

Designating Beneficiaries for Your Retirement Accounts

Like many of us, you probably prepare for your retirement by saving money through an individual retirement account (IRA) or a 401(k). While socking away as much as possible into a retirement account is commendable, don't ignore one of the most important financial decisions that you will make: choosing the beneficiary of your account.

It might not seem very important. But, without careful consideration, your decision may have unexpected tax and estate planning implications. Many people do not realize that the choices made on the beneficiary designation form supersede the instructions found in a will or a trust. Not all beneficiaries are treated alike. When choosing your beneficiaries, you should know the options that are available to them when they receive your retirement benefits. Below is a brief introductory overview to some common beneficiary designations, as well as points you should consider before choosing a beneficiary.

Naming your spouse

Most people voluntarily name their spouse as beneficiary; however, there are situations where federal law mandates that your spouse *must* be your beneficiary, as with certain employer-sponsored retirement plan accounts. If you wanted to name someone else, your spouse would be required to sign a waiver of his or her rights as beneficiary.

But naming your spouse leaves him or her with the most options and flexibility upon your death. Your spouse can take distributions based on his or her own life expectancy. Unlike receiving the account in one lump sum, a payout over your spouse's life expectancy is advantageous because he or she would continue to reap the tax deferral benefits on the remaining account balance.

Your spouse also has two options that are not available to any other type of beneficiary. He or she may choose to roll over the funds to his or her own retirement account. Or the funds can remain in an inherited retirement account, which your spouse can treat as his or her own. He or she will be able to defer receiving distributions until it is time to take required minimum distributions at age 70 1/2.

Naming someone other than a spouse

A non-spouse beneficiary has the option of ~stretching~ the distributions over his or her life expectancy. By doing this, the funds in the account will have

more of an opportunity for tax-deferred growth. This can benefit a young beneficiary, who gains a time advantage to stretching the distributions over a lifetime because of compound interest.

Naming a trust

Naming a trust as beneficiary can give you some control over what happens to your assets after you have passed away. The trust would receive your retirement funds. Those funds would then be distributed to your beneficiaries, according to the terms of your trust. A trust, if properly drafted, may also provide the beneficiaries with some protection against creditors. This may be particularly attractive if you feel your beneficiaries have poor money management skills.

A trust may also receive the same beneficial treatment as a non-spouse beneficiary if the trust's beneficiaries are individuals and certain requirements are met. These requirements can be complicated. To avoid making a mistake that may cost your beneficiaries, you should consult a qualified advisor before naming a trust as your beneficiary.

Naming a charity

This is useful if you have charitable inclinations, or you have already provided for your heirs with other assets. Besides the personal gratification you get by supporting your favorite worthy cause, your estate will receive a deduction against estate taxes if the charity is considered qualified by the IRS.

Naming your estate

Generally, if you fail to name a beneficiary on your account, it will default to your estate. Not only will this produce unfavorable distribution options, but the funds will also be subject to a probate proceeding. Probate is the process through which the court will administer your estate and distribute assets to your heirs. It can be an expensive, public, and time-consuming process that can be avoided by naming a beneficiary other than your estate.

Finally, be sure to review your designations annually to ensure that they are current and aligned with your wishes. For example, many people have neglected to change their beneficiaries after a divorce or remarriage, increasing the possibility for hurt feelings, misunderstanding, or lawsuits.

If you would like to update your beneficiaries, please give me a call to ensure that you understand all aspects of your decision. You may not be around to

know if you made a mistake, but your beneficiaries will feel the effect for years after you have gone.