

Why You Need to Name Beneficiaries

It's important to know that many assets are not controlled by wills.

Beneficiary designations play a crucial role when a person passes away. In fact, they can even override what's in a will. Surprised? You're not alone.

Helen Modly, a CERTIFIED FINANCIAL PLANNER™ practitioner with Focus Wealth Management, Ltd., in Middleburg, Va., says her clients often don't understand the role of beneficiaries. "Two clients came in with elegantly drafted wills," says Modly. "They didn't realize that their home, two retirement plans, an IRA, and even their joint checking account did not pass through their estates, and that their wills would not control these assets at death."

Know the Basics

You can typically name beneficiaries when you enroll in a company retirement plan such as a 401(k) plan, purchase an annuity or life insurance policy, or open a retirement account. What's more, the Uniform Transfer on Death Security Registration Act allows anyone to designate a beneficiary on a nonretirement account, provided their state has passed the Act. And if your state hasn't passed the law, you may be able to set up a Transfer on Death account or a Payable on Death account.

Why bother? Because when you name a beneficiary for an asset, the

asset does not have to go through probate—the often lengthy and expensive process by which a judge allocates the elements of your estate.



What's more, choosing a beneficiary may save you and your heirs some taxes, thus ensuring that your estate makes a bigger difference in the lives of your loved ones or does more good for your favorite charities.

Choosing the Right Beneficiaries

Your beneficiaries can be individuals, charities, or trusts—but probably shouldn't include minor children. "If you choose a minor as a beneficiary, most states will appoint a guardian, who must be bonded and must file very cumbersome accountings with

the court each year until the child turns 18," notes Modly. "Then the courts hand over the money to the 18-year-old, no questions asked, and wash their hands of the consequences."

An alternative means of leaving your assets to someone under the age of 18 could be to designate a trust to receive and manage the inheritance. Creating a Uniform Transfer to Minors Act account and choosing someone you trust as its custodian is one relatively easy way to do that.

You can also designate a trust as beneficiary of retirement or other assets after your death, in order to retain control over the disposition of that money. Such a trust might allow a spouse to draw income from the trust while preserving some assets for children or grandchildren.

Trusts can also be a tool to help provide for physically or mentally disabled family members. If you name the individual as a beneficiary, you could reduce his or her eligibility for government benefits. Moreover, he or she may not be able to manage the assets. Instead, an attorney might recommend creating a special needs trust.

Consider Tax Consequences

It generally makes sense to name a spouse as beneficiary of your company retirement plan assets. He or

she can roll those assets over into an IRA, where the money can continue to grow tax deferred—perhaps for years or even decades.

If naming a spouse isn't an option for an IRA, designating another relative or friend as a beneficiary is wiser than naming no one at all. One reason: If no beneficiary is designated for an individual's IRA, upon that person's death the account becomes payable to his or her estate and must be fully distributed within five years to the heirs of the estate, causing a substantial income tax liability.

But if the owner of an IRA dies before age 70½—when it is required that distributions begin—and designates his or her spouse as a beneficiary, that spouse can roll the inherited account into his or her own IRA and delay payments (and only pay taxes on distributions) until he or she reaches age 70½. If the account is designated for a non-spouse beneficiary, that person can't delay distributions, but can spread them out over his or her lifetime, minimizing the tax impact.

What if the owner of the IRA account dies after age 70½? Assuming he or she named a beneficiary for the account, the money doesn't need to be distributed all at once. Instead, the beneficiary can inherit the assets as an inherited IRA, and then the distributions can be calculated based on the life expectancy of the inheritor.

Keep Beneficiaries Current

Don't forget that your beneficiary designations will override your will. The will may state that you want your spouse to inherit everything—but that might not happen if you named a previous spouse as beneficiary of your IRA and then forgot to change that designation. This happens surprisingly often.

With that in mind, it's essential to

review your beneficiary (and contingent beneficiary) designations on an annual basis—and make immediate changes after an important change in your family or financial status, such as a birth, death, divorce, or inheritance. Making such changes simply requires filling out a change-of-beneficiary form. You can update your beneficiaries on Fidelity.com. You also may need to redesignate your beneficiaries when you or your employer replaces your old retirement plan administrator or insurer.

Request a confirmation of receipt when you send in a new beneficiary

designation. Account administrators can't always be trusted to keep track of documents. The beneficiary designation doesn't take effect until the custodian, trustee, or administrator receives it—and that must occur before the account holder dies.

Some individuals will want to create a customized beneficiary designation that spells out how money will be allocated under a variety of unusual circumstances. For example, such a document could provide instructions about how to disburse certain assets if your beneficiaries die before you do. One caveat: Make sure that the trustee, custodian, or the administrator of your account accepts customized beneficiary designations; some do not.

Make Your Designations Part of a Plan

Use beneficiary designations in concert with other vehicles such as wills

and trusts, as well as with your overall estate plan. For example, let's say you want to leave some assets to your children and some to your spouse. In that case, you probably will want to designate your spouse as beneficiary for your IRA—since he or she can roll that money over into another IRA where it will continue to grow tax deferred. Meanwhile, you will can specify that your children receive your shares in a real estate partnership.

If you're like many folks, you don't even remember designating beneficiaries for your retirement

If naming a spouse isn't an option for an IRA, designating another relative or friend as a beneficiary is wiser than naming no one at all.

plans, insurance policies, and other assets. Now is the best time to remedy that situation. Spend a few hours checking with your financial advisor, insurance agent, employers, and the like, to make sure your money will go where you'd like it to go. And while you're at it, remind your parents or other family members to do the same. The results could make a significant difference in your family's long-term security. •

The tax and estate-planning information contained herein is general in nature, is provided for informational purposes only, and should not be construed as legal or tax advice. Fidelity does not provide legal or tax advice. Fidelity cannot guarantee that such information is accurate, complete, or timely. Laws of a particular state or laws that may be applicable to a particular situation may have an impact on the applicability, accuracy, or completeness of such information. Federal and state laws and regulations are complex and are subject to change. Fidelity makes no warranties with regard to such information or results obtained by its use. Fidelity disclaims any liability arising out of your use of, or any tax position taken in reliance on, such information. Always consult an attorney or tax professional regarding your specific legal or tax situation.

The statements and opinions expressed are those of the author and not necessarily those of Fidelity. Fidelity Investments cannot guarantee the accuracy or completeness of any statements or data.