

5 Potential Beneficiary Designation Pitfalls

Executing an estate plan is not the final step in the estate planning process. Some assets such as life insurance, annuities, qualified plans and IRAs pass by contract to a beneficiary chosen (or not chosen) by the contract owner, and not via an estate plan (e.g., will or trust). Beneficiary designations should be coordinated with your estate plan to help ensure that your distribution objectives are met. The beneficiary to whom the proceeds go first is called the primary beneficiary. Secondary or contingent beneficiaries are entitled to the proceeds only if they survive both you and the primary beneficiary, or if the primary beneficiary disclaims (i.e., refuses to accept) the asset or proceeds.

Before you choose a beneficiary of one of these assets, you should be aware of these five potential beneficiary pitfalls.

1 ► Estate as Primary Beneficiary

Did you know that if you do not name a beneficiary of a life insurance policy, annuity, qualified plan, or IRA generally the default beneficiary is your estate? There are several disadvantages to an estate being a beneficiary of these assets.

First, these types of assets pass by contract and are not required to pass through the probate process if an individual or trust is named as beneficiary. When an estate is named as the beneficiary or is the default beneficiary, the death benefit proceeds must be paid to the individual administering the estate (e.g., Executor, Personal Representative, Administrator). Therefore, the death proceeds are subject to the probate process. Additionally, in some states, life insurance proceeds are exempt from the claims of creditors when there is a named beneficiary, but not when your estate is your named beneficiary.

Second, if you name a beneficiary of these assets (e.g., spouse, heir, trust) the beneficiary can contact the plan administrator, custodian and/or life insurance company and begin the process of claiming the asset, without the involvement of the probate court. Alternatively, if the estate is named as or becomes the beneficiary by default, the process may be delayed. In this situation, the Executor, Personal Representative or Administrator, once recognized by the probate court, must file appropriate paperwork with the issuing company to begin the process, therefore potentially delaying the receipt of the benefit for the heirs. Third, if the owner of the asset did not have a Will, the process may take even longer as an Administrator of the estate must petition and then be appointed by the probate court. Also, when an individual dies without a Will, the state in which the individual resided determines how the assets will be distributed. Therefore, all or a portion of the assets may pass to someone that the individual did not intend to benefit.

2 ▶ Naming a Minor Child As Beneficiary

Minors cannot own property in the United States. Therefore, if you name a minor child as the beneficiary of a life insurance policy, annuity, qualified plan or IRA, an individual may have to petition and be appointed by the court to act as a conservator of these assets for the child. This process may be costly and time-consuming.

4 ▶ Lack of Coordination With Estate Plan

Your life insurance policies, annuities, qualified plans or IRAs pass by contract to the named beneficiary and not through a Will or trust. Therefore, it is important to coordinate the beneficiary of these assets with your estate plan to ensure that all of your assets pass to your intended heirs. For example, if your Will leaves all of your assets to your spouse if he or she survives you, or if not to a trust for your minor children, the beneficiary of your life insurance policy should be coordinated with this distribution.

3 ▶ Not Reviewing Beneficiaries After a Major Life Event

Anytime you experience a life event, such as marriage, death, divorce, birth or adoption, you should review both the primary and contingent beneficiaries of your life insurance policies, annuities, qualified plans, and IRAs. Outdated beneficiary choices could result in unintended heirs and/or adverse tax consequences.

5 ▶ Failing to Name a Contingent Beneficiary

The contingent beneficiary of a life insurance policy, annuity, qualified plan, or IRA is equally as important as the primary beneficiary. It is important to name a contingent beneficiary because if you and your primary beneficiary were to die simultaneously, the Uniform Death Act provides that your beneficiary will be presumed to have died first. By naming a contingent beneficiary, you avoid having the proceeds pass to your estate.

If you haven't reviewed your beneficiary choices for your life insurance, annuity, qualified plan or IRA recently, now may be a good time to do so. Let's meet to ensure that your beneficiary designations are consistent with your goals.

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