



## Naming Beneficiaries of Insurance Policies and Retirement Plans

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 in the person's name 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 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 individuals, 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 prudently 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 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 whomever they choose. And nonspouse beneficiaries are now eligible for a tax-free transfer to an individual retirement account.

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.

### 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 nonspousal 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 professional 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 nonspouse beneficiary must report the proceeds as "income with respect to a decedent" but can 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.

### **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.

### **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.
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.