Wills and Trusts Don't Determine Who Will Get Your IRA and Other Accounts

Retirement Plans and Your Estate Plan

by Alexandra Armstrong, CFP, CRPC, and Christopher Rivers, CFP, CRPC

In our last few articles, we've discussed different estate planning documents, including wills, trusts and powers of attorney. When talking to our clients, however, we've found that many people don't realize that these documents don't govern the recipients of their retirement accounts and their insurance policies. For these assets, the beneficiary designations they make supersede their other estate documents. When they die, these beneficiary designations override any bequests they've made and the assets transfer directly to the designated beneficiaries.

For this reason, we suggest you contact the custodian for your retirement plans annually to obtain a written record of your beneficiaries for each plan. Some custodians provide this information automatically each year, but many don't. This way you can make sure the designations are correct. Once you receive this information, we suggest you put it in a file with your other estate-planning documents.

How Retirement Assets Are Passed On

Beneficiary designations may seem straightforward, but the estate and income tax consequences can be complicated. Understanding the implications of beneficiary designations is critical because an improper beneficiary designation may produce some unforeseen surprises, such as probate and tax liability. Before we go into the details, the bottom line is that if you are married the preferable beneficiary from a tax point of view is your spouse. We'll try not to tie you up in legalese but it's important you understand how it all works.

Primary and Contingent Beneficiaries

The primary beneficiary is the person or legal entity you designate to receive your account assets upon your death.

- **The primary beneficiary** may be more than one person or entity.
- **The primary beneficiary** must be a person or qualifying trust.
- **If a primary beneficiary predeceases** you, his or her share is distributed to any remaining primary beneficiaries per capita unless a per stirpes designation (*more on this below)* is indicated.
- **In the event that all the primary beneficiaries predecease you**, death benefits will pass to any designated contingent beneficiaries. That may be more than one person or entity but again must be a natural person or qualifying trust.
- **If no contingent beneficiary is named** and there are no living primary beneficiaries, the beneficiary designation is no longer valid and the assets may be included in the estate of deceased (by applicable state laws).

Defining Per Stirpes Versus Per Capita Beneficiary Designations

There are two types of beneficiary designations available when you designate multiple primary beneficiaries: per capita and per stirpes.

- **Per Capita — as per the head.** Most financial firms automatically assume your assets are to be distributed per capita to your beneficiaries. Thus, if you name your two children as primary beneficiaries and one of your children predeceases you, your remaining child will inherit 100% of your account balance and the children of your deceased child would inherit none of the proceeds.
- **Per Stirpes — as per the stem.** This designation provides for the next generation if one of your beneficiaries predeceases you. If a beneficiary designation is made per stirpes and that beneficiary dies leaving children of his/her own, the deceased beneficiary's share of the death benefit would be divided equally among these living children. If you use a per stirpes designation, you typically must indicate the words "per stirpes" after the beneficiaries' names.

Spousal Beneficiary

As stated earlier, in most cases, the preferable designation is your spouse. In the case of second marriages, where the retirement plan assets are a significant part of the estate, each spouse may choose to leave these assets to their children by their previous marriage or to other individuals.

Advantages

- **The primary benefit** is that your spouse will have the option of rolling these assets into his or her own retirement plan account or individual retirement account (IRA).
- **Your spouse has immediate access** to the money.
- **Your spouse can delay** taking distributions until the date you would have reached age 72.
- **Your spouse may name** new beneficiaries.

Disadvantages

- **Typically, your retirement account** assets become part of your spouse's taxable estate upon his or her death. If your estate is large enough to trigger state or federal estate taxes, this may be a problem. From a federal point

of view, in 2021 your estate has to exceed $11.7 million to be taxed (state estate taxes vary by state). This level, which affects 1% of estates nationwide, is set to expire in 2026. But this tax law could be changed at any time.

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Nonspousal Beneficiaries

If you are single, the simplest option is to name one or more individuals as beneficiaries. You do have the ability to name a trust, estate or charity as the beneficiary, though each comes with its own complications. Prior to 2019, if someone inherited an IRA from a nonspouse who was over age 70.5, the individual was required to take annual distributions from the IRA, but could stretch those distributions over a lifetime. This had the benefit of spreading the tax obligation out over decades, in many cases.

Following passage of the SECURE Act in late 2019, most new nonspouse beneficiaries now have a shorter window in which to withdraw money from the inherited retirement account. In most cases, the nonspouse beneficiary is required to withdraw the entire amount of the IRA within 10 years of the death of the original account owner. You can withdraw any amount at any time within the 10-year time frame.

As a result, most nonspouse beneficiaries may now have significant taxable income within 10 years of inheriting the IRA. There are a few exceptions to this new rule. If you are an "Eligible Designated Beneficiary" you may still stretch the distributions over your lifetime. But the list is short. To qualify you must be one of the following:

- **Surviving spouse,**
- **Minor child of the decedent,**
- **Disabled,**
- **Chronically ill,**
- **Someone within 10 years of age of the decedent.**

If you meet one of those qualifications you may continue to use the "lifetime stretch" option.

Lastly, if you inherit a Roth IRA that was funded five years prior to the death of the original owner, you don't have to pay taxes on the money you receive and the amount you withdraw is not subject to the 10% early withdrawal penalty. But you still must withdraw the money within the same 10-year time frame.

