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WEALTH MANAGEMENT

Avoid Estate Plan Blunders: Pitfalls in Titling Assets and Beneficiary Designations

Legally, assets can be owned in very different ways. For example, you may be the sole owner or you may own it jointly with your spouse or another person. You may own the asset directly or it may be held in a trust that you direct. In addition, certain assets, such as retirement accounts, have specific rules relating to holding, taxes and bequeathing ownership after your passing.

In estate planning, there is a place for all the various ways to title assets and designate beneficiaries. The need is to match up titling and designations with your objectives and desires. Outright mistakes—such as failing to convey your desires accurately by checking a box on a beneficiary form—and sub-optimal choices can be costly in time and expenses to you or your estate. Even worse, oversights and mistakes could lead to outcomes inconsistent with your wishes and affect family dynamics for years to come.

It is important to review the ownership structure of your assets and your beneficiary designations on an annual basis. Also, as life events occur—such as marriage, divorce, death and birth—consult with your wealth advisor and/or trust and estates attorney to review the details of your accounts and make sure all aspects are consistent with your objectives.

To help inform those conversations, following are pointers on asset titling and beneficiary designations in two major categories: personal assets and retirement plan assets.

Personal Assets

Personal assets, such as bank and investment accounts or real estate, can be titled in a myriad of ways. How you own these assets—by yourself, with your spouse, in a trust, etc.—has significant impacts on your estate plan and asset disposition.

Assets owned with your spouse. Assets owned with joint rights of survivorship (JTWROS) and tenants by entirety (TBE) bypass the provisions of your estate plan as full ownership interest is transferred to the surviving spouse. This may potentially expose the assets to creditors or reduce the assets available for bequeaths in your will or trust. Be especially aware of these factors:

» Assets titled jointly cannot be used to fund a credit shelter trust.

» If you move to or from a state with community property laws, consult an attorney. Community property does not automatically grant right of survivorship. However, some states do recognize this provision.

» If your spouse is not a U.S. citizen, the unlimited marital deduction is not allowed and could cause a significant tax liability. However, a Qualified Domestic Trust (QDOT) can be used to transfer property from the spouse who is a U.S. citizen to a surviving non-citizen spouse.

Assets owned with children or others. It is common to see children or other family members added to the title of homes, bank accounts and investment accounts as parents age. This might be to help facilitate the upkeep and maintenance of a home, the payment of bills or the management of investment assets. You need to be aware of how titling of assets supersedes provisions in your will or trusts and may lead to unintended consequences such as the following:

» Should the joint owner have creditor issues, your assets could be exposed to the creditors and financial problems of your joint owner.

» Jointly owning an asset may unintentionally disinherit other beneficiaries upon your passing or create the inability to meet a bequest.

» Jointly owning an asset may require the other owner's consent to sell. For example, if you add your child's name to the title of a home and later want to sell your home, the joint owner (your child) may be able to block your ability to do so.

» Joint owners may be able to make distributions without your consent.

» Adding the name of a child or other family member onto the title of a house or investment account may be considered a taxable gift. This will reduce the amount of your federal exemption and may necessitate the filing of a gift tax return. In addition, you may be removing assets from your estate plan that would go to other beneficiaries, unintentionally disinheriting them or leaving unequal amounts.

Assets not held in your revocable living trust. Creating a revocable trust and not retitling your assets may expose the assets to probate and to creditors.

Transfer on Death (TOD) or Pay on Death (POD) designations. These designations on bank and investment accounts are methods of bypassing your estate plan and may thwart a well-designed estate plan.

Retirement Plan Assets

Retirement plan assets are often a family's largest category of assets apart from a home. This category includes 401(k)s, IRAs, pension plans and other retirement vehicles. These accounts use a beneficiary designation to pass assets to your heirs, bypassing your will or trust.

This bypass-nature of retirement assets offers several benefits such as tax deferral, creditor protection, avoiding probate, and direct transfer to beneficiaries without delay or court intervention.

Beneficiary designations should be reviewed annually, as changes in your life may comprise the integrity of your estate planning. Following are several examples of potential problem areas regarding beneficiary designations.

