

It's Not Just a Form! – Important Details in IRA/Plan Beneficiary Designations



Estate Planning Council of Greater Miami

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IMPORTANCE OF BENEFICIARY DESIGNATION FORM

- **Could be largest single source of client's wealth**
 - 40% of U.S. households have an IRA
 - Over \$23 trillion invested in qualified retirement plans and IRAs
 - \$6.5 trillion is in IRAs
- **Coordinate with overall estate plan**
- **Coordinate multiple accounts/ plans' beneficiary designation forms**
- **Determine importance of outright distributions vs. trust**

COMMON PROVISIONS

- **All “primary” beneficiaries must predecease accountholder before contingent beneficiary receives anything**
 - Exception: “per stirpes” designation
- **Beneficiary designation must be “received and accepted” to be effective**
 - Follow up to make sure designation was processed/acknowledged
- **Community property state issues require spousal consent to non-spouse beneficiary**
 - Community property states: AZ, CA, ID, LA, NV, NM, TX, WA, WI
 - Spousal consent required if reside or, possibly, if ever resided in those states

PREDECEASED BENEFICIARY

- **Most forms do not automatically provide for “per stirpes” designations**
 - Must be elected and usually not well explained
- **Alternatives:**
 - “Per capita” sharing – other beneficiaries receive balance or other beneficiaries and descendants of deceased beneficiary receive balance, per capita
 - Minority: deceased beneficiary’s interest terminates and other primary beneficiary(ies) or contingent beneficiary(ies) receive that amount
 - Critical: know the financial institution’s form/agreement provisions

CONSIDER EFFECT OF DISCLAIMER

- **IRA or plan should consider disclaimant as predeceasing accountholder**
 - State law-specific requirement for disclaimer
 - IRC disclaimer rules
- **Determine appropriateness of contingent beneficiary(ies) if one primary beneficiary disclaims**
- **Consider alternate contingent beneficiary if primary beneficiary disclaims, as compared with actual death**

“DEFAULT” BENEFICIARY PROVISIONS

- **Be aware of financial institution’s form/agreement provisions**
- **Usually spouse is first, then estate**
 - Others: spouse, then children, then estate (parents before estate)
- **On some, directly to estate**
 - Subject to probate and potential creditors; limited rollover ability
- **Default highlights importance of up-to-date designation**

CHARITY AS BENEFICIARY

- Often, charity receives fraction with non-charity beneficiaries also named
- Income tax considerations generally – no tax if charity named
- Coordinate with “stretch” MRD rules – maximum stretch of minimum payouts under MRD rules not available for other beneficiary(ies) unless charity paid in full by September 30th of year after death

EFFECT OF DIVORCE

- **Florida Statutes §732.703, effective July 1, 2012:**
 - After divorce, spouse previously listed as beneficiary is assumed to predecease accountholder
 - State law does not apply to ERISA-governed plans (federal law controls)
 - Qualified plan may read similarly – ask plan administrator
- **Some institutions' forms mirror Florida law**
- **Law applies to Florida resident even if form does not acknowledge**
- **Client must take action to name former spouse after divorce – cannot rely on previous designation**

OTHER ISSUES

▪ **Minors as beneficiary**

- Guardianship proceeding may be required (parents may act without guardianship if amount involved not greater than \$15,000)

▪ **Beneficiaries naming beneficiary(ies)**

- Check document wording carefully – many do not permit
- Default “second beneficiary” likely is beneficiary’s estate

▪ **Agent acting under Durable Power of Attorney signing form**

- DPOA must grant specific authority to designate beneficiary
- Check IRA/plan document carefully for restrictions

▪ **Determine if separate accounts are permitted and tailor designation accordingly**

