogous to the designation of a beneficiary in a life insurance policy or in an employee pension plan, both of which have been treated as not subject to the rules governing donations.

The beneficial interest the settlor spouse holds is a contractual claim against the trustee, an incorporeal right which is classified as a community right since it was acquired with community funds. This analysis parallels that used in classifying pension benefits as incorporeal community assets and the ownership interest in a life insurance policy as a community asset. Although the matter has not been the subject of much litigation, classification of the IRA rights as community is assumed in a number of cases.

7. An exception is made for spousal trusts and rollovers. See I.R.C. §§ 219(c)(2) and 408(d)(3) (1988). The general policy, however, is to provide taxpayers who do not benefit from qualified employee pension plans with a tax benefit similar to those who do qualify. In both cases, it is funds that are compensation for work that are involved, as opposed to existing savings or capital.

14. Madere v. Madere, 632 So. 2d 1180 (La. App. 5th Cir. 1994) (holding a husband's IRA, funded partly with community and separate funds, was a community asset at partition following divorce, although it is questionable whether the IRA was bought before divorce); Cooper v. Cooper, 619 So. 2d 1210 (La. App. 1st Cir.), writ denied, 625 So. 2d 1042 (1993) (allowing funds in an IRA coming from earnings to be stipulated as community property); Barr v. Barr, 613 So. 2d 1159 (La. App. 5th Cir. 1993) (assuming IRA's to be community property); Fastabend v. Fastabend, 606 So. 2d 794 (La. App. 3d Cir.), writ denied, 609 So. 2d 231 (1992) (assuming IRA's of husband and wife were community property when not litigated on appeal); Terry v. Terry, 565 So. 2d 997 (La. App.
"Spousal IRA's" are provided for in the Internal Revenue Code, whereby the amount that can be contributed to IRA's is increased from $2000 to $2250 for a wage earner if the spouse is not earning income. If one elects to contribute the larger sum, the result is not one IRA that is co-owned by the spouses. Rather, each spouse has an individual IRA trust account, and the $2250 can be divided as they desire, so long as no more than $2000 is deposited in one account. The federal limitations on the amounts eligible to be contributed to the IRA are applied without regard to community property laws, and the nonearning spouse is not considered as earning one-half of the working spouse's income for applying these rules.

A possible remedy, albeit a limited one, for a spouse harmed by the other spouse's funding an IRA with community funds is provided by Louisiana Civil Code article 2354. One spouse is liable to the other for damages caused by fraud or bad faith in the management of community assets. To prevail, the plaintiff must prove intent to harm the other spouse, a difficult burden that would seldom be met absent intent to deprive the spouse of funds he would otherwise receive. Normally, the tax advantages and tax-free compounding of income in the IRA would motivate an employee and would not constitute fraud or bad faith.

B. Power to Designate a Beneficiary

It seems clear that the person who contracts for the IRA can designate the beneficiary who will receive the funds if the settlor dies before receipt of the funds. The federal tax legislation contemplates that the IRA qualifies for tax benefits only if the trust is "for the exclusive benefit of an individual or his beneficiaries." Under state trust law, designation of a beneficiary is a contractual matter between the settlor and the trustee, and nothing in the Trust Code or the Civil Code requires concurrence of both spouses for such contracts. The trust interest is a community incorporeal right which, under rules of privity, is managed by the contracting

---

1. I.R.C. § 219(c) (1988). "The term is a misnomer, because a spousal IRA is nothing more than a garden variety IRA established in the nonworking spouse's name." David R. Baker, IRAs and SEPs at A-19 (Tax Management Portfolio Series No. 355-4th, 1994).
spouse.\textsuperscript{21} Also, it would appear the analogy to life insurance policies and employee benefit plans, under which a designation of beneficiary is upheld, also applies. In the same way, a change of beneficiary is not specified in the Civil Code as a transaction requiring consent of both spouses and can be made by the contracting party alone under the rule of privity. All of these general considerations are reinforced by the adoption, in 1986, of Louisiana Revised Statutes 9:2449, which provides benefits will be paid “as provided in the individual retirement account agreement to the designated beneficiary of the account.”

C. Management of the IRA

Once the trust contract exists, the rule of privity just discussed governs the management powers under the agreement. The settlor spouse has the exclusive power to alter the relations with the third person contracting party, and the other spouse has no management rights in that regard.\textsuperscript{22} To the extent the contributing spouse reserves the right to direct the investment of the funds, that spouse alone can take advantage of that right. One may choose to “roll over”\textsuperscript{23} other assets into the existing IRA or even terminate the IRA. In effect, an incorporeal right replaces the thing itself and results in exclusive management of that right by the contracting spouse. The basic policy involved is one of protecting the trustee from conflicting claims of a spouse who might assert a community interest in the IRA. Even if the IRA is classified as a community asset, such classification does not mean co-management rights exist, but places management power in the contracting spouse.\textsuperscript{24}

The same rule would seem to apply to the prime management right—when and how to pay the proceeds of the IRA when the grantor is eligible. Again, it would seem the contracting parties are the only ones who can affect their rights under the contract. The possible limit on a spouse’s ability to manage the IRA and control the distributions is the remedy of Louisiana Civil Code article 2354—liability for damages caused by fraud or bad faith management of community assets.

