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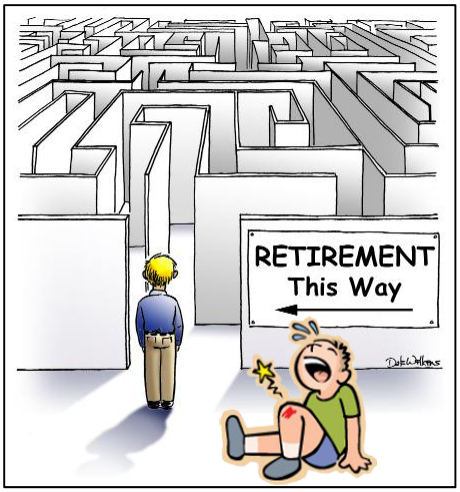
Beware of beneficiary designation boo-boos

Navigating the Retirement Maze



"I am the beneficiary of a lucky break in the genetic sweepstakes."
– Isaac Asimov, American academic and author (1920 - 1992)

Estate planning is one of those things that often gets left to "do later," though sometimes later can be too late (i.e., post mortem). One of the things that I review with new clients is the beneficiary designations and titling on their assets. These are often overlooked because typically right after an asset – real estate, retirement or investment accounts, life insurance, annuities – is acquired and a title and/or beneficiaries are requested, they are promptly forgotten about by the owner.

In my career as a financial planner, I have seen my share of titling and beneficiary mistakes, usually resulting from benign neglect by the client. Considering that these are can be easily checked, I encourage clients to review titling and beneficiaries every few years, particularly when there has been a significant life change: divorce, death of a spouse, moving to a new state, or new family members. The titling of assets and their beneficiary designations can have significant tax and ownership consequences for survivors. While the subject of how assets should be held is a complex topic best addressed by your financial advisor and estate attorney, it is worthwhile to review the basic mistakes present in beneficiary designations so that you can do a self-check to ensure that there aren't any significant problems, and that your heirs say nice things about you at your eulogy.

Titling vs. beneficiaries

It's important to understand the difference between asset titling and beneficiary designations. A title indicates how a particular asset is owned. Assets can be held individually, by multiple parties, or by trusts. The most common titles are individual ownership and joint tenancy with right of survivorship (JTWROS), the latter of which avoids probate by having the assets go directly to the survivor in the event that one of the account owners dies. Less common are Tenancy in the Entirety (TIE) and Tenancy in Common (TIC), which can be useful in situations where there is concern over creditor protection, estate tax issues, or ownership by non-spouses.

Beneficiaries are the entities who legally inherit the asset, provided that the titling and beneficiary designations are consistent with state and Federal laws. These can be individuals, trusts, or organizations. Assets that typically request named beneficiaries are retirement accounts, life insurance policies, and annuities. There is usually the option to name contingent beneficiaries in the event that the primary beneficiaries are no longer alive when the owner dies. Beneficiaries can be changed by the asset's owner, or by a trustee if given permission by the terms of the trust. For other types of assets where beneficiaries are not usually required, they can be titled to include provisions such as Transfer on Death (TOD) or Payable on Death (POD), which have the same effect as naming beneficiaries.

Beneficiaries trump wills

A little known but important fact about asset beneficiaries is that they supersede anything written in a will. At the time of death of the owner, an asset holder – investment institution, bank, insurance company – receives a

death certificate for the owner, divides up the assets as stated by the beneficiary designations, and distributes them accordingly. The only time that a will governs how these assets are distributed is when there are no living beneficiaries to whom to distribute the assets, in which case the assets go into the estate of the deceased.

The advantage of assets directly going to beneficiaries is that they bypass the probate process. Probating an estate can take six to nine months or more, and gets "taxed" by the appointed probate attorney's fee, which is 4 percent in Massachusetts. The disadvantage of designated beneficiaries? When the assets go to someone not intended by the owner because of beneficiary designation errors.

Beneficiary blunders

Most people treat beneficiary designations as a "set and forget" action. The problem with this approach is that life events often necessitate modifications to asset beneficiaries. For the sake of brevity, I will list some of the more common beneficiary designation mistakes:

- Not specifying contingent beneficiaries – If the primary beneficiaries are no longer alive, then the assets go back into your estate unless you have included contingent beneficiaries or used the "per stirpes" designation. The latter indicates that assets that were intended for a particularly beneficiary who is now deceased will instead go to their children in equal shares.
- Naming your estate as beneficiary – In addition to subjecting these assets to probate, they are also liable to claims by creditors. Tax-deferred accounts will encounter additional complications, including the loss of extended tax deferral.
- Not using trusts when appropriate – Neglecting the benefits of tax reduction, creditor protection, and exercising control over assets post mortem.
- Not funding trusts – Setting up a revocable or testamentary (one created via the will) trust to avoid probate and/or provide other benefits isn't going to be effective if the assets are not in them. Either fund them during your lifetime or specify the trust as the beneficiary.
- Ignoring relevant state and Federal laws – ERISA laws governing beneficiary designations on 401(k) accounts can create headaches for second marriages. State laws on probate can vary.
- Naming minors or special needs children as beneficiaries – Financial institutions will not pay out assets directly to a minor, not even to a parent, and usually require proof of a court-approved guardian. Special needs children can have their benefits jeopardized by receiving assets not in a Special Needs Trust.
- Ignoring tax consequences – Particularly important for annuities and retirement assets.

Beneficiary designations are a key aspect of estate planning, but need to be considered together with the rest of an estate plan. The more assets that you have, the more important this becomes. Don't leave the planning for this until that "too late" date.

George Gagliardi is a financial advisor with Coromandel Wealth Management in Lexington, where he helps clients develop and implement investment and retirement strategies. He can be reached at (781) 728-9001 or george@CoromandelWM.com. George is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor. This article is intended for general information purposes only, and may not be appropriate for your specific circumstances. Investment advice is particular to each individual, and should *only be given after an individual situation has been reviewed.*