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The Importance of Beneficiary Designations

By James C. Mulder

I encounter many successful people that have totally failed to plan to protect what, for many of them, are the largest value assets they own. I am talking about their investment accounts, their bank accounts, their IRAs, pension and 401(k) benefits and life insurance proceeds. All of these assets are governed completely by a beneficiary designation.

For investment, brokerage or bank accounts, it is what was presented when the account was established. For life insurance policies or retirement accounts and IRAs, there is usually a separate beneficiary designation form that is filled out when the policy or account is established. Most of the time, you are not really thinking about planning for the beneficiaries of these assets; you are focused on getting the account or policy set up.

Remember, your will or living trust will not govern who is to get the benefits of these assets, only the beneficiary designation on file with the financial institution will determine who and how the beneficiary receives the benefits. And many times it is the how that really needs to be thought out and planned for.

Let's look at two common examples.

Typical Husband and Wife scenario.

Both work and have life insurance, 401(k) and other benefits at their work and they have a couple of joint bank accounts and some mutual funds. Husband also has some personal life insurance. When they set up all of these accounts they named each other as primary beneficiary and their children as contingent beneficiaries. Their children are teenagers.

Now, let's assume husband dies. Wife now gets all of the life insurance, 401(k) benefits and is sole remaining owner of the bank accounts and mutual funds. She owns outright all of these benefits. Depending on the magnitude of these assets, when wife subsequently dies, the children may have to pay estate tax on what their dad left mom.

This could have been avoided with a more comprehensive beneficiary designation. Other issues that could happen are: mom could remarry and leave all of dad's assets to the new husband in the same manner that she received everything, namely with accounts that leave the surviving spouse with everything.

Another issue, what if mom and dad both die relatively young? The children who are under age will have a court administer these assets until they reach age 18 and then the court will hand all of the assets over to this supposedly mature 18 year old! In fact, most judges will not allow the guardian to spend this money on the children unless hardship can be shown.

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How could this have been better planned?

Very easily. All that needs to have been done is to make sure the accounts are not joint accounts with rights of survivorship so they pass under mom and dad's will, and make sure all beneficiary designations coordinate with the planning in their wills.

So, if the will sets up a trust for mom or dad and then for the children to provide asset protection and tax savings for them, all of the benefits will be paid to the trustee of the trust and asset protection for the beneficiaries will be insured. Your will can name the surviving spouse as trustee, so control will remain with the surviving spouse, but the assets in the trust created under the will will not be subject to a second marriage. The beneficiaries are fixed when the first spouse dies. No blended family children can inadvertently become beneficiaries of the first spouse to die's assets.

If the client uses a living trust as their estate-planning device, the bank accounts and mutual funds and other investment accounts will be retitled into the living trust, to avoid probate and to ensure that the trust will govern them.

Single parent with grown children

Mom has several bank accounts, cds, mutual funds, annuities and an IRA. She also has life insurance. Mom has 3 grown children whom she loves equally. Only one child, Sue, lives near her. Sue helps mom out with companionship, chores and doctor visits. Mom decides that she should add Sue to her bank accounts so that Sue can pay her bills, if needed. Mom doesn't realize that Sue will become the owner of these assets upon her death, to the exclusion of her other 2 children. Or, more common, mom and Sue understand this, but Sue says she will split the money with her siblings.

Unfortunately, that doesn't happen very often in my 31 years of experience. It would be so easy to not leave this up to Sue, but make a trust for the children created under mom's will the beneficiary and give Sue a power of attorney, or better yet, set up a living trust for mom, then the 3 children and make Sue a co-trustee with mom.

Sue is now a fiduciary over mom's assets and has the power to pay bills, etc., but she doesn't own them at mom's death. Even if Sue wanted to do the right thing with the assets upon mom's death, she would be making a gift to her siblings and that could adversely affect her ability to leave the maximum estate tax free assets to her children at her death. Worse, the assets she would have gotten from mom would be totally at risk to her creditors.

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