D. Partition at Divorce

If the community is terminated by divorce, the former spouses become simple co-owners or co-holders of all community assets, and normally each is entitled to demand a partition.\textsuperscript{25} In the absence of any exceptions, the rights under the IRA agreement would come under this principle. If the former spouses cannot agree on

\textsuperscript{21} Spaht & Hargrave, supra note 13, § 5.4, at 154-55; Janis L. Kile, Note, Management of Community Assets: Incorporeal Movables, 42 La. L. Rev. 725, 774 (1982).
\textsuperscript{22} Spaht & Hargrave, supra note 13, § 5.4, at 155.
\textsuperscript{23} Rollover provisions of § 408(d)(3) allow assets to be moved from one qualified plan to another without payment of tax.
\textsuperscript{25} La. Civ. Code arts. 2336, 2369.1.
a voluntary partition, the judge, under Louisiana Revised Statutes 9:2801, could allocate the IRA interest to one of the spouses or divide it between them. Since state law, however, did not develop a mechanism to overcome the privity rights of the third person dealing with the contracting spouse, the judge would probably have to allocate the IRA to the contracting spouse if the trustee did not consent to a substitution.

Another option under state law would be to invoke the reasoning of the pension cases decided before the adoption of Louisiana Revised Statutes 9:2801 and to force the ex-spouses to continue as co-holders of the right until payment of benefits. Then, each payment would be divided according to the pro rata rights of the parties. Under the rationale of Sims v. Sims,26 it could be inequitable to force one of the spouses to provide immediate cash or assets to offset the value of the plan that is allocated to the other spouse. Also, it may be equitable to make them share the risks and uncertainties involved in the investments in the account.27

Under either approach, however, state law could not override the federal income tax consequences of such transactions, which could result in significant income tax liability if the partition produced a distribution subject to taxes and penalties.28 Federal law, however, has clarified the tax consequences of distributions incident to divorce and practically overcomes the privity problems under state law.

The latest changes to 26 U.S.C. § 408(d)(6) were made to conform the provisions to the Retirement Equity Act of 1984 (REA)29 under which employee pension plans covered by the Employee Retirement Income Security Act of 1974 (ERISA)30 can be allocated pursuant to divorce or separation agreements. The section provides that a transfer of one’s IRA interest to a spouse or former spouse under a divorce or separation instrument is not a taxable transfer and the transferred interest is to be treated as an individual IRA of the transferee spouse. “Thereafter such account or annuity for purposes of this subtitle is to be treated as maintained for the benefit of such spouse.”31 Given the common practice of dividing such rights under ERISA- and REA-governed plans, it would seem no great burden for trustees to divide similar IRA’s. It would thus seem the Louisiana judge probably has the authority to allocate the IRA to either spouse or to split it as a community asset between the two spouses. The trustee is not likely to object in the normal case since continuation as trustee would probably depend upon keeping the tax benefits

intact. If the trustee objects, the settlor can revoke the trust and roll the funds into another IRA with a more cooperative trustee.

Section 408(d)(6), as amended, grants tax-exempt status to transfers under a divorce or separation instrument described in subparagraph (A) of section 71(b)(2). That subparagraph refers to “a decree of divorce or separate maintenance or a written instrument incident to such a decree.” The exception does not include a simple written separation agreement under section 71(b)(2)(B) or another type of decree requiring a spouse to make payments for the support or maintenance of the other spouse under section 71(b)(2)(C).

The agreement incident to a divorce that can divide IRA accounts is not necessarily a Qualified Domestic Relations Order (QDRO) as required under the REA and ERISA. It is a simpler device. Indeed, it has been suggested it might be possible to distribute the assets in a qualified plan, which normally requires a QDRO to divide, into an IRA without adverse tax consequences; and once in the IRA, they can be divided under the simpler procedures for dividing an IRA.

If the IRA is divided equally, valuation problems are not likely to arise. Though the funds may have been invested tax-free and may be subject to taxation when withdrawn, the future tax liability is probably relatively equal. On the other hand, if the account is allocated to one spouse, it is arguable that its value, considering the potential tax liability upon withdrawal, is less than the value of the account at the time of partition. Standard accounting practice would discount the value on that basis. However, the courts have been reluctant to do so because of the uncertainties involved. In Ramstack v. Krieger, the husband contributed to a community IRA, which was allocated to him in a partition. In refusing to reduce the value by the income tax liability payable upon withdrawal, the court of appeal stated,

While it is true that if he withdraws the money before a certain age, he will incur a tax liability which the plaintiff will not be required to share, it is also true that if he leaves the funds in the account, they will earn interest from which the plaintiff will not benefit. Therefore, we find the trial court’s treatment of the account to be an equitable solution.

