

The Importance of Designating Beneficiaries

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When life gets hectic and your to-do list seems endless, it can be easy to let financial planning details slip through the cracks. However, updates to your designated beneficiaries on 401(k) plans, IRA accounts, and other retirement assets is vitally important.

Why are beneficiary designations so important? Well, contrary to popular belief, you cannot change a beneficiary by naming someone new in your will or trust. The custodian of your retirement assets will only look at your beneficiary designations on file. Designating and updating beneficiaries on your IRA accounts, 401(k) plans and other retirement assets is an important step in maintaining the effectiveness of your estate plans. Failing to do so can jeopardize your wishes being carried out. You'll want to list both primary and contingent beneficiaries, and it's important to understand what your designations will mean for the beneficiaries, too. Below we will review several considerations to keep in mind when selecting your beneficiaries.

Your Will Won't Override Your Beneficiary Designations

This is a critical point that bears repeating: even the most detailed and properly executed last will and testament won't override the beneficiary designations on your IRA, 401(k), or other retirement accounts. It is these designations that will control who receives your assets when you pass.

Failing to Name Beneficiaries Has Consequences for Your Loved Ones

If you fail to name a beneficiary on a retirement account, or your named beneficiary precedes you in death, or if you name your estate or trust as the receiver, your heirs will be forced to pay income tax on any withdrawals five years from your death. A named beneficiary, on the other hand, has more options on how they would like the benefits paid out. For example, they could have it deposited in smaller amounts over a longer period of time in order to defer the tax burden and preserve more of the principal. A designated beneficiary can also name their own beneficiary, allowing your assets to carry on through future generations.

Most People Designate a Spouse — But this isn't the Right Choice for Everyone

Most married individuals choose their spouse as the beneficiary of retirement assets, and he or she can roll those assets into their own account — essentially, taking ownership of the inherited accounts. The benefit of leaving an inherited IRA is that your heirs can take distributions as needed. Note that inherited IRAs must also comply with required minimum distribution (RMD) requirements, which carry over to a beneficiary. This makes it important to discuss, in advance, what options your spouse would take receiving the benefit. It will hinge on your age, your spouse's age, the type of IRA, the need for income, and any debts or creditor protections.

It's possible to name someone else as your beneficiary, though your spouse must give consent. Check out the "Non-Spouse as Beneficiary" box for example scenarios.

Non-Spouse as Beneficiary

There are several scenarios in which someone might choose to list a non-spouse as a beneficiary on an IRA, 401(k), or other retirement account, even if they are married. Here are a few examples:

Adult Children
Some individuals may choose to bypass a spouse who is already financially secure and designate their adult children as beneficiaries. This allows for a direct transfer of the account's assets to the children upon the account holder's passing.

Charitable Organizations
Those with a charitable intent may name a nonprofit organization or foundation as the beneficiary of their retirement account. This enables the assets to be transferred to the charitable organization upon their passing, supporting a cause they deeply care about and avoiding both income and estate taxes.

Trusts
Establishing a trust as a beneficiary allows for more control and flexibility in the distribution of retirement account assets. This can be beneficial when there are complex family dynamics, minor children, or individuals with special needs who require specific planning and protection.

Close Friends or Relatives
In certain cases, individuals may have close friends or relatives who they consider to be like family. They may choose to designate them as beneficiaries to ensure they receive the assets from the retirement account.

It's Possible to Name a Trust as Your IRA Beneficiary

It's common practice to designate a trust as beneficiary of your IRA. This is a good option if you have minor children that can't legally take control of an inheritance, and it's also a way to protect your assets from creditors, lawsuits, or bankruptcy. However, due to new rules passed in the SECURE Act, most trusts will have to withdraw the full balance in the account within ten years of your death. If you want to protect your assets past the ten-year mark, make sure to opt for an Accumulation Trust, which does not require distributions to its beneficiaries. As there are tax implications to utilizing an Accumulation Trust, always consult your tax advisor before going this route.

Steps You Can Take Today to Better Protect Your Assets – And Your Loved Ones

Beneficiary designations eliminate confusion over your wishes and save your loved ones time and money. So, it's prudent to check each of your financial accounts – and insurance policies – to ensure you have properly named primary and secondary beneficiaries. Not only that, but you should also ensure that any beneficiary elections you made in the past reflect your current wishes.

Anytime you open a new account, name your beneficiaries right away. Then, anytime your financial or life situations change, such as through marriage, divorce, or the birth of a child, revisit your designations and update them as needed.

Would you like to discuss your retirement plan?

Schedule your Discovery Call by visiting us at riversidewa.com or calling us at (844) 843-9855.

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