THE ABCS OF BENEFICIARIES

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When you buy life insurance or an annuity, join an employer's retirement plan, or open an Individual Retirement Account, you'll be asked to designate a primary beneficiary to receive the proceeds or benefits at your death. Too often, people give little thought to this decision. They simply jot down whoever seems the most logical choice at the time — generally a spouse or child — or sometimes they don't designate a beneficiary at all. However, the beneficiary you name can make a big difference in how the benefits will be distributed and how much your beneficiary will receive.

A Will is Not the Way

If you don't name a beneficiary, insurance proceeds and retirement benefits will be paid to your estate to be distributed to your heirs under your will. Your family won't be able to receive the assets until your estate is probated, which could take months — or even years. Moreover, your beneficiaries lose the access and opportunity to use financial planning strategies that may better meet your loved ones' needs and potentially increase the assets they eventually will receive.

Naming Your Spouse

For many married couples, naming a spouse as primary beneficiary for retirement assets provides the greatest planning flexibility. (Under pension law, some employer-sponsored retirement plans require you to designate your spouse as your primary beneficiary unless your spouse agrees in writing to your choosing someone else.) For instance, if you have not yet begun receiving required minimum distributions at your death, your spouse, like any beneficiary, can begin taking distributions based on his or her life expectancy immediately without penalty, even if he or she is younger than age 59½. Generally, a 10% tax penalty is imposed in addition to income tax on distributions of retirement assets received before age 59½. Your spouse can also begin taking withdrawals until the later of December 31st of the calendar year following your death or December 31st of the calendar year in which you would have reached 70½.

A spouse also has the option of rolling over the account assets into his or her own IRA and waiting until the year after he or she turns age 70½ to start receiving distributions. Your spouse is free to name his or her own beneficiary for the new account.

If you die after your required beginning date, the remaining portion of your account must be distributed at least as rapidly as under the distribution method being used as of the date of your death. If you have a designated beneficiary, distributions can be taken over the longer of (a) the beneficiary's life expectancy or (b) your remaining life expectancy based on your attained age in the year of death. If you die without a designated beneficiary, distributions can be taken over your remaining life expectancy. If your surviving spouse is your sole beneficiary, he or she can also choose to make a rollover to his or her IRA or qualified plan (after the required minimum distribution for your year of death has been taken.)

Considering the Children

You also should designate at least one contingent beneficiary in case your primary beneficiary predeceases you or dies before all the benefits are distributed. Children are a frequent choice for contingent beneficiary. But naming your spouse primary beneficiary and your children contingent beneficiaries may not be the best arrangement. If your children are still minors when they receive your insurance proceeds or retirement benefits, a court-appointed guardian will be needed to receive and hold the money for them.

Also be aware that, unless you make other specific arrangements such as designating a trust as your beneficiary, your primary beneficiary will have free access to all of the assets at your death and, in the case of retirement benefits, may be able to designate his or her own beneficiaries. Your children or other contingent beneficiaries might not receive anything.

To avoid this situation, consider creating an irrevocable life insurance trust to manage and distribute your insurance proceeds and/or a trust in your will to receive and distribute your retirement assets. In that way, you can be sure your assets will pass to your children even if your spouse should remarry after your death. As long as all IRS requirements are met, beneficiaries of a trust can be treated as the designated beneficiaries of a qualified plan or IRA, and the life expectancy of the oldest trust beneficiary will be used to determine minimum required distributions.

Designating beneficiaries is not a task to take lightly. Your decision can have a significant impact on your family’s or other loved one’s financial security. For assistance in choosing beneficiaries for your insurance and retirement plan assets, talk with your professional financial planner.