In the proper factual setting, if the discount is less speculative, the potential tax liability should be considered.

32. For example, though Madere v. Madere, 632 So. 2d 1180 (La. App. 5th Cir. 1994), may be questionable since the IRA was purchased after the divorce and was not community property at all, it was partitioned incident to a divorce and would not be a taxable distribution.
35. Spaht & Hargrave, supra note 13, § 11.3, at 439.
36. 470 So. 2d 162 (La. App. 4th Cir.), writ denied, 474 So. 2d 1310 (1985).
37. Id. at 167.
IRA’S AS COMMUNITY PROPERTY

E. Voluntary Partition

Louisiana law allows married couples to terminate their community regime by agreement or to partition community assets voluntarily without terminating the community regime. This authority would allow spouses to partition their IRA’s consisting of community funds, at least if the trustee agrees. Even without such agreement by a trustee, one could terminate the IRA relationship and roll the funds over into separate IRA’s. Such voluntary transactions, however, could result in significant unfavorable federal tax consequences.

The exception that allows tax-free distributions incident to a separation or divorce does not, by its terms, apply to a simple partition or termination of the community. The Internal Revenue Service (IRS), in a Private Letter Ruling, has taken such a view. In that case, spouses, contemplating a separation in fact, but not a divorce, voluntarily agreed to divide the husband’s IRA’s. The IRS ruling specified:

The separation agreement is not incident to either a divorce or a legal separation, and your authorized representative has not asserted that Taxpayers A and B intend to present their agreement to a court which has jurisdiction over their marital affairs in order for the court to enter a decree with respect to the separation agreement.

Thus, based on the above, we conclude that the separation agreement entered into between Taxpayers A and B does not constitute either a decree or written instrument within the meaning of section 71(b)(2)(A) of the [Internal Revenue] Code.

The strength of the federal policy of taxing and penalizing early distributions is shown by its application even to involuntary distributions from IRA’s. In Aronson v. Commissioner, the Tax Court ruled a distribution from the receiver of a failed savings and loan that was not reinvested in another IRA was subject to tax.

F. IRA Distributions During the Community

Upon distribution of an IRA consisting of community funds, Louisiana law would treat the funds as community property. The distribution would be a return of capital in part and, thus, community property under real subrogation princi-

40. I.R.C. § 72(t)(1) (1988) subjects early distributions from an IRA to an increase in tax equal to ten percent of the portion of the distribution which is included in gross income.
42. Id.
The increase in value would be the fruits of community property and, thus, also community. The federal rules regarding taxation of income apply, basically taxing the untaxed contributions and investment income. There appears to be no conflict between state law and federal law in these regards.

If, for some reason, part of the fund would be separate contributions and part community contributions, the account would presumably be divided on a pro rata basis as the benefits under the T.L. James apportionment. The appropriate apportionment would then be made and each payment would be so characterized.

G. Death of the Non-Covered Spouse Once Distributions Start

A narrow Louisiana provision adopted in 1990 protects the covered spouse who is collecting IRA or other pension benefits when the other spouse dies. It was added to the Louisiana Civil Code as Article 890.1 and provides the covered spouse will continue to receive the cash flow from the IRA until death, even though the heirs of the deceased spouse might have claims to part of the asset under community property principles.

Article 890.1 applies to “a public or private pension or retirement plan, an annuity policy or plan, an individual retirement account, a Keogh plan, a simplified employee plan, or any other similar retirement plan.” If a spouse dies while the other spouse is receiving “a recurring payment” from the plan, the surviving spouse enjoys a legal usufruct over the continuing recurring payment, which was the deceased spouse’s share of their community, if the source of the benefit is traced to payments made by or on behalf of the surviving spouse. The usufruct is mandatory and applies even if a testament provides otherwise.

Although Article 890.1 calls this a “legal usufruct,” it is not provided that the usufruct terminates upon remarriage, as Article 890 provides with respect to the regular legal usufruct of the surviving spouse. As a legal usufruct, it would be free of the normal requirement of security, but Article 890.1 goes further. It also provides that such a usufruct is not an impingement on the legitime of forced heirs.

The basic policy behind Article 890.1—protecting the rights of the surviving spouse to a retirement benefit at the expense of the heirs of the deceased

46. Perhaps some of the funds would be separate as a result of the spousal IRA rules; some could have been contributed before marriage, and some could have been rolled over into an IRA containing community funds.
47. See supra note 11 and accompanying text.
49. A simplified employee plan is similar to an IRA; both are governed by I.R.C. § 408 (1988 & Supp. V 1993).
spouse—would seem to also apply in the case of a death of the other spouse before regular distributions are begun. However, Article 890.1 strictly construed seems to apply if the “recurring payment is being made . . . and one spouse dies.” As suggested in the next section, the underlying policy seems broader, and the provision might well be construed to apply more broadly by analogy.

Since the right of the surviving spouse is a usufruct of money that would otherwise go to the heirs, the usufructuary has the right to spend those funds. In so doing, the usufructuary incurs the obligation to compensate the naked owners for those sums at the termination of the usufruct, which would normally be upon death.

