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Beneficiary Considerations

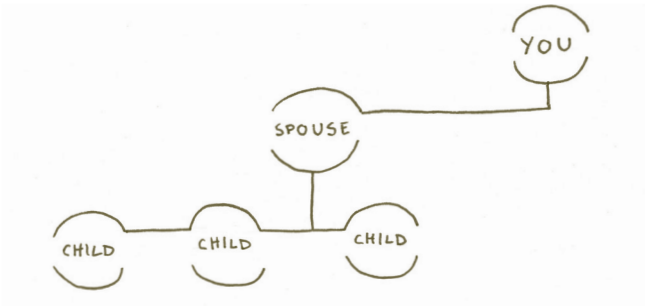
The purpose of estate planning is to ensure that, after your death, your assets will be distributed according to your intentions. If there are discrepancies between various components of your plan, your intended gift to your heirs can become a complicated and potentially costly burden. Understanding the ways in which your assets can transfer after your passing can help you avoid problematic inconsistencies, ensuring that your plan is executed as seamlessly and tax efficiently as possible.

Typically, a person's assets are transferred in one of four ways:

1. through an ownership structure such as a joint account, where, when one account owner passes away, the other owner automatically receives the assets;
2. through a trust, where assets are transferred according to the provisions within the associated document;
3. according to the terms of your will (or, in the absence of a will, according to the laws of your state); or
4. through beneficiary designations, which serve to pass assets to beneficiaries that have been designated on accounts.

It is important to remember that an up-to-date will alone may not be sufficient to guarantee that your wishes are carried out as intended, as your will may be superseded by the beneficiary designations on your accounts. The primary objective for adding a beneficiary designation is usually either to ensure that assets in tax-deferred accounts can be passed on to heirs in the most tax-efficient way possible or to simplify asset transfer upon death by avoiding probate[1] for the associated assets.

Because anyone who has ever saved for retirement has had to go through the process of designating a beneficiary, this article focuses on important considerations related to beneficiaries.



Deciding on a beneficiary structure

When it comes to transferring assets after your death, simpler is generally better. In most cases, a person's wishes can be carried out simply by naming individual beneficiaries on his or her accounts. One of the most common beneficiary structures names a spouse or partner as the primary beneficiary and identifies others (such as children) as contingent beneficiaries, after the spouse or partner. This structure is an efficient way to pass assets on to heirs while avoiding the hassles of probate and preserving the "stretch benefit" of passing tax-deferred dollars to younger beneficiaries. Another common »

beneficiary structure is *per stirpes,* wherein each branch of the family receives an equal share of the estate with no need to name each child or beneficiary separately. However, certain circumstances may warrant a more complex beneficiary structure. Naming a trust as a beneficiary can avoid transferring assets directly to a spouse or child when it does not make sense to do so.

Common instances for using a trust include:

- If your beneficiary is a minor and not legally allowed to inherit or manage assets outright, a trust can hold the assets until the child is of age. In the interim, a trustee would manage the assets on the minor's behalf.
- If your beneficiary is unable or unwilling to manage the assets on his or her own, a trust can help add structure around specific use of funds.
- If you worry that your beneficiary is imprudent or too inexperienced to handle the responsibility of inheriting your assets, a trust can offer additional protection from creditors and/or predators. Additionally, a trust can also set parameters around how the funds can be used and how much can be removed from the account each year.
- If you have remarried, you may not want to name your spouse from a later marriage as the primary beneficiary outright. Naming a trust instead can minimize the risk of your assets not passing through to your children in the event of disagreements after your passing.

While helpful in these instances and others, using a trust as a beneficiary can add cost and complication to your plan and should be considered carefully. In order for a trust to qualify as a beneficiary in the IRS's terms, it must be an irrevocable trust, meaning it cannot be changed upon the owner's death. It also can have only a *person* as a subsequent beneficiary, not an estate or charity. These requirements are in place to ensure that the government can force distributions out of the tax-deferred accounts at some point. If the IRS finds that a trust does not qualify as a beneficiary, all assets must be distributed from the account within five years of the owner's death, essentially eliminating the beneficial tax treatment of the account and potentially creating a significant tax burden for your beneficiaries.

Reviewing your beneficiaries

Regardless of the beneficiary structure you use, we recommend reviewing your beneficiaries annually—or, at a minimum, in conjunction with life events such as birth of a child or grandchild, marriage, divorce, inheritance, or the death of a family member. Reviewing your beneficiaries regularly helps to ensure that your assets will pass to the people you intend to inherit them. For example, if you initially designated your spouse as a beneficiary and later remarried without updating your beneficiaries, your assets may go to your former spouse even if your will says otherwise. Additionally, if you have a trust named as a beneficiary and circumstances no longer warrant it (e.g., your minor beneficiaries have reached the age of majority), it may be appropriate to remove that unnecessary complication from your plan.

If you have any questions about the ownership structure on your accounts or other estate planning tools, please contact your wealth advisor. ■

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1 *Probate is the legal process by which assets of the deceased are distributed through an executor; in many states, it can be costly and time consuming for your heirs.*

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