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The Importance of Beneficiary Designations

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Who really benefits? You may be surprised!

If you participate in a 401(k) or other retirement plan, have one or more IRA accounts, or life insurance policies, you need to designate beneficiaries to receive the benefits or proceeds in the event of your death. Making such designations can be confusing, and in some cases - daunting! Surprising, unintended and costly consequences can result if Beneficiary Designations are misunderstood, made incorrectly, or not made at all.

Here are some common misconceptions and realities about Beneficiary Designations:

Misconception: I have a Will or living trust that will determine who receives my benefits after my death, so I do not have to make separate Beneficiary Designations for my retirement or insurance benefits.

> **Reality**: 401(k), IRA and other retirement plan benefits, as well as life insurance benefits, pass by the terms of the contract that governs the plan or policy, and thus, independently of your Will or trust. Generally, the terms of your Will or trust do not apply to such benefits, unless the benefits are payable to your estate or trust, intentionally or by default.
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> If you do not complete a separate Beneficiary Designation for each life insurance contract, retirement plan and IRA in which you participate or have a benefit, the plan's or contract's default provision will determine who will receive your benefit and how it will be paid.
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> All default provisions are not the same. Some may state that if no beneficiary has been designated or survives your death, your benefit will be paid to your estate; others may specify a sequence of default beneficiaries

such as spouse, then children, then your estate; or a sequence that follows the laws of intestacy of your state. The default beneficiaries may not be those you would choose to receive the benefit.

Retirement plan and traditional IRA benefits that have not previously been taxed are generally treated as ordinary income when received by the beneficiary. Payment to your estate or a beneficiary who is in a high income tax bracket can result in significant income taxes that may otherwise be minimized with careful planning.

Misconception: The beneficiaries I designate to receive my life insurance proceeds will also receive my retirement plan and IRA benefits.

Reality: A separate Beneficiary Designation must be completed for each retirement plan, IRA account and insurance contract in which you have a benefit. The designation you make for your 401(k) plan benefit will not apply to your IRA. If you have more than one IRA you must complete a separate Beneficiary Designation for each one. The designation you make for your life insurance policy will not apply to any other benefit.

Misconception: If I designate my children to receive my 401(k) or IRA account in equal shares, a child's share will be paid to his or her children if that child does not survive me.

Reality: Beneficiary Designation forms are often designed to simplify retirement plan or IRA administration. A typical design provides that where multiple beneficiaries are named, and one does not survive, the deceased beneficiary's share is divided among the remaining beneficiaries rather than distributed to his or her issue. That approach may not be obvious on the face of the form and is often contrary to the account owner's intent. Some retirement plan and IRA providers permit "riders" with additional details to be added to the standard Beneficiary Designation forms, which, when carefully worded, can clarify the account owner's intent and, where applicable, override the approach that would otherwise apply.

Misconception: I am married, so my benefits will automatically be paid to my spouse.

Reality: 401(k) plans and similar retirement benefits are often payable to the participant's surviving spouse unless the spouse consents to a different Beneficiary Designation. However, some plans apply this rule to only 50% of the benefit. Further, IRAs and insurance contracts generally are not required to follow this rule. While the spouse is often treated as the default beneficiary if no Beneficiary Designation form is completed, or the designated beneficiary is no longer living, it is also common for benefits to be paid to the plan participant's or policy holder's estate.

In many cases, the value of retirement plan benefits and life insurance proceeds are a significant portion of an individual's total assets. It is essential to address these important assets in your estate plan. Complex rules apply to the timing and options for payment of death benefits, including the circumstances under which

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a trust can be designated as a beneficiary, and required distributions can be extended over the life expectancy of a beneficiary. These rules may impact your Beneficiary Designations and estate planning decisions.

Consultation with your estate planning professional or tax advisor as well as your benefit providers before completing your Beneficiary Designations will insure that you make informed decisions about your benefits. You can avoid unintended and costly results by making sure your Beneficiary Designations are consistent with your wishes and your estate planning goals. Contact a member of our Employee Benefits or Trusts and Estates practices if you have questions.