**H. Death of the Non-Covered Spouse Before Distributions Start**

If a spouse in a community property regime dies, Louisiana law provides the community property regime is terminated and the heirs or legatees of the deceased inherit one-half of the former community property. Absent special rules for IRA’s, it appears the heirs or legatees would become co-owners or co-holders with the surviving spouse of the beneficial interest in the IRA trust.

The Idaho Supreme Court took that approach in *In Re Mundell*. A surviving wife had funded an IRA with community income. Her husband willed the bulk of his property to children of a prior marriage, who claimed his estate included a one-half interest in the stepmother’s IRA. The supreme court accepted the lower court’s conclusion, which the parties did not contest, that the IRA’s were community property. It further concluded state law was not preempted by 26 U.S.C. § 408(g), which provides, “This section shall be applied without regard to any community property laws.” It reasoned there was “no intent by Congress to preempt Idaho community property law as it relates to the characterization of IRA’s.” The court also cited 26 U.S.C. § 408(d)(6), which provides for division of the IRA at divorce, reasoning that it indicates Congressional acceptance of the influence of state domestic law on IRA’s. It distinguished cases involving federal disability and social security benefits on the basis that the government had less interest in controlling the disposition of privately funded IRA’s. Also, Congress did not provide in the IRA regulations the anti-attachment and anti-assignment provisions of other types of pension regulations.

A concurring opinion in the Idaho Supreme Court emphasized the congressional purpose of adopting separate property concepts primarily for the purpose of considering only the taxpayer’s earnings in calculating the deductible contribution, and not the taxpayer’s interest in community earnings of the other spouse.

---

56. *Id*. at 633.
The supreme court then approved an order providing the deceased estate was entitled to a one-half interest in the IRA’s; but, given the case’s procedural posture, the court did not have to address the difficult question of partitioning the interests.  

Under Louisiana law, preliminary issues involve whether such inchoate interests in IRA’s can be inherited and determination of state policies concerning such assets. The inquiry is to be pursued in the context of other protective devices if a spouse tries to use IRA’s to remove assets from another in fraud or bad faith. Also relevant is the fact that, if IRA trust interests are inherited by children, they may be subject to the legal usufruct of the surviving spouse until remarriage. Those heirs would be unable to manage or receive the value or the fruits of the asset as long as the usufruct continues. Still, it could become a problem upon remarriage, or if a will is construed as including the IRA interests. The problem must also be considered in light of treatment of similar interests in qualified pension plans and life insurance policies.

Under the Louisiana Civil Code, strictly personal obligations cannot be inherited. It is difficult, however, to fit the other spouse’s IRA rights within the Civil Code’s definition of strictly personal obligations. That distinction is made in the context of the rights of the parties to a contract and does not address the rights of the spouse of a contracting party. The Civil Code provides: “An obligation is strictly personal when its performance can be enforced only by the obligee, or only against the obligor.” If that definition were determinative, it would classify as strictly personal a spouse’s interest in every community contract entered into by the other spouse because of the denial of enforcement rights, a classification inconsistent with the inclusion of incorporeal rights as property subject to the community regime. It is more likely the analogy to pensions under T.L. James and Sims would apply, and the IRA trust pension rights of the other spouse would be considered as community assets under Louisiana law. That conclusion, however, is only the beginning of the analysis. The nature of contract rights is such that it places limitations on the rights of the non-contracting spouse. Under basic privity concepts, the rights of the non-contracting spouse (and that spouse’s heirs) are limited in that they cannot affect the obligations of the contracting parties. This reflects a basic policy of protecting third persons from the possibly conflicting interests of the co-holders.

57. The court’s solicitude for the children may have been influenced by the existence of other IRA’s purchased with community funds, of which the wife was the beneficiary and obtained sole ownership.
60. Id.
63. See generally Spah & Hargrave, supra note 13, §§ 2.1-6, at 25-39.
of the right. Whatever the rights of the heirs of the deceased under the IRA, they would be carved from the rights of the settlor spouse under the trust and, arguably, would be enforceable against that spouse rather than against third persons. But even if the rights of the heirs are limited in this regard, that fact would still not preclude the inclusion of the right in the succession of the deceased under general law.

Absent a statute like Louisiana Revised Statutes 9:2801, which allows allocation of assets in a partition between co-holders, a partition between the surviving spouse and the heirs or legatees would be governed by the general partition rules. Those rules do not provide for allocation of assets with corresponding allocation of other assets to other co-owners. Those rules do not provide a mechanism to overcome the privity principle and affect the rights of the third person trustee. Again, the pension analogy appears appropriate; the survivor and the heirs would remain co-holders of the IRA rights against the trustee without a partition. Only when the incorporeal right is transformed into money or other things would there be a partition. If the grantor of the IRA trust revokes it and collects the funds, they could then be divided.

