

Double-Check Your Beneficiaries

By U. Cal Brown, Jr., CFP

Most of us want our assets passed on after our death to the people we care the most about: spouse, children, relatives, and our favorite charities. We also want this transfer to take place with the smallest possible tax bite. But we may not achieve those goals if we don't pay attention to how we name names – that is, who we designate as beneficiaries.

First, it is important to review your situation with a Certified Financial Planner™ and an estate planning attorney. Next, you need to carefully consider your options and the ramifications of each one.

Property is passed to designated heirs in four ways:

- As **jointly owned property** – all property in joint ownership -- home, car, savings and investments -- automatically passes to the surviving owner. It does not go through probate. This is the most common arrangement in a marriage.
- By **beneficiary designation** – Proceeds from life insurance, investments in IRAs (Individual Retirement Accounts), annuities, and qualified retirement plans (such as 401-ks, Thrift Savings Plans, SEPs, etc.), as well as POD or TOD accounts, pass directly to the named beneficiary and bypass probate.
- Through a **trust** – Trust property goes to the beneficiaries of the trust without going through probate.
- By a **valid will** – This is the last resort, and only happens if the other three don't preempt it. The property will go through probate. There are costs and lengthy delays in probate.

These four methods may appear to be simple and straightforward, but there can be serious pitfalls. A very common mistake is forgetting each named beneficiary takes priority over the instructions in the will. Those you name as beneficiaries of your retirement plan, for example, will inherit those assets even if you decide later to name someone else in your will to receive everything you own! You have to change the beneficiary for each specific asset. IRAs, other retirement accounts, and life insurance will not be affected by your will. Rather, these amounts will go directly to the named beneficiary(ies).

The same applies to jointly owned property. If you designate in your will that your children (say, from a previous marriage) should get your stocks and mutual funds but they are jointly owned by your current spouse, then the spouse – not the kids – will inherit those investments.

Also, keep in mind that minor children cannot receive property or money – anything designated to them will go through probate. This is why you should have a testamentary trust as part of your will, or a separate trust, to receive large life insurance amounts for minor children. This way, you can name someone you know and trust to manage the money for the children (otherwise the probate court will name someone). You can avoid giving a lump sum to each child when they reach age 18. It is usually better to spread out the distribution of large sums of money over several years (e.g., age 25, 30, and 35), and for specific events (monthly stipend to guardians, or lump sums for college, wedding, down payment, seed money for a business, etc).

Many people neglect to name “contingent” or “secondary” beneficiaries in the event that the primary beneficiary predeceases them or dies at the same time. Without a contingent beneficiary, the property will go into the owner’s estate and will go through probate. Probate and other problems can be avoided by simply naming contingent beneficiaries.

Finally, as you consider creating or updating your estate plan, remember the limited exclusion from estate taxes and plan to fully utilize it. If your total estate value – including the death benefit of life insurance policies and the value of a business you own – is over \$1.5 million, it may be counter-productive to have everything in joint ownership with your spouse. Estate taxes can be avoided for estates up to \$3 million, but each named spouse must own \$1.5 million separately! A “Credit Shelter Bypass Trust” (also called an “A-B Trust”) should be established to save literally hundreds of thousands of dollars in estate taxes!