

IRAs and Conflict of Laws

Take-Away: An IRA custodial agreement and beneficiary designation will be interpreted according to the laws of the state where the IRA custodian is located, not the state of the IRA owner's residence.

Background: Michigan's public policy favors the enforcement of contractual forum-selection clauses and choice-of-law provisions. Generally, a Michigan court will enforce contractual choice-of-law provisions if certain conditions are met. [Restatement Conflict of Laws 2d, Sections 187 and 188.] The Restatement provides, in part:

"[the]law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue. Determining whether the particular issue presented in this case is one that the parties could have resolved by explicit agreement potentially implicates the local law of all potentially interested estates." [Section 187(1), comment c.]

IRAs: According to the U.S. Supreme Court, an IRA is a trust that is created or organized in the United States for the exclusive benefit of an individual and his or her beneficiaries, but only if the written governing instrument creating the trust satisfies specific requirements. The Court describes an IRA as a contract.

"If the accountholder dies before all the funds are distributed, the custodian will distribute any remaining assets in accordance with the contract terms. Those terms allow the accountholder to designate beneficiaries, and provide that, in the event there is no effective designation, the remaining assets shall be distributed as the custodial contract directs. When disputes arise about the disposition of IRA assets, the disputes are governed by state law, which varies considerably in the treatment of these issues." *Clark v. Rameker*, 573 U.S. 122 (2014).

EPIC: Michigan's Estates and Protected Individuals Code (EPIC) contains specific provisions that deal with beneficiary designations on the death of the account owner and how the account contract controls. [MCL 700.6307; MCL 700.6309(1).]

Conflict-of-Laws: These principles, leading to a choice-of-law contained in an IRA custodial agreement were at the center of a recent 17-page Michigan Court of Appeals decision.

Veucasovic v. Veucasovic and Fidelity Management Trust, Michigan Court of Appeals, No. 22010031-CK (July 25, 2024)

Facts: The deceased mother (Barbara) held her IRA at Fidelity. Starting in 2007 Barbara made two changes in 2016 to her IRA's beneficiary designations, usually allocating her IRA among two of her three children, but sometimes also she changed the percentage allocations among some others (I think her grandchildren were these others of one daughter who was 'skipped' after the 2007 beneficiary designation.) Often with these changes to the IRA allocations, Barbara referred to a 'Relationship Trust' in her beneficiary designation form, either for her son Craig or named others (grandchildren from her daughter Deena?). Barbara's last IRA beneficiary change was in 2018, when she named her two children, Michelle, and Craig as the IRA beneficiaries, but in doing so, Barbara created some confusion regarding Craig's share. For her daughter 50% share of the IRA, Barbara reported:

Michelle M. Veucasovic

Relationship Non-Spouse Individual

Share 50.00%

For her son's portion of the IRA Barbara reported:

Craig D. Veucasovic

Relationship Trust

Share 50%

At Barbara's death in 2020 there was no Trust created for Craig. In fact, there was never a Trust created for Craig. Nor was a trust ever created by her for the interim-named IRA beneficiaries (assuming they are Barbara's grandchildren through Deena) when 'Relationship Trust' also appeared after their names on Barbara's IRA beneficiary designations in 2016. 'Relationship Trust' was used on Barbara's IRA beneficiary designation forms in 2016, yet she never created any Trusts, nor was there any other description associated with the 'Relationship Trust' that might have referred to a Trust created by

another. In short, Barbara's IRA beneficiary designation forms created an ambiguity with their references to a 'Trust(s)' that were never created. Coming as no surprise, Fidelity's IRA custodial agreement contains a Massachusetts choice-of-law provision.

Dispute: Michelle brought a Declaratory Action in the Circuit Court, in her personal capacity and not as the Personal Representative of Barbara's estate, in which she claimed that she was entitled to 100% of the IRA balance since there was no 'Trust' created for Craig at the time of her mother's death, and therefore the 50% beneficiary allocation (to Craig's Trust), by default, passed to the sole surviving designated beneficiary of the IRA. Michelle cited MCL 700.6307 as authority for her claim to her brother's share of their mother's IRA. Craig disputed Michelle's interpretation of the IRA beneficiary designation, that the allocation to him 'failed.' Fidelity interpleaded the disputed 50% of the IRA balance that was not distributed outright to Michelle with the Circuit Court, and it was, then practically speaking, released from the lawsuit, although Fidelity did participate in discovery and its representative testified in court. , Fidelity never asked any questions of Barbara about her reference to a 'Trust' and instead simply relied on what Barbara described in her IRA beneficiary designation form.

