

# DOTTING THE i'S IN ESTATE PLANNING

By Blake W. Kirkpatrick

**Y**ou have signed all your documents...health care surrogates or medical directives, living wills, HIPPA declarations, declaration of pre-need guardians, powers of attorney, wills and/or revocable trusts. All done and everything is in order, right? Probably not.

Often there are a few other items people never get around to, or worse, try to handle on their own without the assistance of legal counsel or tax advisors. It has to do with (1) updating their "beneficiary designations" on assets such as IRAs and/or insurance and, if applicable, (2) funding and administering their Trusts. The latter concept will be discussed in a follow up article. For purposes of maintaining consistency with the title of this article, all retirement accounts (401ks, 403b, etc.) and life insurance have been lumped into the category of IRAs and Insurance. This article will discuss some of the problems associated with not properly addressing beneficiary designations with respect to assets such as IRAs and insurance:

## BENEFICIARY DESIGNATIONS – DEFAULT RULES WHEN THEY ARE INCOMPLETE

The beneficiary designation is actually an agreement between the principal/owner and the financial institution. The financial institution agrees to carry out the intentions of the principal/owner, according to the terms of the beneficiary designation. However, if those intentions are not stated (i.e., no one is designated), some financial institutions have "default rules" that will govern. Since the principal/owner (hereinafter "owner") signs the beneficiary designation form, it is as if the owner agrees to be bound by the default rules. In certain cases, when no beneficiary designation has been made, default rules may state that the IRA or insurance proceeds will pass to certain heirs (such as a surviving spouse, or if none, "heirs at law"). The end result may be fine if the owner's Will or Trust effectively conveys the assets to the same intended beneficiaries, but it may also result in unintended distributions. In many other cases, not having a properly completed beneficiary designation may result in the asset (e.g., IRA or insurance proceeds) passing to the decedent's probate estate. While this may mean it will eventually pass to the heirs designated under the owner's estate plan, other unintended consequences described below can result.

## FAILING TO PROPERLY NAME CONTINGENT BENEFICIARIES ON RETIREMENT ACCOUNTS OR INSURANCE

Unfortunately, we find that many married couples fall into this category. It is not uncommon for someone to say "I know I want my spouse to inherit my IRA, but I'm

not sure who I want to name as a contingent beneficiary yet so I will get around to that later." This is not uncommon for young couples without children who later have children. Because planning for the transfer of retirement accounts and life insurance policies doesn't receive the same focus as the rest of the estate planning process, people neglect to name a contingent beneficiary after the spouse or update their beneficiary designations if their primary beneficiary predeceases, etc. This often results in someone having no designated beneficiary. It is at this point that things can go awry.

## INCOME TAX CONSEQUENCES

As most people are aware, IRAs and other retirement account assets have certain tax deferral benefits associated with them. Generally speaking, an owner of an IRA is entitled to defer taking distributions over their lifetime according to a complex set of rules. When the owner of the IRA dies, what happens next will depend upon whether a beneficiary has been named, and if so, who that beneficiary is.

Without going into the technical rules and specifics, generally, a surviving spouse who inherits an IRA from the predeceased spouse owner/participant may "roll over the account into the surviving spouse's IRA and thus continue to benefit from the deferred payout structure based on their life expectancy. Children and/or other identifiable non-charitable beneficiaries (any person) may also benefit from continued deferred payout based on their respective life expectancies, provided they are specifically named as beneficiaries. (Side note...if at your death you intend to provide for one or more charities under your estate plan, it may be better to direct the gift to come from your retirement account rather than naming the charity as a beneficiary under your will or trust and naming your other heirs as beneficiaries of your IRA. Your spouse or descendants, or other non-charitable beneficiaries have to pay tax on what they withdraw from the IRA whereas charities do not). A carefully crafted beneficiary designation, can lead to maximizing the net dollar amount passing to all of your heirs.

If it is deemed that no beneficiary has been named on your IRA, then it is likely that your IRA will pass through probate. From an income tax perspective, this generally will result in an accelerated payout of the IRA and, thus, accelerated income tax consequences.

## INADVERTENT PROBATE

Generally speaking, much discussion is given to the concept of "avoiding probate." However, there can be beneficial reasons for opening a probate administration,

such as narrowing time frames for creditor claims or properly clearing title to certain assets. However, for those wanting to avoid the expense of administration the focal point should rather be "avoiding the necessity of probate." This is especially true for the transfer of assets that (1) could have easily passed by beneficiary designation alone and (2) may have been otherwise exempt from claims of the decedent's creditors. Those assets include retirement accounts and death benefits from life insurance.

Failing to have a designated beneficiary on your retirement accounts or life insurance will cause such assets to pass through probate, and expose them to potential creditor claims (*the exposure to potential creditors is actually why the IRA fails to have a "designated beneficiary" resulting in the accelerated payout and income tax consequences discussed above*). Furthermore, retirement account assets and life insurance benefits are often paid quickly after date of death. If such assets pass under probate, however, the timeframe for receipt of such assets by the beneficiaries can be extended for many months.

## CONCLUSION

Not much effort needs to be put into properly addressing the issues discussed in this article. That being said, it is important that you take action to complete this important step and, as always, consult with your legal and/or tax advisor to help guide you through the process. In most cases, obtaining good advice will go a long way, but it may not require as much time or cost as you might think.

*This Article does not constitute legal advice and may not be relied upon as such. Each individual's facts and circumstances are different. If you have any questions regarding your particular situation, please consult with legal counsel.*



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