When recurring payments start to be made from the account, perhaps they could be divided. But at this point, the state’s policy of protecting the retired person’s pension benefits would seem to come into play. Louisiana Civil Code article 890.1 would seem to apply, at least by analogy. Under the article, if one spouse dies, the surviving spouse enjoys a legal usufruct over the continuing recurring payment, which was the deceased spouse’s share of their community, if the source of the benefit is traced to payments made by or on behalf of the survivor. This is a forced usufruct which applies even if a testament of the deceased spouse provides otherwise. The policy of protecting the rights of the living spouse to a retirement benefit would seem to apply also in the case of the death of the other spouse before payments are made.

This apparent conclusion under the general law and Article 890.1 is a messy, complicated one. For example, the continuing IRA payment could be partly a return of principal and partly investment income. The latter would presumably be a fruit owned by the usufructuary and the former would have to be accounted for to the naked owners at the termination of the usufruct over the recurring benefit.

In any event, the IRA fund could well be considered as any other community asset in the absence of special rules, and there appear to be no special state law rules to govern the situation other than Article 890 by its terms and Article 890.1 by analogy. Perhaps the trust law might be invoked with the determination that the heirs’ interest is not in the underlying IRA assets but in the beneficial rights under the trust. Furthermore, like life insurance, ownership by the non-covered spouse is virtually worthless. Also, it could be a disastrous tax situation if a state court in such a situation would order half the account paid to the heirs. This would probably be a distribution of the IRA subject to taxation and penalty to be paid by the initial contracting spouse.
Despite its complexity, however, this approach balances the rights of the parties so as to give substantial protection to the surviving spouse’s interests and fulfills the policy of providing retirement income to spouses no longer able to work, rather than benefitting what would normally be the next generation.

If one were to find, however, that federal law preempts in this area and the interest of the grantor of the IRA trust is, therefore, that spouse’s separate property, additional complications might arise. This preemption might, arguably, result in the use of community funds to purchase separate property, providing the basis for reimbursement to the other spouse at termination of the community for one-half the community funds so used. The grantor of the trust in such a case might then be worse off, being required to come up with liquid funds to pay the heirs one-half the value of the very illiquid IRA interest. This result would be inconsistent with the federal policy of fostering the retirement plans of taxpayers.

In any case, the federal issue comes into play if the state considers the IRA trust interest a community asset, an issue that involves the construction of 26 U.S.C. § 408(g), which provides “this section” is to be applied without regard to state community property law. The reference is to section 408, which governs the taxation of IRA interests and establishes the complex rules to qualify for the tax benefits under those plans. The provision does not state that interest must be considered separate property for all purposes. The implication is the section’s tax policies and related policies are to be applied as though the IRA interest were the contributor’s separate property if a conflict with community property state law arises. It would seem that dividing the asset would not conflict with tax policy; the interest would be a distribution that would be taxed and the federal fiscal interest would be maintained.

On the other hand, it is arguable that the IRA tax benefit is designed to encourage pension plans for persons not otherwise covered by qualified employee pension plans, and to provide a rough parity of tax and retirement benefits for such persons. To that extent, the policies involved under ERISA might be invoked here, and the more general case law under ERISA might be relevant.

In Ablamis v. Roper, the Court of Appeals for the Ninth Circuit held ERISA preempted state community property laws. In that case, a wife attempted to bequeath her interest in her husband’s qualified pension plan in her will, but the court held “that an employee whose pension interests are covered by ERISA may not be so divested of his entitlement.” The court relied on: (1) the policy of protecting workers against loss of pensions and the related limited extent of spousal and ex-spousal protection under ERISA and REA; (2) the spendthrift, anti-attachment provisions contained in ERISA, which reflect a desire to protect the covered employee against loss of rights; and (3) the Supreme Court

64. La. Civ. Code art. 2366.
65. 937 F.2d 1430 (9th Cir. 1991).
66. Id. at 1452.
language in Guidry v. Sheet Metal Pension Fund\(^6\) reflecting the policy to “safeguard a stream of income for pensioners (and their dependents . . .) even if that decision prevents others from securing relief for the wrongs done them.”\(^6\) The court emphasized pensions are designed to benefit people during their lives and not their heirs.

In *Meek v. Tullis*,\(^6\) the District Court for the Western District of Louisiana agreed ERISA preempted state community property laws in a similar situation. Upon the death of the wife, who did not have a will, her heirs sought to include one-half the value of the husband-employee’s pension in her succession. In a declaratory judgment proceeding, the court denied the heirs’ claim for an interest in the pension or for assets of a similar value. To allow the latter claim “would be little different from allowing the main demand. In either instance, [the husband] is deprived of one-half the value of his pension.”\(^7\) *Meek v. Tullis* expounds the view that Louisiana community property laws are preempted as to any claim of benefits under an ERISA governed pension plan.\(^7\)

Later, the District Court for the Eastern District of Louisiana decided otherwise without citing *Meek*. In *Boggs v. Boggs*,\(^7\) also a declaratory judgment action, the court found no intent to preempt state community property interests in the pension plan of the deceased wife. Later, another judge in the Eastern District, in *Gaudet v. New Orleans Sheet Metal Workers’ Pension Funds*,\(^7\) cited *Meek v. Tullis*, but not *Boggs v. Boggs*, and held ERISA preempted state community property laws.