Circuit Court: After conducting an evidentiary hearing and taking testimony from Fidelity's representative, the Circuit Judge denied Michelle's claim that she was entitled to 100% of the IRA balance on her mother's death due to the 'failure' of the other named beneficiary, i.e., the nonexistent Trust for Craig. Instead, the circuit judge felt that he had to go all the way back to the first IRA beneficiary designation in 2007 which divided the IRA 33% to Michelle, 33% to Craig, and the balance to Deena (who was skipped over in the interim beneficiary designation changes in 2016.) The circuit judge felt that because the two 2016 IRA beneficiary designations also used the term 'Relationship Trust' when no Trusts ever existed, they too were invalid, and therefore he had to go back to that first IRA beneficiary designation, and he allocated Barbara's IRA consisted with her 2007 IRA beneficiary designation [taking Michelle down from 50% to 33.3%.]

Court of Appeals: The appellate Court vacated the Circuit Court's decision to follow Barbara's 2007 IRA beneficiary designation. It remanded the case to the Circuit Court to follow Massachusetts' law to dispose of 'Craig's' 50% of the IRA.

Reversal: The circuit judge had concluded that because Barbara's beneficiary designation to a non-existent trust failed, her entire 2018 IRA beneficiary designation was invalid, and thus it was necessary to look back to her first beneficiary designation that had named identifiable beneficiaries and had disposed of 100% of the IRA's assets. This Court found that the trial judge misinterpreted an early Michigan court decision which had attempted the distribution of more than 100% of life insurance

death benefit, which resulted in a failure of the insured's entire beneficiary designation. [*Security Mutual Life Insurance Co v. Amira-Bell*, 342 Michi App 417 (2023).]

Choice of Law: This Court relied on the Restatement of Conflict of Laws 2d, Sections 187(1) and 188 to find that Massachusetts law controlled the interpretation and legal effect of Barbara's IRA beneficiary designation, citing those sections and reasoning behind those sections at length. The Court found that both Michigan and Massachusetts allow the 'depositor' to choose how to dispose of the assets upon the 'depositor's' death, and both states allow the terms of the arrangement to be made by contract, citing MCL 700.6309(1).

"Instead, the contract incorporated by reference the law of Massachusetts to provide rules necessary to fill in any gaps in the agreement regarding the disposition to beneficiaries... These issues do not involve matters regarding the capacity of a party, contractual formalities, or whether the contract is illegal. Accordingly, we will enforce the choice-of-law provision, and the substantive question regarding the distribution of IRA asset will be resolved under Massachusetts law."

Massachusetts Law: Like Michigan, Massachusetts courts will enforce non-probate transfers made in accordance with their own contractual terms, even when faced with a subsequent Will provision to the contrary. While the Fidelity's agreement neither defined 'non-spouse individual' nor 'trust,' it did define 'beneficiary' to mean 'the person(s) or entity (including a trust or estate, in which case the term may mean the trustee or personal representative acting in their fiduciary capacity) designated by the depositor. Relying on Massachusetts case law, the Court held that:

"If the intended beneficiary of all or part of an express trust is unascertainable, that portion of the trust fails, and a resulting trust arises in favor of the settlor or her estate as if she has died. That is the result we reach here.... Accordingly, as a matter of law, although a trust for Craig was an intended beneficiary of the IRA, that designation failed because the trust did not exist and was thus unascertainable. The share should have passed instead to Barbara's estate. The designation of Michelle as a 50% beneficiary was not invalidated by the failed designation to a non-existent trust."

Remand: The result is that Craig's 'share' of the IRA will be paid to Barbara's estate, and it will be divided in accordance with her estate plan. If Barbara's Will, or Trust, divide the residue of her estate between her three children, then Michelle will receive another 16+% to go along with her 50%. If the one child Deena has died, or she was disinherited for other reasons (e.g., she did not financially need an inheritance) so only Michelle and Craig are the residuary beneficiaries of Barbara's estate, then

Michelle may pick up an additional 25% of the IRA, leaving her with a total 75% of Barbara's IRA and Craig the remaining 25% (which is not the 33.3% that the circuit judge awarded him.)

Conclusion: While the *Veucasovic* case dealt with a Fidelity IRA, not to be ignored is increasing use of transfer-on-death (TOD) security accounts held with the major stockbroker companies, all of which also 'bury' choice-of-law provisions in their TOD contracts which govern the beneficiary designation. Those TOD contracts will contain broker- favorable (to the broker) choice-of-laws, not to mention mandatory binding arbitration clauses in some situations. Simply knowing Michigan law is no longer 'enough' when an estate plan relies heavily on beneficiary designations, whether they be IRAs, life insurance, annuities, or TOD and POD arrangements. Individual account owners need to be reminded that part of their estate plan could well be governed by the laws of another state with which they are unfamiliar.

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