

**ESTATE PLANNING**

**By the numbers**

- Inherited retirement accounts generally have required minimum distributions beginning **December 31** of the year following the account holder's death.
- A missed required minimum distribution may be subject to a **50%** penalty tax.
- Consider meeting with your financial advisor at least **once a year** to ensure that your retirement investments, beneficiaries and overall financial plan meet your needs.

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This material should be used as helpful hints only. Each person's situation is different. You should consult your investment professional or other relevant professional before making any decisions.

## CHOOSING BENEFICIARIES FOR YOUR RETIREMENT ACCOUNTS

Whom you choose as a beneficiary of your retirement accounts, and how you designate each beneficiary, can have a significant impact on your family. Properly designating beneficiaries as part of your retirement planning process can help you contribute to the financial well-being of your heirs, giving them more options for how they receive the money and when those assets are taxed.

### Different accounts have different rules

Many people saving for retirement have their assets in a mix of tax-advantaged retirement accounts, such as 401(k)s, 403(b)s and IRAs. While these accounts have many similar features, there are important distinctions.

One of the most critical differences involves spousal beneficiary rights. In a 401(k) plan,<sup>1</sup> your spouse is considered your beneficiary unless they sign a waiver. This can get complicated if your spouse at the time of your death was not your spouse when you named your beneficiaries since you may not think of asking them if they are willing to sign a waiver after you are married. The beneficiary rules for IRAs are governed by state law or by the IRA document. Some states protect a spouses right to be a beneficiary while others do not.

Why is this important? Suppose that after his divorce, Edward names his children as beneficiaries on his IRA and his 401(k) accounts but neglects to change the beneficiary on his ROTH IRA (leaving it as his ex-wife). A couple of years later, he remarries and dies a short time later. His current wife receives the proceeds of his 401(k), because she didn't sign a waiver. The assets in his IRA go to his children and his ex-wife would be entitled to his Roth IRA unless state law or the IRA document say differently. This may not be what Edward intended; however a situation like this shows why it is important to conduct a full beneficiary review after any major life change such as marriage, divorce or the birth of a child.

<sup>1</sup> This applies to any qualified plan covered by ERISA. Most plans that receive employer contributions are subject to ERISA.

### Key points

- What your beneficiaries do with your retirement account assets can be as important as what you do with the assets. You may want to include them in your planning.
- Beneficiaries of all types of retirement accounts are subject to required minimum distribution (RMD) rules. It is important to understand these rules.
- A legal and tax advisor can help you designate beneficiaries for a retirement account so that your decision fits with your own financial and estate plan.

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### Types of beneficiaries

Your primary beneficiaries are the people first in line to inherit an account. If they are alive when the account holder dies, these beneficiaries may choose to accept the account or disclaim it. If the beneficiaries decide to disclaim or decline the benefit, they cannot choose who will receive it instead.

In this situation, the account goes to the person who would have received it if the disclaiming beneficiary had predeceased the account holder.<sup>2</sup>

You may also name *contingent beneficiaries*, and this is generally a good idea. Your contingent beneficiaries will inherit your retirement account if the primary beneficiary predeceases you or disclaims the benefit. For married couples with children, it is common to name your spouse as the primary beneficiary and your children as the contingent beneficiaries.

*Surviving spouse as beneficiary* for all ERISA qualified retirement plans such as 401(k)s and some 403(b)s, a spouse is the automatic beneficiary unless he or she signs a waiver authorizing you to choose a different beneficiary.

### Multiple beneficiaries and segregated accounts

You may wish to name more than one beneficiary for your retirement account. Generally, if you do this, the life expectancy of the oldest beneficiary determines the distribution period for all beneficiaries. However, it may also be possible to split the account into separate accounts for each of the beneficiaries. Depending on the terms of the retirement account, separate accounts may be established during the owner's lifetime, automatically created only upon the owner's death, or the executor may direct this to occur after the owner's death. When the accounts are separated, each beneficiary is able to take distributions based on his or her own life expectancy from his or her own portion of the retirement account assets.

### Spouse as primary beneficiary and family trust as secondary beneficiary

Under this type of designation, your surviving spouse can keep part or all of the retirement account, if he or she needs it, or can disclaim part or all of it to fund the family trust.

If the trust is properly drafted, the beneficiaries of the trust, rather than the trust itself, will be treated as retirement account beneficiaries and may receive required minimum distributions based on the life expectancy of the oldest beneficiary.

### Your beneficiaries' options

Your beneficiaries have a choice about what to do with an inherited retirement account, and their decision will have important tax implications. Because of this, you may want to suggest that beneficiaries talk with your financial or tax advisor before deciding on a course of action.

*Any beneficiary* may choose to receive a cash distribution if cash distributions are an option under the particular plan, although there may be tax consequences. Distributions from traditional IRAs and qualified plans generally are taxable, so taking a complete distribution in a single tax year can create a substantial tax liability. Generally, distributions from a Roth IRA that is at least five years old are tax-free.

*Any beneficiary* may choose to reregister an IRA as an inherited IRA or roll a lump sum distribution from a qualified retirement account into an inherited IRA. Depending on the type of IRA, who the beneficiary is and what required minimum distribution rules may apply, this option can spread the inherited account's income tax liability over a longer period of time or, in the case of tax-free Roth distributions, it could potentially result in more after-tax income than taking a lump sum withdrawal. You and your beneficiaries should consult your financial advisor about the rules specific to your account.

<sup>2</sup> A valid disclaimer must be made in accordance with state law within nine months of the account owner's death.

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*A spousal beneficiary* has the option to treat an inherited IRA as his or her own. Spouses can also roll an inherited retirement account such as a 401(k) into their own IRA. In both instances, all regular IRA rules apply once the transactions are complete. Keep in mind that there are advantages and disadvantages to an IRA rollover depending on the investment options, services, fees and expenses, withdrawal options, required minimum distributions, tax treatment and your unique financial needs and retirement goals. Your advisor can assist in determining if a rollover is appropriate for you.

As you can see, beneficiary choices about how to deal with an inherited retirement account have important tax implications. Heirs should always consult their financial and tax advisors before making any decisions.

### **Conclusion**

Determining the beneficiaries for your retirement assets is a crucial part of any estate plan. Check with your legal and tax advisors about the beneficiary options that are right for your estate planning needs.

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