No contingent beneficiaries named. It is common for an individual to name a spouse, children or friends as the primary beneficiary and leave the contingent beneficiary blank. Sometimes this is done with good intentions to update the entries at a later date. However, should your primary beneficiary pass before you, what happens to your account?

» Custodians such as Fidelity and Charles Schwab have default language in their account agreements whereby in this scenario the beneficiary becomes your estate.

» If this occurs, your IRA will be distributed according to your will and will be subject to probate. These assets may become subject to creditors and are forced to be distributed to your heirs within five years, eliminating the ability to stretch out the distributions over their lifetime and potentially subjecting the distributions to a higher level of taxation.

» To avoid these and other problems, be sure to verify contingent beneficiary entries upon your annual review of all beneficiary designations.

The Per Stirpes box isn't checked but should be. Per Stirpes is a legal term in Latin that allows for a named beneficiary's share of an estate to be passed down to his or her legal lineage (children and grandchildren) should that beneficiary pass.

» For example, imagine you name your two adult children as primary beneficiaries of your IRA, with each receiving 50 percent. Both children have children of their own (your grandchildren). If you did not check the box marked Per Stirpes on your custodian's account application—perhaps not understanding its meaning—then in the event one of the children named as a primary beneficiary passes, the remaining child will receive 100% of your retirement plan upon your death.

» If it is your desire that your grandchildren receive their parent's share of an IRA or other account, make sure you review and check the Per Stirpes box on your custodial beneficiary form.

Naming your trust as a beneficiary. There are several good reasons for naming a trust as the beneficiary of a retirement plan, including maintaining control for minors and asset and creditor protection. However, you should be aware of several important factors.

» Use of trusts creates another layer of complexity and costs, along with the loss of flexibility if your beneficiary is your spouse. Should you want to have a trust as the beneficiary of your retirement plan, discuss the positives and negatives with your wealth advisor and attorney. Be sure to review the provisions of your trust documents to ensure your documents are compliant with applicable laws.

» If you are considering naming a trust as a beneficiary of a retirement plan, be aware of the IRS's four requirements:

1. The trust is valid under state law.
2. The trust is irrevocable upon death.
3. The beneficiaries are clearly identifiable individuals.
4. Documentation is provided to and approved by the custodian.

Limitations on minor children's ability to control assets. Since minor children cannot legally own property, they cannot legally inherit an IRA outright, oversee the management of the assets, or direct the distribution of funds from the account.

» To avoid the courts appointing a guardian on behalf of the child, you should consider naming a guardian on your beneficiary form (if the custodian allows). Name a UGMA/UTMA account as beneficiary or create a trust for the benefit of the minor child.

» If a guardian is not named or a trust used, the courts will have to intervene and approve one. There is no guarantee that the courts will abide by your wishes and approve the person whom you would want to oversee the property or manage the assets in accordance with your views on asset allocation and distributions.

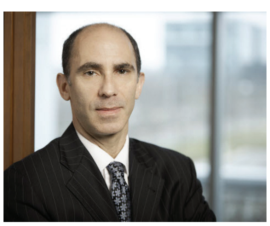
» A trust provides you with the greatest flexibility to provide instructions on how distributions are to be provided to the child. In addition, you can control a child's ability, upon reaching the age of majority, to take distributions greater than the required minimum distribution.

Community property complications. If you are married and live in a community property state, contributions into retirement plans are considered community property. Even if you name someone other than your spouse as your primary beneficiary, your spouse may have a legal claim against those assets. Under federal law, you likewise need your spouse's consent if you name someone else as beneficiary of a qualified retirement plan. Therefore, make sure to get your spouse's written consent if you are going to name a non-spouse beneficiary as a primary beneficiary.

Conclusion

We hope that as you have considered the scenarios we have highlighted in this article you have recognized one or more outcomes you don't want to occur. Although the topics covered here are not an exhaustive list of potential pitfalls, you may find them a good starting place for conversations with your wealth advisor and attorney.

We encourage you to contact us to discuss your specific situation. In the event of your death or incapacity, prior estate planning will help ensure your wishes are carried out in the most efficient and tax-effective way possible.



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