

Naming Beneficiaries of Insurance Policies and Retirement Plans

Topical Education for Today's Investor

PLANNING FOR YOUR RETIREMENT

A major issue in estate planning is who to name as beneficiaries on life insurance policies, pension plan accounts, and IRAs. Often this important decision is given too little consideration. However, naming beneficiaries can be complicated and can present estate and income tax consequences to the beneficiary.

When Naming Beneficiaries, Remember to Consider:

- **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 for their benefit would be better than a direct transfer.
- **Pension plans** Unless waived by the spouse in writing, the law requires a spouse to be the primary beneficiary of the account.
- **Naming contingent beneficiaries** Should something happen to your primary beneficiary, the contingent beneficiary would receive those 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. Avoiding probate does not exclude these proceeds from your federal taxable estate.

For many married individuals, a spouse will be the most logical beneficiary. A trust may be a prudent beneficiary choice if a surviving spouse would not have the ability to prudently manage a large sum of money or if estate planning considerations suggest certain tax benefits. 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 will go to an 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.

Pension Plans and Individual Retirement Accounts (IRAs)

The law requires that a spouse be the primary beneficiary of a 401(k) or a profit-sharing account unless he/she waives that right in writing. A waiver may make sense in a second marriage — 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 whoever they choose. And, effective in 2007, non-spouse beneficiaries became eligible for a tax-free transfer to an individual retirement account, assuming that option is available under the plan.

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

Naming Children May Not Be Best

Naming children as beneficiaries may cause unforeseen problems. For example, insurance companies, pension plans, and retirement accounts may not pay death benefits to minors. The benefits would likely be held until they could be made to a court-approved guardian and/or trustee of a children's trust. 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, for example, 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.

In November of 2002, the IRS issued regulations that allow non-spousal beneficiaries to annuitize retirement plan distributions over the life of the beneficiary. Check with your employer to find out if this is an option under your plan prior to naming a child as a beneficiary. A competent financial advisor and tax advisor can also offer guidance as to whether this action may be appropriate for you.

Special Tax Considerations

Life Insurance Benefits are transferred free of income taxes.

Pension Plans A non-spouse beneficiary must report the proceeds as taxable "income with respect to a decedent" but may be able to transfer them tax free to an IRA.

IRAs 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; this does not avoid the income tax, but may defer the distribution of the account. Roth IRAs are generally income tax-exempt.

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. Therefore, it is important to integrate your beneficiary designations with your other testamentary documents. Since many assets subject to beneficiary designations are subject to both income and estate taxes, you should plan so that these taxes are allocated fairly among your beneficiaries.

As is always the case with estate planning, consult with qualified professionals such as your financial advisor, tax advisor or attorney concerning your particular situation in order to ensure that your beneficiary designations are in tune with your goals.

For more information, please consult with your financial advisor.

Points to Remember

1. Beneficiaries of life insurance policies receive the benefits income tax free.
2. A trust or charity may be an appropriate beneficiary in some cases. Unlike individuals, charities do not pay tax on amounts received from IRAs or pension plans.
3. Trustees (often a legal entity rather than an individual) take charge of managing, investing, and disbursing the money.
4. Be sure to name contingent, or secondary, beneficiaries as well.
5. The law requires that a spouse must be the primary beneficiary of a pension plan account, unless waived in writing with spousal consent.
6. Anyone can be named beneficiary of an individual retirement account.
7. Children may not be the most appropriate beneficiaries. Many insurance policies and retirement plans will not pay benefits to minors without a court-approved guardian or trustee.

Important Additional Notes

IRS Circular 230 Disclosure: This is not intended to provide legal, tax or accounting advice. Any statement contained in this communication (including any attachments) concerning U.S. tax matters is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties imposed on the relevant taxpayer. Clients should obtain their own independent tax advice based on their particular circumstances.

This material is provided for educational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities.

The information contained in this presentation is not intended to be used as a general guide to investing, or as a source of any specific investment recommendations. This presentation makes no implied or express recommendations concerning the manner in which any client's account should or would be handled, as appropriate investment strategies depend upon the client's investment objectives.

This presentation is for the general information purposes only. It does not take into account the particular investment objectives, restrictions, tax and financial situation or other needs of any specific client.

Opinions expressed are current opinions as of the date appearing in this material only. No part of this material may, without prior written consent, be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorized agent of the recipient.