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Avoid Common Beneficiary Designation Mistakes

You've carefully reviewed the investments in your retirement accounts with a professional advisor to make sure they fit both your objectives and your risk profile. You review your plan with your advisor at regular intervals. Your will is up to date, and you stay current on the markets, the financial industry, and the ways the regulatory environment affects your retirement plan.

In other words, you're doing everything right. You've left nothing to chance.

Except . . .

When was the last time you checked the beneficiary designations for your IRAs and other retirement accounts? Did you open an account years ago, when your circumstances—and beneficiaries—were different? Have you named your estate as the beneficiary for one or more of your retirement accounts? In other words, have you committed one of the all-toofrequent mistakes in retirement account beneficiary designation that can needlessly expose assets to taxation, litigation, or both?

Many investors—even those with significant retirement account assets—do not fully realize the implications of the information they enter on the forms used in opening retirement accounts. Did you know, for example, that the beneficiary designations on retirement accounts and other financial documents can supersede the terms of your will? Account holders may not fully understand the tax and legal implications of naming minor children, persons with special needs, or even spouses as primary or sole beneficiaries of retirement accounts. You owe it to yourself to maintain current, accurate beneficiary designations that are in accord with your objectives for the disposition of your assets. In certain cases, you may also be well advised to consider a properly designed trust as the beneficiary for your retirement plan assets in the event of your passing.

The consequences of obsolete or poorly considered beneficiary designations recently became all too clear to Heidi Heffron-Clark. Heidi was the daughter of Ruth Heffron and beneficiary of her mother's retirement account, which was worth $450,000 at Ruth's death in 2001. In 2010, when Heidi and her husband filed for bankruptcy, the account was still valued at about $300,000. Because retirement accounts are, by federal law, typically exempt from the claims of creditors, Heidi fully expected that the bankruptcy court would uphold her right to the assets in the inherited account. But in a 9-0 decision on June 12, 2014, the US Supreme Court held that an account owned by an individual as the result of being a beneficiary of a deceased account holder no longer meets the strict legal definition of "retirement account" and was therefore no longer exempt from the claims of creditors (Clark v. Rameker, 134 S.Ct. 2242). If a properly designed trust had been named as beneficiary of Ruth Heffron's retirement account, her daughter might have retained the retirement account assets without fear of having them attached by creditors.

Another situation that often results in unintended consequences occurs when account holders fail to precisely identify beneficiaries, using such designations as "all my children." Although this designation meets the minimum requirements of US Treasury regulations, it can lead to unnecessary complications in certain situations. A problem occurs, for example, when one or more of the children designated in this way predecease the account holder. The plan administrator is then left to decide what to do about such matters as whether a deceased child's portion of the plan assets should go to that child's heirs or simply be divided equally among the surviving siblings. Naming beneficiaries in clearly identifiable, specific ways can eliminate such uncertainty—along with the potential delay and expense it can entail.

All too often, beneficiary designations are completed in a "default" manner, according to the "usual" patterns familiar to the broker-dealer, account executive, or even the bank teller who happens to be assisting the client with opening the account. As reported in Carolyn T. Geer's July 6, 2011, Wall Street Journal article, Martin Shenkman, an estate-planning attorney in New Jersey, refers to this phenomenon as "bank-teller estate destruction." Because assets going to designated beneficiaries bypass the probate process, it is crucial that you make sure what you write on the beneficiary designation form for any retirement account be congruent with your estate planning strategy and your wishes for the disposition of your assets following your death.

But beware of simply naming your "estate" as beneficiary of your retirement accounts. Doing so can needlessly subject your retirement plan assets to the costs and delays of the probate process. Further, designating an individual beneficiary for your retirement plan often allows for stretching out the mandatory distribution—and taxation—of the assets.

Many financial advisors and estate planners have clients who simply forgot who they had named as beneficiaries of accounts they opened in the past. Ex-spouses, former boyfriends, and other forgotten beneficiaries have received thousands of dollars in assets that their benefactors would have never intended to bestow, had they been more mindful. Do the names of deceased relatives occupy the beneficiary designations of retirement account documents that you haven't thought about for years? If so, you owe it to yourself and your loved ones to make the necessary updates and changes as soon as possible! The results of not doing so could include, at the very least, hurt feelings and, at worst, expensive and needless litigation.

Ultimately, of course, the best solution to the problem of beneficiary designations for retirement funds is to have a plan. Talk to an advisor who is well versed in the laws governing the taxation and distribution of retirement plan assets. Make sure your beneficiary designations work in tandem with your estate planning strategy. Carefully review all your plan documents. You'll gain peace of mind and will ensure that your loved ones avoid unpleasant surprises.

Stay Diversified, Stay the Course!

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