In any event, the purpose of the federal taxation scheme and the tax benefit given to IRA’s may well reflect a federal policy of encouraging retirement pensions and the protection for covered workers. That is accomplished by keeping the fund intact for the benefit of the worker when he retires. It would diminish his interests to give one-half of it to the heirs of the deceased. Even under state policies, where a statutory usufruct would allow the survivor to enjoy the benefits of the fund until death or remarriage, there is a similar policy which may militate against recognition of the heirs claims.

\(^{67}\) Gaudet v. New Orleans Sheet Metal Workers’ Pension Funds, No. Civ.-A-93-2856, 1994 WL 285019 (E.D. La. June 23, 1994). It could be argued the IRA legislation also reflects a policy of encouraging pensions by giving tax preferences to those not eligible for employee pensions. Here, too, the purpose would be to benefit the pensioner.


I. Death of the Settlor of the IRA

Upon the death of the covered individual, the remaining benefits must be paid to the beneficiary or beneficiaries designated in the trust. Though the matter is not free from doubt (as the discussion below indicates), it appears the benefits will likely be free of claims by forced heirs or claims by the surviving spouse of the deceased.

Under the Louisiana Trust Code, sums due upon the settlor's death must be paid to the beneficiaries designated in the trust agreement. That result is reinforced by analogy to pension and profit-sharing plans and life insurance, under which the designation of a beneficiary is upheld under general contract law. Additional authority in that regard comes from the federal provisions that define qualified IRA's in terms of a trust for the benefit of an individual and that person's beneficiaries. Furthermore, if there were any doubts, Louisiana Revised Statutes 9:2449 dictates the same result by its terms, especially the first sentence of part (A) and the provisions of part (C):

A. Any benefits payable by reason of death from an individual retirement account . . . shall be paid as provided in the individual retirement account agreement to the designated beneficiary of the account. Such payment shall be a valid and sufficient release and discharge of the account holder for the payment or delivery so made and shall relieve the trustee, custodian, insurance company or other account fiduciary from all adverse claims thereto by a persons claiming as a surviving or former spouse or a successor to such a spouse.

B. No account holder paying a beneficiary in accordance with this Section shall be liable to the estate of any heir of the decedent nor shall the account holder be liable for any estate, inheritance, or succession taxes which may be due the state.

C. The provisions of this Section shall apply notwithstanding the fact the decedent designates a beneficiary by last will and testament.

In a typical case, when the IRA beneficiary is the surviving spouse, there would be no basis for the spouse to complain that community funds were used to fund the IRA. The beneficiary spouse would gain separate funds and suffer no loss. The possible complaint here would come from the forced heirs of the deceased, who might claim the deceased's patrimony was lessened by one-half of the contributions to the IRA. The forced heirs, however, would be at a serious disadvantage in making that argument since the amendment of Louisiana

75. See also La. R.S. 47:2404(C) (1990 & Supp. 1992). The exemption from inheritance tax of such benefits is legislative recognition of the view that the contractual beneficiary acquires an ownership right.
Civil Code article 1505(D) provides IRA proceeds (and other pension benefits) are not considered in determining the mass from which the forced portion is determined. If a forced heir is denied the forced portion (albeit a smaller one since the IRA proceeds were not considered in determining it), he can pursue an action to reduce other donations under the formula of Louisiana Civil Code article 1507. Under that formula, it may be arguable that one of the transactions that can be undone is the IRA, raising the issue whether federal rules or other state laws would prevent that action.

If someone other than the surviving spouse is the beneficiary of the IRA, the survivor could argue his rights were decreased to the extent of one-half of the community funds that were used to produce this benefit to a third person. The claim would be presumably a claim for one-half the funds used to enrich the separate estate of the deceased, under an analogy to Louisiana Civil Code article 2366. If the deceased's action was a bad faith effort to harm the surviving spouse, the latter could also have a claim under Article 2354 against the deceased's estate. It may be also argued that the transfer to the beneficiary was the completion of a donation of community funds without the consent of the other spouse, and, thus, that transfer is subject to being annulled. This last approach may be problematic in many cases, depending on the facts, because the other spouse may have ratified the donation or may be precluded by prescription from asserting such rights.

