

Independent Investor

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It's 2008: Are Your Beneficiary Designations Up-to-Date?

Regardless of their level of personal wealth, there is one estate planning concern that is shared by people from all walks of life - the decision of who gets what when you are gone. While many people logically assume that a will is the official forum for expressing such decisions, that's not always the case. For instance, did you know that the proceeds from workplace retirement plans, IRAs and life insurance policies are passed on independent of what may be spelled out in a will?

Naming beneficiaries to these types of accounts is one of those planning activities that is typically given too little thought, however those named to inherit such assets often face unique tax and legal consequences.

Employer-Sponsored Retirement Plans and Individual Retirement Accounts (IRAs)

Regarding employer-sponsored plans, such as 401(k)s, an individual who is not married can name whomever they like as beneficiary. If you are married, however, federal law states that your spouse is automatically the beneficiary of a 401(k) or profit-sharing plan. If you wish to name someone else as beneficiary, then your spouse must sign a written waiver.

For example, someone who has been separated from his or her spouse may wish to name a domestic partner as the intended beneficiary. The spouse still has a legal claim to the 401(k) assets, and the domestic partner will not be able to receive the funds unless the spouse signs a written waiver. A waiver may be appropriate in other situations, such as a second marriage in

which children from the first marriage need the money more than the new spouse.

Until recently, one drawback was that nonspouse beneficiaries were not eligible for tax-deferred transfers to IRAs. Instead, these beneficiaries would have to begin taking distributions, on which they would be required to pay income tax. However, rules signed into law in 2006 allow nonspousal beneficiaries to have qualified plan proceeds rolled over into a special type of IRA called a "Decedent IRA" set up on behalf of the beneficiary via a trustee-to-trustee transfer.

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

IRS regulations do allow nonspousal beneficiaries to annuitize retirement plan distributions over the life of the [beneficiary](#). Check with your employer or policy issuer to find out if this is an option under your arrangements prior to naming a child as a beneficiary. A competent financial professional and tax advisor can also offer guidance as to whether this action may be appropriate for you.

Life Insurance

No matter who is designated as beneficiary of a life insurance policy, he or she 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 people, a spouse will be the most logical [beneficiary](#). A [trust](#) may be a better beneficiary choice, however, if a surviving spouse was not capable of (or comfortable with)

managing a large sum of money. In this case, the [trustee](#) (often a legal entity rather than an individual) would 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. A secondary beneficiary - either an individual or trust - would be next in line to inherit the insurance proceeds if the primary beneficiary predeceases the insured. 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 state law.

Avoid Naming Minor Children

Naming minor children as beneficiaries may cause unforeseen problems. For example, insurance companies and retirement accounts may not pay death benefits to minors. Instead, these benefits are held until they can be paid to a court-approved guardian and/or [trustee](#) of a children's trust or until the child reaches legal age. A guardian, trust or trustee should be named [beneficiary](#) to ensure competent management of the proceeds for the children. By naming a children's trust as a beneficiary, the proceeds could be invested and managed by a competent trustee (a person or institution) you choose. A revocable [living trust](#) could also be named as a beneficiary, which keeps the proceeds out of probate.

Keep Your Plan Up-to-Date

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

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.

This article is not intended to provide specific investment or tax advice for any individual. Consult me, your financial advisor, or your tax advisor with questions.

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