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BENEFICIARY DESIGNATION OPTIONS ON QUALIFIED RETIREMENT PLAN ACCOUNTS

As many people know, qualified retirement plan accounts will be the most heavily taxed assets in an estate. Because the assets in a qualified plan are "pre-income tax", they not only are included as an asset of an individual's estate, and thereby subject to estate tax, they also represent income to a beneficiary when the funds are withdrawn from the plan.

The impact of the federal estate tax and federal and California income tax can substantially erode the value of the accounts.

In order to preserve these assets for future generations, it is necessary to accomplish two (2) objectives:

1. Assure that there are sufficient liquid assets within the estate to pay the estate taxes without forcing a liquidation of the qualified plan assets for that purpose. In many cases, this liquidity can be provided through an Irrevocable Life Insurance Trust; and

2. Review the beneficiary designations to assure that the beneficiary has the option of taking money out of the plan over the longest period of time allowed by law, typically the beneficiary's life expectancy. If the beneficiary designation is not properly structured, the beneficiary may be forced to withdraw the assets from the plan, and pay the income taxes at that time, within one (1) calendar year following death of the plan participant.

The objective is to create a "stretch out" IRA, that allows the assets to be maintained in a tax-deferred environment for the longest possible period of time. This results in the plan assets being distributed to the beneficiaries over a period of years while allowing the remainder of the plan assets to continue to earn and grow in a tax-deferred environment.

In reviewing the beneficiary designation options, and the consequences of those options, there are a few choices:

1. Spouse is Beneficiary

If the surviving spouse is designated as the beneficiary, the spouse has the option of rolling over the plan into his or her own IRA. This is normally the best choice because it avoids any estate tax and allows deferral of income taxes based on a new life expectancy.

A spousal rollover may not be the best choice if the participant wants to control who the ultimate beneficiaries of the account will be when the spouse dies. For example, if the participant dies, and the spouse rolls over the IRA and remarries, the spouse could designate a new husband or wife as the beneficiary.

If the participant wants to control the ultimate beneficiary, it may be necessary to have a trust designated as the beneficiary as further discussed below.

2. Individual Beneficiary(s) other than a Spouse

If the beneficiary is an individual other than a spouse, that beneficiary may take distributions over his or her life expectancy. If there are multiple beneficiaries, then each individual can take distributions over his or her life expectancy.

3. Trust as Beneficiary

If the designated beneficiary is the participant's Revocable Trust, and the Trust becomes irrevocable as of the participant's death, then the trust beneficiaries may take distributions over the eldest beneficiary's life expectancy.

The above rules can be summarized as follows:

1. For a married couple, normally it is most advantageous to designate the spouse as the primary beneficiary, to qualify for the spousal rollover privilege;

2. After the spouse, it may be next most beneficial to designate adult children as beneficiaries and to allow for distributions over each child’s own life expectancy;

3. It is normally best to designate a trust as the beneficiary in the following circumstances:

   A. The assets in the qualified plan are needed to take advantage of the deceased spouse's $5 million estate tax exemption;

   B. The participant does not want the spouse to have the ability to change the beneficiary on the plan after his or her death; and

   C. The child or children are not at an age or maturity level where they are capable of managing funds on their own, and a Trustee has been appointed to administer the funds for their benefit.