In case of claims by forced heirs or the surviving spouse against the beneficiary, one could make analogies to designations of beneficiaries in life insurance contracts. The spouse in a community property regime receives no compensation for the use of community funds to pay life insurance premiums that produce a benefit to a third person, and the forced heirs have no claims to the proceeds of the insurance. Perhaps a closer analogy would be to the pension and profit-sharing plans. In T.L. James Co. v. Montgomery, the Louisiana Supreme Court suggested in dictum that the designation of a beneficiary in a pension and profit-sharing plan would not be effective to the extent it infringed on the rights of forced heirs or a surviving spouse. Weakening that analogy, however, is the fact that, since T.L. James was decided, Article 1505 was amended to make clear that forced heirs have no claim over pension, profit-sharing, and IRA proceeds. The developing policy would seem to treat the pension and profit-sharing proceeds as outside the normal successions rules and to favor a simple and direct disposition of such assets. Still open though, since

77. La. Civ. Code art. 1505(C) excludes § 408 plans from the active mass, along with life insurance and pension benefits. See David M. Prados, Comment, Louisiana Civil Code Article 1505: Donations Inter Vivos to Establish the Mass Estate, the Forced Portion, and the Reduction of Excessive Donations, 34 Loy. L. Rev. 546, 555 (1988).
79. La. Civ. Code arts. 2031, 2032; Spaht & Hargrave, supra note 13, §§ 5.17-.18, at 179-84.
80. Wilkins, supra note 11.
81. 332 So. 2d 834 (La. 1975).
no analogous legislation was adopted with respect to surviving spouses, is the question of whether the dictum would be applied to protect the interest of the other spouse whose interest in community funds was used to purchase this IRA benefit for a third person. Each spouse has a present undivided one-half interest in the community property, and, thus, presumably a stronger claim to those funds than the inchoate claims of the forced heirs.

Another analogy can be drawn to the savings bond cases, in which federal policy prevails and apparently prevents forced heirs and spouses from proceeding against the beneficiary of the funds invested in savings bonds. That federal policy results from federal fiscal needs—making the bonds attractive to investors by freeing the proceeds from the complexities of state inheritance laws. The policy may not be as strong when applied to IRA's, private investments which do not implicate federal fiscal interests. However, it could be argued that there does exist a strong federal policy of encouraging pensions, including giving private persons without employee pension plans benefits equivalent to those of employees of large companies. But that policy might lend credence more to the T.L. James analogy than to the savings bond analogy. On the other hand, there is the literal language of the federal provision, 26 U.S.C. § 408(g): "This section shall be applied without regard to any community property laws." Reliance on that text would at least be a simple and direct solution to a difficult problem.

Even if one accepts the view that, if one's community interests are infringed, the beneficiary is not immune from claims, it does not necessarily mean the entire IRA beneficiary designation is upset. It is only to the extent the spouse's rights are harmed that the designation of beneficiary would fall. If there are other community assets available to satisfy the survivor's claims to one-half of the total community assets, there is no loss to the survivor. That is the same result that would follow under Louisiana Civil Code article 2354. If the spouse acts in fraud or bad faith to put assets beyond the reach of the innocent spouse, the remedy provided in that article is a damage claim for the loss, and not necessarily the undoing of the transaction. If the deceased's separate estate shrinks because of payment of such damages, it is the forced heirs whose interests might be invaded, but only if their portion (one-half, at most, of the mass considered with the IRA benefits included) is not paid.

The foregoing illustrates how limited the relief that would be allowed is. But, in addition to these limitations, there is also a strong argument—based on the literal construction of the first sentence of Louisiana Revised Statutes 9:2449—that the beneficiary is to be paid the funds according to the agreement and free of any claims by forced heirs or surviving spouses. An investigation of the proper construction of that language leads to an unclear legislative history and an uneven case development.

83. Spaht & Hargrave, supra note 13, § 3.34, at 103.
The original provisions in Act 600 of 1986 stated nothing about community property interests. Those provisions provided simply: (1) benefits from IRA’s shall be paid as provided in the individual retirement account agreement to the beneficiary; (2) these benefits shall be paid to the exclusion of the creditors, representatives, heirs, and legatees of the decedent; and (3) the value of benefits paid to a forced heir shall be deemed applied in satisfaction of the forced heir’s claims.85

The third aspect of the rule echoed the provisions of Louisiana Civil Code article 1505(D), which excluded IRA benefits from the active mass of the succession and provided that IRA benefits payable to the forced heir would be credited to the forced heir’s claims.

In Act 131 of 1987, the second and third provisions were deleted. However, Louisiana Civil Code article 1505(D) was not amended, leaving the proceeds of the IRA outside the succession mass. It would seem any change lessening the protection of the beneficiary, if intended, was illusory.86 That same act also added part (B) which provided that no account holder paying a beneficiary shall be liable to the estate of any heir of the decedent nor shall the holder be liable for taxes due on the estate. Nothing was said about a surviving spouse’s interest.

