

7 Things You Must Know About Designating Beneficiaries



When it comes to planning for the successful transfer of your wealth, reviewing your beneficiaries periodically is extremely important. Even if you've recently met with an attorney to review your will, or completed a revocable living trust and have detailed documents, it's important to review your beneficiary forms. No matter how thorough you believe your estate planning is, the only document that matters to the custodian of your IRA, 401(k) or other retirement account is the beneficiary designation form.

1) Your will, trust or any other legal document will not supersede the beneficiary designation form.

Illustrated by a story in the New York Times titled "Pension Pickle," the article is about Bruce and Anne Friedman. The Friedmans were happily married for nearly twenty years when Anne, a former city school principal, died suddenly of a massive heart attack in September 2001. At the time of her death, Anne had saved a little more than \$900,000 in a retirement account with the New York Teachers Retirement System. After mourning the loss of his wife, Mr. Friedman thought he would receive the retirement funds. However, officials at the Teacher Retirement System could only find one beneficiary designation form that was filled out 27 years ago, four years before the couple met. It indicated that Anne's mother, uncle and sister were to receive her retirement funds. Since Anne's mother and uncle had predeceased her, the entire account went to Anne's sister. Her husband for over twenty years was left without a single cent and the sister would not give him anything.

Not only did his sister-in-law prevent him from receiving anything, Bruce was also rejected when he went to challenge the beneficiary designation in court. Both a Manhattan Supreme Court and the Appellate Division upheld decisions that the law states the beneficiary designation form is binding and no assumption can be made as to an individual's intention. Therefore it's important to review your beneficiary designations and make sure your spouse and family receive the accounts you would like them to receive.

Be sure your forms are updated after a life event such as a marriage, death of a loved one or divorce. Even if you update your will to exclude an ex-spouse, they can still receive your life insurance, annuity proceeds or retirement account if you have not updated your beneficiary forms.

Since these forms are important in designating who will receive your life insurance or retirement investments, you should keep a copy of the most recent forms with your important legal, estate planning documents to allow you to readily review your beneficiaries from time to time.

2) You can and should, name contingent or secondary beneficiaries.

Beneficiary forms give you the option of adding a contingent or secondary beneficiary. A contingent beneficiary is important because if you are predeceased by your primary beneficiary, you automatically have a second beneficiary or beneficiaries in place to receive your insurance or investments. It is also important to name a contingent beneficiary on your accounts for estate planning purposes. Having a secondary beneficiary named gives the primary beneficiary the opportunity to disclaim the account or insurance proceeds and have the funds pass directly to the contingent beneficiary if he or she chooses to.

3) Do not name your estate as an IRA beneficiary.

By doing so, you put the will back into the driver seat as to who will receive the funds; however, the heirs would need to withdraw the funds out of the account within 5 years. Depending on the size of your retirement account(s), this could trigger a huge amount of income taxes, especially if the distributions, which are taxed as ordinary income, push your beneficiaries into higher tax brackets. 30% - 40% of your retirement funds could be lost to federal and state income taxes and that doesn't include the potential for additional estate taxes.

By naming a person as a beneficiary, you allow the individual to maintain the tax deferral of the account. A spouse can transfer the retirement account into their own IRA or 401(k) and a non-spouse beneficiary can transfer the account to an inherited-IRA. A non-spouse beneficiary cannot combine the inherited funds with their own IRA like a spouse can, but can continue the tax deferral while only taking a required minimum distribution each year. If the beneficiary does this and "stretches" the IRA, the total amount paid out to them over their lifetime could be substantially more than the amount originally left to them. In addition, they could potentially stretch out the retirement funds and pass a balance on to another generation beyond them.

4) Be careful when naming a child under the age of 18 as a beneficiary on your insurance and investment accounts.

If a minor is a beneficiary, typically the investment custodian will require proof of guardianship of the minor from the probate court. This could potentially be a slow and costly process. In addition, the guardian will be required to provide triennial accountings to the probate court as to the use and distribution of the funds for the support of the minor. In some cases you may want to create a trust for the benefit of younger children. The trust will give you more control over who will serve as the Trustee and you can create various restrictions on the distribution of funds, for example the child may not receive funds until they graduate college or reach age 25.

5) There are advantages to naming a spouse as a beneficiary over a child.

Spouses can rollover a retirement account into their own, deferring distributions from the account until they are age 70½. If your child or non-spouse beneficiary inherits a retirement account, they will be required to start taking minimum distributions the year after your death.

6) Updating the beneficiaries on your insurance policies and retirement accounts is easy.

Many firms offer their beneficiary designation forms online or you can call the company to request one. You will need your beneficiaries name, date of birth, address and sometimes their social security number. Be sure to keep a copy of the form and request written confirmation that the beneficiary information has been updated on your policy or account. Keep these copies and confirmations with the rest of your estate planning documents.

7) Including a charity in your beneficiary designations is an easy way to leave a lasting legacy to a favored non-profit organization or cause.

Many people fail to create a legacy with a non-profit because of the expense or finality of including an organization in their will. Why not start by including an organization in your beneficiary designation for a retirement account? It's an easy, low cost way of making a difference in the world.

The process of including a non-profit on your beneficiary form could be called the "IRS IRA Gift Matching Program." As you look at your IRA or retirement account balance you need to realize that it is not all yours. Uncle Sam will receive part of your retirement funds in income taxes when they are paid out to you or your beneficiaries. By designating a non-profit organization for part or all of your taxable retirement account, the non-profit will receive 100% of the funds designated for it, thus the IRS is matching your gift with what your beneficiaries would have paid in income taxes.

Everyone with a retirement account can do this. You might consider starting with a designation of \$1,000 or \$10,000. If you decide later in life you can afford to leave more, it is very easy and inexpensive to update your beneficiary designation form. This allows you to plan for what you feel you can afford now and make adjustments in the future.

If you are comfortable and definite about your inclusion of a non-profit organization in your estate planning, you should notify the organization of your intentions to include them in your beneficiary designations. This will allow the organization to provide you with the specific language to use on the beneficiary designation to make sure your gift will reach your intended destination at the non-profit. It will also allow them to note your gift and make sure they receive it after your passing. In addition, the organization may have a legacy society or some other donor group you can now be included in with your beneficiary designation.

The simple act of naming beneficiaries on your life insurance and retirement accounts is an important step that should be reviewed periodically. You may wish to consult with a knowledgeable financial advisor to review your current beneficiary designations to determine if they are set up properly or in a way to avoid unnecessary income taxes.

If you would like Hammond Iles Wealth Advisors to review your beneficiary designations or give you a second opinion, please call 800.416.1655 or email us at clientcare@hiwealth.com.

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