OTHER ISSUES

- Determine if IRA/plan allows for designation of manner of distribution, e.g., not permit beneficiary to take lump sum
- Confirm portability of inherited IRA account (direct or “trustee-to-trustee” transfer)
- Creditor protection issues with inherited IRA
- If trust named, considering naming sub-trust or continuing trust to avoid IRD acceleration upon allocation of pecuniary amount in trust
- Periodically check on what institution has on file and confirm acceptance of new designation

CREDITOR PROTECTION ISSUES

- **Clark v. Rameker**, No. 13-299, 134 S Ct 2242, 2014 WL 2608860, 2014 BL 162980 (U.S. June 12, 2014), available at http://www.supremecourt.gov/opinions/13pdf/13-299_6k4c.pdf
 - Question: Do inherited individual retirement accounts (IRA) contain "retirement funds" within the meaning of 11 U. S. C. §522(b)(3)(C)?
 - Holding: No they do not
- **Rameker** decision less critical in Florida than other states because Florida Statutes §222.21 protects inherited IRA
- ERISA protects interests of beneficiaries in most qualified plans

TRUST AS BENEFICIARY

- **Trusts as Beneficiaries of Retirement Accounts (IRAs and Qualified Plans)**
 - More complicated than directly naming individual as IRA/plan beneficiary
 - Trust as beneficiary of IRA/plan should qualify as spendthrift trust
 - Typical reasons for using trust in the estate plan also apply
 - Consider state law issues - trust beneficiary as trustee, too much power, etc.

TRUST AS BENEFICIARY FOR CREDITOR PROTECTION AND INCOME TAX BENEFIT

- **Combine Creditor/Trust Protection with “Stretch-out” of Distributions from IRA/Plan**
 - IRC § 401(a)(9) – “Minimum Required Distributions” (MRD) at age 70½ and after death (Roth IRA - only after death)
 - Use of life expectancy tables
 - Stretch out payments over life expectancy only if “designated beneficiary” (DB) exists
 - If no DB, complete distribution within 5 years but creditor protection still applies

MRD “STRETCH” WITH TRUST

- **Trust as Designated Beneficiary of IRA/Plan**
 - Works only if:
 - Trust valid only state law
 - Trust irrevocable upon death
 - Beneficiaries of trust must be “identifiable” individuals
 - Custodian/trustee receives notice by 10/31 in year after death
 - Consider separate trust for IRA/plan funds or IRA established as trust

“SEE-THROUGH” RULES FOR TRUST

■ “See Through” Rules – For Life Expectancy – Look Through Trust to its Beneficiaries

- By 9/30 of year after death, all beneficiaries of trust must be identified individuals or IRA/plan has no DB
 - Pay out non-individuals, e.g., charity
 - Disclaim/remove/amend provisions that won't work
- “Estate” will be a beneficiary of trust if IRA/plan can be used to pay creditors
- Oldest beneficiary's life expectancy is used

SEE THROUGH – CONDUIT TRUST

- **“See Through” Rules – Disregarding “Mere Potential Successor” Beneficiaries – Conduit Trust**
 - Current beneficiary is treated as sole beneficiary (measuring life) if all IRA/plan benefits must be paid immediately to him/her (trust is a “conduit”)
 - Pros and cons
 - No ability to accumulate
 - Strict tracing
 - Issues with multiple current beneficiaries

SEE THROUGH – ACCUMULATION TRUST

- **“See Through” Rules – Disregarding “Mere Potential Successor” Beneficiaries – Accumulation Trust**
 - All IRA/plan funds are not required to be paid out
 - Generally all present and future trust beneficiaries must be taken into account in determining whether there is a DB and whose life counts – stop when beneficiaries will inherit outright after current beneficiary dies
 - Avoid/eliminate powers of appointment that might result in older, unknown beneficiary (resulting in no DB because not identifiable)

OTHER TRUST ISSUES

- **Interplay with marital deduction for spousal beneficiaries**
- **Income tax issues**
 - Quickly at maximum rate of tax in accumulation trust
- **Consider Charitable Remainder Trust as Outright Beneficiary**

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QUESTIONS?