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Timely Insights for Your Financial Future

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It's 2016: Do You Know Who Your Beneficiaries Are?

Whether you're wealthy or earn a modest income, there is one estate planning concern that is shared by people from all walks of life-the decision of who gets what when you're gone. While some individuals logically assume that a will is the only official forum to express such decisions that is not always the case. Often, an equally important issue in estate planning is whom to name as beneficiary on life insurance policies and retirement plan accounts such as 401(k)s and IRAs, since these assets are passed on regardless of what may be spelled out in a will.

Naming beneficiaries can be complicated and could present unintended consequences to the beneficiary. For instance, an improper designation could make life difficult for your family in the event of your untimely death by putting assets out of reach of those you had hoped to provide for, possibly even increasing their tax burdens. Further, if you have switched jobs, become a new parent, divorced, married, or survived a spouse or child, your current beneficiary designations may need to be updated.

At your next financial review, be sure to include a beneficiary review as part of that process. Here are a few general pointers to keep in mind when naming beneficiaries, followed by some specific guidelines for insurance policies, employer-sponsored retirement plans, and IRAs.

General Considerations

- **Age of beneficiary.** Many policies and plans will not directly transfer assets to minors until a trustee or guardian is approved by a court.
- **Ability of beneficiary to manage assets**. Perhaps a trust set up in the person's name would be better than a direct transfer.
- **Naming contingent beneficiaries**. Should something happen to your primary beneficiary, the contingent beneficiary would receive your assets.

Life Insurance

No matter who is designated, the beneficiaries will receive the death benefit proceeds income tax free. Unlike property disposed of in a will, if the beneficiary designation form is properly completed, insurance proceeds do not go through probate.

For many married couples, a spouse will be the most logical beneficiary. A trust may be a prudent beneficiary choice, however, if a surviving spouse would not have the ability to effectively manage a large sum of money. The trustees (often a legal entity rather than an individual) would then take charge of managing, investing and disbursing the policy proceeds for the benefit of the surviving spouse.

Be sure to name contingent or secondary beneficiaries. This means that if the primary beneficiary has died, the insurance proceeds would go to the secondary individual or trust. If there are no surviving beneficiaries, then your beneficiary is generally the "estate of the insured," which means the death benefits end up being probated and ultimately distributed according to the instructions of the decedent's last will and testament. If an individual dies without a valid will (intestate), then the order of legal beneficiaries to whom assets are distributed is specified by that state's law.

Retirement Plans and IRAs

Federal law generally requires that a spouse be the primary beneficiary of a 401(k) or a profit-sharing plan account unless he/she waives that right in writing. A waiver may make sense in a second marriage -- for example, if a new spouse is already financially set or if children from a first marriage are more likely to need the money.

Single people can name whomever they wish as beneficiary of a retirement account, and nonspouse beneficiaries are now eligible for a tax-free transfer to an IRA.

The IRS has also issued regulations that dramatically simplify the way certain distributions affect IRA owners and their beneficiaries. Consult your tax advisor on how these rule changes may affect your situation.

Keep Your Plan Up-to-Date

When completing overall estate plans and wills, it is imperative to readjust all beneficiary designations so that your estate plan accurately reflects your intentions. Remember, outdated beneficiary designations (e.g., older parents or ex-spouses) could misdirect the intended flow of an entire estate plan unless changed now.

Also keep in mind that beneficiaries are paid directly as named. Thus, beneficiary designations are not governed by the directions of last wills and testaments.

As is always the case with estate planning, consult with qualified professionals concerning your particular situation in order to ensure that your beneficiary designations are in tune with your goals.

Tax Tips

- Life insurance benefits are transferred free of income taxes.
- A nonspouse beneficiary of a pension plan, such as a 401(k) must report the proceeds as "income with respect to a decedent" but can transfer assets tax free to an IRA.
- IRA beneficiaries must pay income taxes up to the fully deductible portion of the IRA proceeds and earnings. A spousal beneficiary may be able to treat the IRA as his or her own IRA.