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Are Your Beneficiary Designations Up to Date?

Who should inherit your IRA or 401(k)? See that they do.

Here's a simple financial question: who is the beneficiary of your IRA? How about your 401(k) or annuity? You may be saying, "I'm not sure." It is smart to periodically review your beneficiary designations.

Your choices may need to change with the times. When did you open your first IRA? When did you buy your life insurance policy? Was it back in the Nineties? Are you still living in the same home and working at the same job as you did back then? Have your priorities changed?

While your beneficiary choices may seem obvious and rock-solid when you initially make them, time has a way of altering things. In a stretch of five or ten years, some major changes can occur in your life and may warrant changes in your beneficiary decisions.

In fact, you might want to review them annually. Here's why: companies frequently change custodians when it comes to retirement plans and insurance policies. When a new custodian comes on board, a beneficiary designation can get lost in the paper shuffle. (It has happened.) If you don't have a designated beneficiary on your retirement accounts, those assets may go to the "default" beneficiaries when you pass away, which might throw a wrench into your estate planning. An example: under ERISA, your spouse receives your 401(k) assets if you pass away. Your spouse must waive that privilege in writing for those assets to go to your children instead.¹

How your choices affect your loved ones. The beneficiary of your IRA, annuity, 401(k), or life insurance policy may be your spouse, your child, maybe another loved one, or maybe even an institution. Naming a beneficiary helps to keep these assets out of probate when you pass away.

Many people do not realize that beneficiary designations take priority over bequests made in a will or living trust. For example, if you long ago named a son or daughter who is now estranged from you as the beneficiary of your life insurance policy, he or she will receive the death benefit when you die, regardless of what your will states.²

You may have even chosen the "smartest financial mind" in your family as your beneficiary, thinking that he or she has the knowledge to carry out your financial wishes in the event of your death. But what if this person passes away before you do? What if you change your mind about the way you want your assets distributed and are unable to communicate your intentions in time? And what if he or she inherits tax problems as a result of receiving your assets?

How your choices affect your estate. If you are naming your spouse as your beneficiary, the tax consequences are less thorny. Assets you inherit from your spouse aren't subject to estate tax, as long as you are a U.S. citizen.³

When the beneficiary isn't your spouse, things get a little more complicated – for your estate and for your beneficiary's estate. If you name, for example, your son or your sister as the beneficiary of your retirement plan assets, the amount of those assets will be included in the value of your taxable estate. (This might mean a higher estate tax bill for your heirs.) And the problem will persist: when your non-spouse beneficiary inherits those retirement plan assets, those assets become part of their taxable estate, and their heirs might face higher estate taxes. Your non-spouse heir might also have to take required income distributions from that retirement plan someday and pay the required taxes on that income.⁴

If you properly designate a charity or other 501(c)(3) non-profit organization as a beneficiary of your retirement account assets, the assets can pass to the charity without your estate being taxed, and the gift will be deductible for estate tax purposes.⁵

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Citations:

1 - forbes.com/sites/ashleaebeling/2018/01/08/five-retirement-housekeeping-moves-for-the-new-year/ [1/8/18]

2 - thebalance.com/why-beneficiary-designations-override-your-will-2388824 [8/28/17]

3 - nolo.com/legal-encyclopedia/estate-planning-when-you-re-married-noncitizen.html [2/4/18]

4 - corporate.findlaw.com/law-library/who-should-be-the-beneficiary-of-your-qualified-retirement-plan.html [2/4/18]

5 - ameriprise.com/research-market-insights/financial-articles/insurance-estate-planning/charitable-giving/ [2/4/18]