Good Financial Planning Starts with the Beneficiary Designation

One of the most important financial planning and estate planning tools available is the beneficiary designation form for an Individual Retirement Account (IRA). Unfortunately, this is also one of the most overlooked planning tools.

With proper execution of the beneficiary designation form, a person can see to it that their surviving spouse has adequate income for their needs, or can establish a living legacy for future generations to enjoy for decades to come. It all depends on what the individual's intentions are, as spoken through the beneficiary designation form.

Traditional Individual Retirement Account (IRA) balances represent untaxed funds that must be carefully addressed and considered with respect to both estate and financial planning issues. It is important to understand what the law requires of a beneficiary who inherits a Traditional IRA account as well.

When a spouse is named as beneficiary of a Traditional IRA, he or she will have several options available at the time they inherit the account. These options depend on many factors, such as the age of the deceased spouse at time of death, and whether that spouse had begun taking Required Minimum Distributions (RMDs). The surviving spouse may always perform a spousal rollover and treat the IRA inherited from the spouse as if it had been theirs in the first place. While this is generally the simplest option, it may require an immediate distribution if the deceased spouse was older than 70 ½ and had not taken his or her RMD for the year.

The second option for the surviving spouse is to leave the IRA in the deceased spouse's name. This option may require larger Required Minimum Distributions since future calculations for RMD distributions would be based on single life-expectancy tables. This option also requires distributions to occur according to the RMD mandates the deceased spouse would have had if he or she continued to live.

The third option is a "Five-Year Rule", whereby the surviving spouse is required to completely withdraw the deceased spouse's IRA by December 31st of the fifth year after the year of death. This is the most costly of the options in that the surviving spouse will not only withdraw but also pay taxes on the entire account balance over the course of five years, or by the fifth year.

Non-Spouse beneficiaries have similar requirements and benefits, but do not have the option of maintaining the deceased IRA owner's account as is. The non-spouse beneficiary must roll the IRA over to what is known as a Beneficiary IRA and follow some important rules for distributions.

Any distributions taken from the Beneficiary IRA are not subject to the 10% penalty, regardless of the age of the beneficiary. Beyond that, the non-spouse beneficiary is allowed to make distributions based on their own life expectancy, thereby providing the ability to stretch these funds out for years. The non-spouse beneficiary may also elect to withdraw based on the Five-Year Rule described above.

Both a spouse and a non-spouse may elect to disclaim their inheritance. Such an act could serve as an important estate planning strategy but must also follow certain rules.

We will discuss the spousal and non-spousal beneficiary rules in greater detail in future articles. For now, be aware that any decisions should be carefully considered for their short-term and long-term financial impact. If you are an IRA owner and have not reviewed your beneficiary designations recently, I would recommend you do so soon. Make sure you have evaluated your estate and financial planning goals, and discussed these with your financial or tax advisor to make sure your beneficiary designations fit into your plans.

Gary W. Beard, CLU, ChFC, is the owner of Beard Financial Group, and is a local, independent financial advisor and planner and has over 37 years experience in the financial community. www.beardfinancialgroup.com
Mailing address 370 N. East Camano Dr. #149, Camano Island, WA 98282. (360) 387-2431 (866) 217-3350. Securities offered through KMS Financial Services, Inc., Seattle WA.