Trust Beneficiary Designation

If you designate a trust as the beneficiary of your retirement account(s), your account will be transferred to a trustee who will manage those assets for the beneficiaries named in your trust. Although trusts have many benefits, they're also generally more complicated and costly to set up and require the expertise of an attorney. A trustee has to be paid to manage the assets.

Naming a trust as beneficiary can be attractive for families with large estates, complicated bequests or minor children or for supporting family members who are unable to handle their own financial matters. However, they introduce a number of complications regarding when the inherited account must be distributed, which are beyond the scope of this article. In short, you may lose the ability to stretch distributions over the 10-year or lifetime provisions.

Every situation is different but generally we recommend you name individual(s) as beneficiaries of your retirement account rather than a trust. If you have a trust named as the beneficiary of a retirement account currently, we recommend you consult an attorney to discuss the ramifications following the change in regulations.

Estate Beneficiary Designation

We usually recommend that you not make your estate the beneficiary of any retirement account, as that will mean the account would have to go through probate to be distributed. Probate can be a lengthy, complicated and expensive process. When retirement benefits are payable to the estate instead of individuals or a qualifying trust, the beneficiaries lose the ability to stretch the IRA distribution over the 10-year or lifetime provisions.

Charitable Beneficiary Designation

If you designate a charity as the beneficiary of one or more of your retirement accounts, your estate may receive an estate tax deduction for assets that are gifted to charity. Your estate will need to include the value of the assets as part of the gross estate but will receive a tax deduction for the charitable contribution, which can be used to offset the estate taxes. Care must be taken that the charity is clearly identified by its proper name and is sufficiently specific.

Divorce

In the event of divorce, some states revoke the beneficiary designation naming your former spouse unless the divorce decree states otherwise. You need to check what your state laws stipulate. In most cases, making a new beneficiary designation immediately after a divorce is final is advisable.

Conclusion

As we said at the beginning of this article, it's very important that you verify all your existing beneficiary designations periodically to make

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A Herd of Monthly Charges Can Gobble Up Your Budget

Rein In Your Subscription Services

by Matt Mondoux, CFA, CFP, CMT

It seems like not a month goes by without a new subscription-based service being launched: movies, television shows, music and on-demand works all streamed to your home via internet. Like it or not, this will be the delivery mode for almost all technology platforms in the future. Beyond streaming, more and more functions can and will be sold as monthly subscriptions, for example last summer BMW announced they would offer heated seats and cruise control as subscription options.

Soon the large cable bill that left you pulling your hair out will be traded for a myriad of $6 to $15 monthly charges that don't cause you to bat an eyelash. The annual increases will be smaller than the cable bills of old: What's an extra $1 per month? It's likely becoming obvious where I'm going with this. Soon is the day where the cost of the 10 to 15 monthly subscription services will dwarf the shockingly high cable bill. A solution is desperately needed before you become overwhelmed by your $9.99 monthly charges. I have a simple strategy:

■ **1. Exclusively assign all subscription services** to the same unique e-mail address. I recommend making it an e-mail address with subscription or service in the address, for example: **DoeFamilySubscriptions@domain.com**. This creates a repository for all services you're paying for. Make it easy on yourself to see what you're paying for. The added benefit is less mail to your primary e-mail address.

■ **2. Add it all up**, whether with pen and paper or Microsoft Excel, it's important to calculate what you're paying so the totality of the subscription expense is understood. A potential pitfall would be to only rely on a monthly credit card statement. Often as new subscriptions are added a different payment method is used, either a checking account or new credit card. Be sure to comb all potential payment sources for monthly charges. Finally, pay special attention to annual charges. Sometimes there is a price break for an annual subscription versus monthly and it's important that those are factored in, too.

■ **3. Maybe your eyes just popped** after adding up those expenses. If so, it's time to make some choices. Having every television and streaming service likely isn't very realistic; ask yourself, can I get 75% of what I want and cut 50% of the expense? If so, do it. Unsubscribe to the redundant and least used things you're paying for.

■ **4. Finally, in my opinion, here comes the fun part.** Subscribe to your savings account. Take the savings from what you just cut out and begin a monthly transfer to your savings account or 401(k)/IRA/Roth IRA/debt service, etc. After all, the best person to pay is yourself.

I highly recommend going through this exercise at least annually. There are too many new and innovative services offered that you may be signing up for. We intended to get "three free months" but end up sticking with something for years that's relatively unused. Set a reminder in your phone or calendar to cancel a service before you're charged or to review its fit in your life after six months or one year.

Monthly subscriptions generate big profits for companies because their relative cost is low. Don't fall into the trap of saying "it's just $8.99;" it's that mind-set that will leave you spending unnecessary money and having a suboptimal budget. Subscription services aren't going away anytime soon and if your habits to monitor them don't evolve, you'll end up with an accumulation of small charges that equal something very significant. B

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sure they're recorded correctly. Also, if you inherit a retirement plan, make sure you designate primary and contingent beneficiaries for the new plan. As always, we recommend you talk to your estate-planning attorney about the best strategy for your particular situation.

Our thanks to our colleague Sumedha Malhotra, CFP, who contributed to this article. B

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