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IRA BENEFICIARY OPTIONS A SUMMARY EXPLANATION OF BENEFICIARY CHOICES UNDER AN IRA

There are many considerations in deciding who the beneficiary of an IRA should be. In this article I briefly explain some (not all) of the issues involved. If you would like to discuss this in more depth, please call for an appointment.

NAMING A SPOUSE AS A BENEFICIARY

For married couples, it is common that the spouse is individually named as beneficiary of an IRA. The estate and income tax laws often favor naming the participant's spouse as beneficiary. One of the benefits of naming a spouse is that if the Participant predeceases the spouse, the spouse can rollover the IRA to his or her name, and then choose a new beneficiary (usually a child or children). With a much younger beneficiary named, the minimum distributions can be stretched out over a longer period of time, enhancing the "wealth" in the IRA, because of the longer income tax deferral. This type of rollover is only available to spouses.

However, in choosing the spouse as beneficiary, the spouse will have full control of the IRA monies after the death of the participant, and is under no obligation to follow the participant's wishes. This may not be what the participant wanted, especially if there are children from a previous marriage or the participant feels that the spouse may be too easily influenced by others after he/she is gone.

NAMING CHILDREN, GRANDCHILDREN OR OTHERS AS BENEFICIARIES

If your spouse will have plenty of assets after you die, or if you have reason to believe your spouse will die before you, or if you are not married, you could name your children, grandchildren or other individuals as beneficiary(ies).

This will let you stretch out your account without the spousal rollover. While you are living, you would use the IRS Uniform Table to determine how much you need to take as the minimum distribution, but after your death, your beneficiary's actual life expectancy can be used for the remaining distributions.

Anytime you name an individual as beneficiary, you lose control over how the assets will be used or distributed after your death. After your death, your beneficiary can do whatever he/she wants with this money, including cashing out the full balance of the account and destroying your careful plans for long-term, tax-deferred growth. The money could also be available to the beneficiary's creditors, spouses and ex-spouses. If any of this concerns you, consider using a trust.

NAMING A TRUST AS BENEFICIARY

Naming a trust as beneficiary will give you maximum control over your tax-deferred money after you die. That's because the distributions will be paid not to an individual, but into a trust that contains your written instructions stating who will receive this money and when.

For example, your trust could provide income to your surviving spouse for as long as he or she lives. Then, after your spouse dies, the income could go to someone else. The trust could even provide periodic income to your children or grandchildren, keeping the rest safe from irresponsible spending and/or creditors.

While you are living, the required minimum distributions would be paid in accordance with the Uniform Table. Then, after you die, the distributions continue to be paid to the trust over that beneficiary's actual life expectancy.

The trustee can withdraw more money if needed to follow your instructions, but the rest can stay in the account and continue to grow tax-deferred. You can name anyone

as trustee, but many people name a bank or trust company, especially if the trust will exist for a long period of time.

Naming a trust may not afford you the ability to both provide for your spouse and stretch out the tax-deferred growth beyond your spouse's actual life expectancy. That's because you must use the life expectancy of the oldest beneficiary of the trust. If your spouse is a beneficiary of the trust, your spouse will probably be the oldest beneficiary.

If your spouse is not a beneficiary of the trust, the oldest beneficiary may be one of your children. That would let you stretch out the tax deferral over your child's life expectancy. But then the money would not be available to your spouse unless your child wants to be generous.

However, there are now ways to plan that do allow for the stretch-out for each individual beneficiary.

NAMING A CHARITY AS BENEFICIARY OF YOUR IRA

If you are planning to leave an asset to charity after you die, a tax-deferred account can be an excellent one to use. That's because the charity will pay no income taxes when it receives the money, and the account will not be included in your taxable estate when you die, reducing the amount your family may have to pay in estate taxes.

Now, with the changes in the Minimum Distribution Rules, naming a charity does not cause you to take more minimum distributions. You can use the new Uniform Table to determine your minimum distribution.

SPLITTING YOUR IRA INTO SMALLER ONES

You don't have to choose just one of these options. You can split a large IRA into several smaller ones and name a different beneficiary for each one. (If your money is in a company plan, you can roll it into an IRA and then split it.)

This will let you make full use of your beneficiaries' different life expectancies after you die. If you name several beneficiaries for one IRA, you must use only the oldest beneficiary's life expectancy. But with separate IRAs (one for each beneficiary), you can use each one's life expectancy, giving you the maximum stretch out.

For this to work, it is wise that you do the split before or at the time you start taking your required minimum distributions. (Another time to split one IRA into several IRAs is when a surviving spouse does a rollover and names new beneficiaries.)

This will make it a little more complicated to calculate your required distribution each year, because one will have to be figured for each IRA. But it can be well worth the trouble. Splitting your IRA can also help you save estate taxes.

WHAT ARE ESTATE TAXES AND WHY SHOULD YOU CARE

Estate taxes are different from, and in addition to, income taxes. When you die, your estate will have to pay estate taxes if its net value (including your tax-deferred accounts) is more than the amount exempt at that time. The "estate tax exemption" is \$3.5 million.

Estate taxes must be paid in cash, usually within nine months of your death. If money must be withdrawn from a tax-deferred account to pay the estate taxes, the result can be disastrous-because income taxes must be paid on the money that is withdrawn to pay the estate taxes. You actually pay (income) tax on money you pay in (estate) tax!

WHAT CAN YOU DO ABOUT ESTATE TAXES?

You can reduce your taxable estate by giving some assets to your loved ones now. You can buy life insurance within a special type of trust (so the insurance is not taxable in our estate) to pay estate taxes. And, if you are married, make sure you use both your estate tax exemptions.

Everyone is entitled to an estate tax exemption but many married couples waste one exemption when they leave all their assets outright to each other. Currently, you can leave your spouse an unlimited amount of assets when you die and there will be no federal estate taxes at that time. But when your spouse dies later, he or she will only

be entitled to one exemption. That can cause your family to pay too much in estate taxes. See my other website article, "Saving Estate Taxes."

HOW SPLITTING YOUR IRA CAN HELP

Any assets you own (including a tax-deferred account) that you leave to anyone other than your spouse (your children, grandchildren or a trust) can use your exemption. Splitting a large IRA into smaller ones will make this easier to do.

Let's say, for example, that most of your money is in one large IRA and you do not have enough other assets to fully use your exemption. If you split the large IRA into smaller ones, you can name a trust as beneficiary of one of them. Then, if you name your spouse as beneficiary of this trust, the money from this IRA can provide for your spouse and use your exemption to save estate taxes.

IF YOU ARE NOT MARRIED

If you are single, naming a beneficiary will be less complicated because you have just one estate tax exemption and there will be no spousal rollover option.

CHANGING A BENEFICIARY

You can change your beneficiary at any time, and under the IRS Regulations, your minimum distributions are not measured by who you name as beneficiary.

Some employer-sponsored plans [401(k), pension and profit sharing plans, etc.] have restrictions on beneficiary options. If your plan will not let you do what you want, consider rolling your money into an IRA as soon as you can. If your money is in an IRA and the institution will not agree to what you want to do, move your IRA to one that will.

Starting in 2010 it will be mandatory for employers to allow non-spouse beneficiaries to rollover their inherited company plan to an inherited-IRA and the distributions can be based on the beneficiary's life expectancy. This is different from a spousal rollover. There are very specific rules on how this must be done, so a beneficiary should definitely have an advisor help them.