Act 712 of 1988 continued the original first sentence of part (A) and added the new sentence,

Such payment shall be a valid and sufficient release and discharge of the account holder for the payment or delivery so made and shall relieve the trustee, custodian, insurance company or other account fiduciary from all adverse claims thereto by a person claiming as a surviving or former spouse or a successor to such a spouse.87

Determining the purpose of that language is problematic. In a more perfect drafting world, the first sentence of the statute would seem to be enough to protect the interests of financial institutions. Saying the money shall be “paid” means ownership will be transferred to the payee, and since there would be no mechanism for undoing that transaction, it would mean the payee would become the unconditional owner without any obligations to forced heirs or a spouse in community. That such would be the legislative aim is reinforced by the analogy to life insurance payments, the proceeds of government savings bonds, and the federal legislation which states IRA rules are to be applied without regard to community property laws. California and Texas seem to follow this view.88

86. Because of the failure to amend Article 1505 at the same time, it is not clear that “[t]he statute now is aimed solely at protecting the account holder in paying the named beneficiary, not in protecting the beneficiary from the claims of forced heirs.” Cynthia Samuel, Successions and Donations, Developments in the Law, 1987-1988, 49 La. L. Rev. 517, 542 n.98 (1988).
88. Under California law, IRA proceeds go to a beneficiary without going into the estate of the deceased. Creditors have no claims against the proceeds. Estate of Davis, 171 Cal. App. 3d 854.
Presumably, legislative tinkering, in response to pressures from the bar and bench concerning forced heirship, produced some of the amendments described; the interests of financial institutions in protecting themselves against claims were also accommodated. It does not appear there was a coherent policy addressing the interests of surviving spouses. In all this uncertainty about legislative purpose, perhaps fidelity to the text would be the proper approach, and a literal application of the first sentence, in light of the savings bond and insurance analogues, would provide a simple solution.

The case law here is uneven, but tending towards construing section 2449 literally. In *Succession of McVay v. McVay*, the deceased husband invested community funds in an IRA account and designated his wife as the beneficiary. The court of appeal held the whole of the account, $500, became the property of the wife and was not a succession asset. However, the court directed "the amount of $500.00 representing the value of the IRA, be set forth in the detailed descriptive list as community property." It would then follow that upon division of the community the husband's estate would be entitled to $250 and the wife $250 of the "value." But there was no real asset to include; it was a fiction. Although the court did not say so, and since it obviously cannot pull the $500 out of nowhere, what happened was the wife's share of the community was reduced by $250 and the husband's by $250, putting the parties in the same position as though the asset were left out.

In *Succession of Egan*, the deceased husband designated his second wife as the beneficiary of his IRA's. The lower court appeared to enforce this designation of beneficiary, but then ordered the wife to "reimburse... for decedent's community and separate property interest in decedent's individual retirement account." The court of appeal reversed, stating its agreement with *McVay* that there be no such reimbursement. The court also pointed out there was no showing that community property rights or forced heirship rights were infringed. In such a situation, "we see no justification for requiring Egan's widow and beneficiary to reimburse her stepchildren."

Most recently, in *Minvielle v. Dupuy*, it was argued, while Louisiana Revised Statutes 9:2449 applied and the trustee was required to deliver the funds to the beneficiary, the statute permitted proceedings against the beneficiary for

856 (Cal. Ct. App. 1985): “Upon the death of the depositor, an individual retirement account does not become an asset of the decedent’s estate subject to the claim of a judgment creditor, but passes to the named beneficiary.” For an example of Texas law, see Ashmore v. Carter, 716 S.W.2d 171 (Tex. Ct. App. 1986) (allowing the second wife, the named beneficiary, to receive the funds as against a claim by the daughter of the deceased that the IRA was part of the estate).
89. 476 So. 2d 1070 (La. App. 3d Cir. 1985).
90. Id. at 1074.
91. Spaht & Hargrave, supra note 13, § 3.35, at 108.
92. 543 So. 2d 940 (La. App. 5th Cir. 1989).
93. Id. at 940.
94. Id. at 946.
95. 638 So. 2d 1186 (La. App. 1st Cir. 1994).
a return of the community interest in the funds. The court disagreed, concluding
the ownership of the funds was determined by the agreement and the beneficiary
owned those funds.\textsuperscript{96} The court, however, cited \textit{T.L. James} for authority that
the designation was valid so long as it did not infringe on the legitime or the
community rights of a spouse.\textsuperscript{97}

To the extent federal policies apply, there is the suggestion in 26 U.S.C. §
408(g) to ignore the state community property laws and the definition of IRA's
referring to trusts for the benefit of the covered individual and the designated
beneficiaries. Again, since the IRA agreement establishes a trust, the trust
provisions that protect the beneficiaries would apply, except for the provisions
made for the rights of forced heirs. There seem to be no trust provisions that
would protect the rights of spouses as against beneficiaries.

\textbf{J. Conclusion}

Individual Retirement Accounts are developing into a common and important
part of the patrimonies of married persons. In the absence of comprehensive
legislation to adjust community property laws to these special trust accounts, a
close textual and policy analysis of federal and state provisions is necessary to
determine the proper construction of the rules applicable to them. It seems
desirable to construe the provisions in a way that gives maximum protection to
the interests of the retired persons. Such protection is supported by a policy
which can be found in both the federal and state legislative schemes. If attempts
are made to injure a spouse using IRA's, state law provides a reasonable measure
of redress under Louisiana Civil Code article 2354.

\textsuperscript{96} It was argued "ownership of the funds was not determined by the agreement. We do not
agree." \textit{Id.} at 1188.

\textsuperscript{97} \textit{Id.}