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Making the Most of Your Beneficiary Designations

The disposition of many different types of assets is governed by contract rather than by a will or trust. Most notably, life insurance and retirement plan assets are structured to pass to a beneficiary designated by the contract owner. In most instances, naming a beneficiary keeps the asset out of probate, allowing it to pass directly to the named beneficiary within a short time following the account owner's death. When an asset bypasses probate, it is protected from the claims of creditors and the administrative expenses of the probate process.

Taking advantage of beneficiary designations is an efficient and cost-effective way to pass title to assets upon death. But it only works if a beneficiary is actually named. Designating one's estate as the beneficiary, or failing to designate a beneficiary at all, will subject the asset to probate and all associated delays and expenses. In addition, retirement plan assets such IRAs, 401(k)s and the like which pass through probate will suffer the loss of certain elections and benefits. For example, an IRA which names the owner's spouse as beneficiary can be "rolled over" by the spouse and added to his or her own IRA. A spousal rollover IRA is governed under the same rules and entitled to the same benefits as the spouse's own IRA such as delayed distributions to age 70½. If, instead, the owner fails to designate a beneficiary or names his "estate" as beneficiary of the IRA, the entire account will be subject to established rules which will ensure a faster payout and require the estate to remain open for a longer period of time than may otherwise have been required.

Where the IRA owner names his estate as beneficiary, or fails to name a beneficiary, if the owner dies before the date he is required to begin taking distributions (the "required beginning date" or "RBD"), the entire account must be distributed by the end of the fifth year following the year of the owner's death. If he died after his RBD, the post-death required minimum distributions are calculated over the owner's remaining single life expectancy determined in the year of death and subtracting one from that number for each year thereafter until the account is completely depleted. In either case, these payments would be paid to the owner's estate, causing the estate to remain open until the account has been depleted.

Because beneficiary designations in effect as of the date of the owner's death will control the availability of various postmortem tax deferral opportunities, it is important to carefully consider options in establishing beneficiary designations to maximize those opportunities. In some cases, it makes sense to name a trust instead of an individual as the designated beneficiary. However, not every trust will qualify as a "designated beneficiary" for tax purposes. Therefore, it is important to discuss options with your estate planning attorney. But remember, not all estate planners have expertise in a tax planning. Look for an attorney who has established proficiency in tax and retirement benefits planning, and not just "estate planning" to answer both the questions you know to ask as well as those you don't. An estate attorney with expertise in tax and retirement benefits planning can provide you with the best tax and non-tax advice to protect both your retirement plan assets and the beneficiaries you leave them to.