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# A Beneficiary Designation Is an Estate Plan — Educating Clients and Heirs

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# ESTATE PLANNING



## A Beneficiary Designation Is an Estate Plan — Educating Clients and Heirs

Do your clients know the ins and outs of choosing beneficiary designations?

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There are several methods of transferring property at death. A transfer of probate property by a valid will or a deed of transfer will generally involve the assistance and advice of an attorney. While transferring property through probate is unavoidable in certain cases, this does have its downsides. As the probate court becomes involved, the



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# ESTATE Beneficiary Designation Is an Estate Plan

transfer of property can become more costly and delays can occur. Some of the largest transfers of wealth made by Americans are directed by beneficiary designations and outside of probate. Unfortunately, the beneficiary designation is sometimes made without a great deal of thought, almost no advice and in a hurry. We always tell our estate planning students that a beneficiary designation is an estate plan because it provides a mechanism for wealth transfer. However, beneficiary designations should be thoughtfully made in accordance with other estate planning documents, as the decision can have both intended and, perhaps, unintended consequences.



## COORDINATION WITH OTHER ESTATE PLANNING ADVISORS

An important consideration in determining an appropriate beneficiary designation is the extent to which the client has already taken other steps in the estate planning process. It may come as a surprise to some readers that clients diversify their advisors in a manner that may be even more haphazard than their diversification of investment products. While building a team of appropriately skilled advisors is a best practice, the team must be integrated and communicate.

In advising a client about beneficiary designations, it is important to determine if he or she has a will or trust instruments and whether these documents were created with some cohesive design. It is important to account for the client's other assets and to determine which assets may be transferred through probate or by beneficiary designation to determine if all of the work previously done is structured in coordination with the client's existing estate plan. Of course,

all new products or assets that are (or could be) transferred by beneficiary designation should be acquired and titled or designated appropriately. Certainly, the financial advisor who is the current center of influence should examine all existing documents and beneficiary designations and audit these periodically. A failure to review and update beneficiary designations can completely undermine a client's wealth transfer plans. It is certainly appropriate to discuss any new assets or products with the client's estate planning attorney, CPA, trust officer and other advisors to determine the appropriate form of asset ownership or beneficiary designation to ensure coordination with the client's existing plan.

## EDUCATING CLIENTS ABOUT BENEFICIARY DESIGNATIONS

No matter how many times the estate planning attorney tells the client his or her will only transfers probate property, the client tends to eventually presume the will distributes all of his or her wealth. We are often bemused that the client

will procrastinate and agonize over some decisions in the process of drafting a will when the lion's share of the client's wealth is distributed by beneficiary designations where a decision is made quickly and often without estate planning advice. For example, life insurance, annuities, 401(k)s, pensions and IRAs can all be transferred via beneficiary designation and outside of the domain of the will.

The financial advisor who holds the center of influence should continuously reinforce the structure of the client's planned wealth transfers. In practice, we have seen more than one disappointed family member who, perhaps justifiably, cannot believe the decedent would have left an inappropriate beneficiary designation in place if the decedent had been appropriately advised. Remember, in this business an inappropriate beneficiary designation or other asset transfer could result in the eventual impoverishment of an intended family heir. For example, the act of a divorce may have an impact on a beneficiary designation based on state

law, regardless of the perception of the parties. A remarriage is another point that should trigger the audit of beneficiary designations. A blended family situation is not generally conducive to the cooperation of the surviving family members, who will all believe they should have been the designated beneficiary.

It is important to emphasize to the client that any employee benefit, asset or investment product that provides the ability to name a beneficiary should be considered in conjunction with the overall estate planning objectives. The client needs to stop and reflect anytime the employer or representative of a financial institution provides a beneficiary designation form.

#### **EDUCATING HEIRS ABOUT BENEFICIARY DESIGNATIONS**

It is a universally accepted fact among estate planning professionals that communication between the client and his or her heirs concerning the intended estate plan provides the best outcomes in the majority of cases. Generally, a smoother and friendlier process in settling the estate will ensue when the family members know what to expect in advance. However, there may be some special circumstances where silence is more appropriate. This must be determined on a case-by-case basis. In general, beneficiaries are not legally required to be notified that they are a beneficiary or of changes to their status as a beneficiary.

With respect to assets transferred by beneficiary designation, the heirs should be prepared for inheriting wealth. The types of benefits or accounts that might be transferred by beneficiary designation would include (but are not limited to):

- Employer-provided life insurance
- Individual life insurance
- Annuities
- Employer-provided retirement benefits
- IRAs or Roth IRAs
- Payable-at-death financial accounts



*A trust is potentially a complex document and is governed by laws of the state that has jurisdiction over the trust.*

It would be a great idea if the client and the appropriate financial advisor could provide the heirs with information about how to claim the asset. This could be as simple as indicating that a payable-at-death financial account can be transferred to the heir with the presentation of a death certificate. Or, in the case of life insurance, that the benefit can be received by filling out a claim form and mailing it back to the company with a death certificate. It certainly is more costly if a beneficiary engages the attorney settling the estate with questions about claiming such benefits rather than having the knowledge in advance.

Of course, there may be circumstances where it is appropriate to educate the heir with respect to decisions that might be available to the beneficiary. For example, life insurance can provide a variety of settlement options, such as a lump-sum payment, life annuity or period certain annuity. In addition, qualified retirement accounts or nonqualified annuities provide choices with respect to the timing of the receipt and form of benefits. These choices could have a dramatic impact on the financial security of the beneficiary and the federal income tax liability. Additionally, the beneficiary of an IRA or other qualified retirement might have to deal with required minimum distributions. If the client has planned for an

appropriate receipt of benefits by the beneficiary, it is important to communicate and reinforce the proposed design to the beneficiary. The beneficiary should be provided with enough information to discuss his or her choices with the appropriate advisor.

#### **WHEN SPECIALIZED ADVICE IS INDICATED**

In some instances, a direct beneficiary designation is not appropriate. For example, when utilizing a trust the trustee will be the designated beneficiary. It is beyond the scope of this article to discuss all of the types of trusts that might be used for specific estate planning objectives. However, a trust is recommended in the following circumstances:

- A beneficiary has not reached the age of majority
- A beneficiary has not reached the age of maturity
- A beneficiary has a disability or health concern
- A beneficiary has potential creditor risks
- Preservation of principal for remainder beneficiaries is the client's goal

A trust is potentially a complex document and is governed by laws of the state that has jurisdiction over the trust. Asset protection is often a goal of the trust, and the safety of the principal will depend on the nuances of the laws of the state of jurisdiction. A recent Supreme Court decision (*Clark v. Rameker*) highlighted the importance of trusts in estate planning, as the Court determined the creditors of the beneficiary of an IRA were able to reach the inherited IRA. However, protection from the beneficiary's creditors could have been provided if the decedent had designated a trust as beneficiary of the IRA instead of an individual. As many of these issues can become complex, it is important that any trust planning and drafting be done by an estate planning attorney licensed to practice in the appropriate jurisdiction. ■■