Retirement Plan Beneficiary Designations: Go Ahead and Take a Second Look

~ Rose-Anne B. Frano

It is satisfying to check items off our to-do lists, especially for busy executives working hard to grow their businesses and achieve financial success. As easy as it may appear to fill in a few blanks and return a beneficiary designation for your IRA, pension plan, 401(k), or other retirement account and then mark it "complete" on your to-do list, this approach comes with risks. Your beneficiary designation is an important estate planning document that should be reviewed regularly, considered carefully (often with advice from your attorney), and prepared as thoughtfully as you prepare your last will and testament or revocable trust. Go ahead—take a second look at your retirement plan beneficiary designation to ensure you have thoughtfully considered and carefully drafted it, and encourage your valuable employees to do the same.

A Considered Plan

Step One: Ask the custodian of your retirement plan to provide you with a copy of your filed beneficiary designation and confirm you have a current and effective beneficiary designation filed with the plan custodian. Carefully read the filed beneficiary designation form and review how your stated beneficiaries would receive the plan benefits if your death were to occur at that moment. Take the time to read not only the beneficiary name you have included, but also the "small print." What happens if a beneficiary predeceases you? What happens if a beneficiary is a minor? What happens if you have a later-born child? What happens if you are divorced from a named beneficiary? What happens if you have married since you filed the beneficiary designation? Can your spouse roll over the retirement plan to his or her sole name after your death? Are there any required beneficiaries of the plan by reason of law or plan terms (such as a spouse or an ex-spouse)?

Step Two: Decide if any revisions are required or desired to your filed designated beneficiary form. Review the desired or required changes with your estate planning attorney and financial advisor to ensure that you understand the effect of considered changes and that such changes will dovetail with your overall estate planning objectives. When you complete your revisions, submit your updated beneficiary designation form as required by your retirement plan and ask for written confirmation of receipt by the plan custodian.

Step Three: Provide a copy of filed beneficiary designations to your estate planning attorney for his or her files whenever you modify your beneficiary designations. It is critical that you treat your retirement plan beneficiary designations as one of your core estate planning documents because only the beneficiary designation you execute and file with the plan custodian (or in the absence of a filed effective beneficiary designation, as the applicable law and the plan's underlying terms direct) will govern the disposition of such retirement account after your death. However, the estate tax effects of the disposition of the retirement account are governed by the tax apportionment provisions of your estate plan, and, most assuredly, you want to ensure the retirement plan beneficiary designation works as part of your overall estate plan.

Step Four: Repeat steps one through three at every major life event, or at least annually. Make this review part of an annual financial well-check. Important life events prompting you to consider a sooner review of your filed beneficiary designation may include a change in your job, the birth of a child or grandchild, a change in marital status (married, divorced, separated, or widowed), a change in your health, or a change in your philanthropic goals (both during your lifetime and at death).

Important Reminders

Retirement plans have unique tax attributes, and how you designate your beneficiaries can have significant tax consequences to the beneficiary and your estate. Be responsible with these decisions and knowledgeably review, revise, and update your beneficiary designations in consultation with your legal, accounting, and financial advisors.

Do not underestimate the importance of the tax qualities of one retirement plan type as compared to another and as compared to other assets of your estate. For example, Roth IRAs, as compared to traditional IRAs, will have very different ultimate benefits to a designated beneficiary because of the inherent tax implications of the two plan types. Likewise, your profit-sharing plan may have multiple distribution options available to your beneficiary (e.g., lump sum, over a period of years, over a life expectancy), so you need to consider whether or not you want your beneficiary making one distribution choice or another. Can you restrict the options available to a beneficiary for distribution? Should you educate your beneficiary about the choices and the consequences of each choice? Furthermore, one size does not fit all. If you have multiple plans, you should both consider each plan's designated beneficiary separately and also as a coordinated part of your overall estate plan.

Knowledgeably decide how to designate a beneficiary of your retirement plan. The tax and distribution laws that govern retirement plans are technical and stark. The designation of a beneficiary without proper education as to the tax or distribution results can be calamitous. It is critical that you consult with proper advisors as to your beneficiary designations to ensure that the laws and distribution rules of your plan will apply as you intend. With that said, for the most part, you can work within the rules to carry out your intentions. Trusts, charities, and family members can all be very good beneficiaries of your retirement plan, but the beneficiary designation itself and the supporting documents required (e.g., a trust that will be the beneficiary of the retirement plan) also must be technically considered and drafted to ensure that your intentions are not disrupted by the tax laws and plan distribution rules that will apply.

The distribution of retirement plans may be controlled by your beneficiary designation, but the value of the retirement plan is still considered part of your gross estate for federal estate tax purposes. Therefore, you should consider how the estate tax attributable to the retirement plan, if any, will be paid by your estate and/or by the plan beneficiaries.

For many individuals, retirement plans are significant assets of their estates. Designating a beneficiary of your retirement plan is as important as, and at times can be more technical than, the preparation of other estate planning documents. Do not minimize the importance of reviewing and updating the beneficiary designation of your retirement plan, and do so with the counsel of your legal, financial, and tax advisors who can help you navigate the many complicated rules that will impact the outcome of your beneficiary choices. If possible, encourage your company to establish good systems to remind employees of the importance of these retirement accounts, both as to participation and as to regular review of the participants' designated beneficiaries of their retirement plans. Make this a part of your annual financial well-check, and also encourage your valued employees to do the same.

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She is a board certified specialist in wills, trusts, and estates. Rose-Anne focuses on estate, gift, and generation-skipping transfer tax planning for individuals and their families and on the administration of estates and trusts. She earned her LLM in Taxation and her JD from the University of Florida College of Law and her BA from Tulane University.