Retirement Plans Play a Role in Estate Plans

Beneficiary designations override other bequests, follow new rules.

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In our last few articles, we've discussed different estate-planning documents including wills, trusts and powers of attorney. However, when talking to our clients we've found that many people don't realize that these documents don't govern their retirement accounts, annuities and 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 check your retirement plans, annuities and life insurance policies annually to confirm your beneficiaries. Some custodians send you this information automatically each year, while others provide it online. One way or the other it's important to be sure the designations are correct. Beneficiary designations should be coordinated with your overall estate plan and kept on 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. 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**, their 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**If no contingent beneficiary is named** and there are no living primary beneficiaries, the beneficiary designation is no longer valid and the assets may be included in the estate of deceased (by applicable state laws).

THE HEAD OR THE STEM

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. If you name your two children as primary beneficiaries, with each inheriting 50%, and one of your children predeceases you, your remaining child will inherit 100% of your account balance. The children of your deceased child would not inherit any of the proceeds.

Per Stirpes — as per the stem

By contrast, this designation provides for the next generation if one of your beneficiaries predeceases you. In this case if again you have two children who are 50/50 beneficiaries, and one predeceases you, the deceased child's 50% share will be divided equally among their children (your grandchildren). If you use a per stirpes designation, you typically must indicate the words "per stirpes" after the beneficiaries' names.

In our experience, clients with multiple children tend to prefer the per stirpes designation, so that each of their children's families are treated equally.

SPOUSAL BENEFICIARY

If you are married the preferable beneficiary from a tax point of view is your spouse. It is not uncommon, in the case of second marriages, for each spouse to choose to leave these assets to their children by their previous marriage. But for most, naming your spouse as beneficiary will be the best option.

Advantages

- **Your spouse will have the advantage** of rollingyour individual retirement account into their own IRA account.
- **Your spouse can delay** taking required minimum distributions (RMDs) until she/he reaches age 73.
- **Your spouse may name new beneficiaries.**

Disadvantages

■ **Once they have been inherited**, your retirement 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 2024 your estate has to exceed $13.6 million to be taxed (state estate taxes vary by state). However, be aware that this high level, which affects 1% of estates nationwide, is set to expire in 2026 and revert back to a lower level, expected to be around $7 million, adjusted for inflation.

NON-SPOUSAL 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 beneficiary, although each comes with its own complications.

Prior to 2019, if someone inherited an IRA from a non-spouse who was more than age 70.5, they were required to take annual distributions from the IRA but could stretch those distributions over their lifetime. This benefit, known as the "stretch IRA," meant you could spread the tax obligation out over decades, in many cases.

Following passage of the Secure Act in late 2019, most non-spouse beneficiaries now have a shorter window of time in which to withdraw money from the inherited retirement account. First, non-spouses are required to take annual Required Minimum Distributions from the inherited accounts based on their own life expectancy. (Note that the IRS has postponed enforcing this requirement until 2025.)

Second and more onerous, the non-spouse beneficiary is required to withdraw the entire amount of the IRA within 10 years of the date of death of the original account owner.

As a result, most non-spouse 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 age of the decedent**

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

Finally, 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. However, 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.

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. This is an example of why a good estate attorney and financial adviser are key to help you understand the implications of naming a trust as beneficiary.

Every situation is different but generally we recommend you name individuals as beneficiaries of your retirement account rather than a trust, if at all possible.

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. If an estate is named as beneficiary, the entire IRA must be distributed (and taxed) within five years of the date of death.

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. While the assets will be included in the value of the gross estate, you will receive a tax deduction for

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security at the same time on other extended-hours trading venues. During regular trading hours, brokerage firms are generally required by SEC rules to fill customer orders for listed stocks at the best price at the time — known as the National Best Bid and Offer (NBBO). But the NBBO is only published during regular trading hours, so this requirement doesn't apply to extended-hours trading. As a result, you might receive an inferior price in one extended-hours trading system than you would in another system.

Extended-hours trading doesn't change exchanges' official closing prices or determine the next day's opening prices. The share prices recorded at 4 p.m. on the exchanges on a given day are considered the official closing prices for that day, regardless of what happens during extended-hours trading.

These official closing prices are what investment funds use to calculate the value of their holdings at the end of regular trading hours. The next day's opening prices are generated based on supply and demand for the securities at or around the time markets open.

The pricing dynamics at market open might differ from the prior extended-hours trading session, which creates the risk that the price you receive during the extended-hours period might be worse than during the following day's regular trading hours. Stock options generally don't trade in extended hours. At present, options exchanges offer extended-hours trading in only a limited number of options contracts.

Your brokerage firm may set specific parameters for extended-hours trading. Rules among brokerage firms about when and how customers can participate

in extended-hours trading may vary. For instance, a firm might impose set times for such trading, restrict activity to a specific trading venue or allow investors to trade only certain products. They might only accept limit orders during extended-hours trading and may have different policies regarding whether unexecuted extended-hours trades are canceled or carried over to the start of regular trading hours. They also might not offer extended-hours trading at all.

All brokerage firms, however, must advise customers of the risks of trading outside of regular trading hours, per FINRA rules. Before engaging in extended-hours trading, review the related risk disclosures provided by your brokerage firm and check for any limitations — for example, regarding available order types — placed on your choices for trading outside of regular trading hours.

FINRA is the largest independent regulator for all securities firms doing business in the U.S. Its chief role is to protect investors by maintaining the fairness of the U.S. capital market.

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the charitable contribution, which will offset any estate taxes. Care must be taken that the charity is clearly identified by its proper name and is sufficiently specific. Again, with the current estate tax exclusion at $13.6 million, estate tax will not be an issue for most people.

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. A review of your beneficiary designation immediately after a divorce is final is advisable.

CONCLUSION

Choosing a beneficiary can seem straightforward, but life takes many twists and turns. What made sense five or 10 years ago may have changed. Children grow up and start families of their own whom you may want to provide for. Divorce or death of a spouse may necessitate a new plan for your assets. Even in stable situations, tax regulations may change, affecting how your assets are taxed and inherited by the next generation. It's crucial that you verify all your existing beneficiary designations periodically to make sure they match your current wishes. On the flip side, if you inherit an IRA, take care to properly name your own beneficiaries. As always, we recommend you talk to your estate-planning attorney and financial planner about the best strategy for your particular situation.

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