



Beneficiary designations in estate plans: An important (often overlooked) step

By Holly A. Beecher and Benjamin S. Cranston | Published in the March 18, 2022 issue.



If you have executed estate planning documents such as a Last Will and Testament (Will) or a trust, you may think that no further steps are necessary to ensure that your estate plan is complete. However, reviewing and updating beneficiary designations on bank accounts, investment accounts, retirement accounts and life insurance policies to coordinate with your estate plan is an important and often overlooked step in the estate planning process. Inaccurate and outdated beneficiary designations can frustrate your carefully considered estate plan and cause your assets to pass in unintended ways.

Beneficiary designations are form documents completed by an account owner (“Owner”) that are submitted to the entity holding or managing the account. The forms provide how the Owner would like the account assets to pass upon the Owner’s death.

Where a valid beneficiary designation is in place, such designation supersedes any provision of the Owner’s Will that purports to dispose of the beneficiary-designated asset. This is why beneficiary-designated assets are referred to as “non-probate” assets – because they pass outside of the Owner’s probate estate. There are advantages to using beneficiary designations to create a class of non-probate assets in an Owner’s estate, including probate avoidance, avoiding attachment by creditors and the ease and speed of collecting assets by a beneficiary.

Nonetheless, it may still be advantageous or necessary to name a trustee of a trust under a Will (a testamentary trust) as a beneficiary of an account or even name the Owner’s estate in order to provide liquidity for business continuation purposes or for payment of taxes and expenses.

EXAMPLES OF BENEFICIARY DESIGNATIONS

Bank deposit accounts and investment accounts: Bank deposit accounts (checking accounts, savings accounts and certificates of deposit (CDs)) can be transferred to a named beneficiary upon the Owner’s death by a Payable on Death (POD) des-

ignation. Investment accounts (brokerage accounts, stocks and bonds) can also be transferred by a Transfer on Death (TOD) designation. Alternatively, an investment account can be held as an “In Trust For” (ITF) account, to be held and managed by a trustee for the benefit of the Owner’s nominated beneficiary.

Life insurance and retirement accounts:

An Owner of a life insurance policy or retirement account (IRA, 401(k), 403(b), etc.) may name one or more beneficiaries to receive the death benefit proceeds from the policy or the retirement account balance. While these assets are frequently directed to individuals as beneficiaries, the benefits may also be directed to lifetime trusts or testamentary trusts, charities or, in certain cases, to the Owner’s estate. A beneficiary, other than an estate or trustee of a testamentary trust, does not need a court proceeding to collect the policy or account benefits.

BENEFICIARY DESIGNATION BLUNDERS

While it may appear simple, there are many common mistakes made by Owners in completing beneficiary designations.

GUIDE to WEALTH MANAGEMENT

First, Owners commonly fail to update beneficiary designations after the occurrence of a significant life event, such as marriage, the birth of a child, the death of a family member or a divorce.

Second, a common estate plan for a married Owner is to leave all assets to the spouse outright, or if the spouse doesn't survive, all assets then fund testamentary trusts for the Owner's minor children. However, it is often the case that the beneficiary designation reflects the spouse as primary beneficiary with minor children named as contingent beneficiaries. Without changing the beneficiary designation, if the spouse predeceased the Owner, the minor children would be the direct beneficiaries of the asset rather than the testamentary trust. By not updating the beneficiary designation, the Owner has now subjected his beneficiaries to an expensive guardianship proceeding, allowed the assets to be held in a guardianship account subject to court oversight, and has thwarted the terms of the testamentary trust since guardianship accounts must be distributed when the minor reaches the age of 18.

Third, because retirement accounts comprise a large share of the value of most estates, the

beneficiary designations for such accounts must be seriously considered, especially in light of the passage of the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) of 2019. Under current law, most non-spouse beneficiaries are required to receive the entire account balance within 10 years of the Owner's death. This payout carries significant income tax liability, but may also put significant sums of money in the hands of an individual if that individual is designated as the beneficiary. Using the beneficiary designation to direct an account to a testamentary trust does not extend the period of time in which the account must be paid out, but does allow the trustee of the trust to control and protect the amounts received for the individual in trust and make informed decisions to potentially reduce income tax.

Finally, if an Owner seeks estate tax minimization or deferral provisions through the use of testamentary trusts, improperly designating individuals as beneficiaries may result in significant estate tax ramifications. For example, if an Owner intends to use testamentary trusts to utilize the New York and federal estate tax exemption amounts, but fails to

direct assets to such trusts, there may be insufficient assets in the probate estate to fully utilize the exemptions. Further, depending on the named individuals on the beneficiary designation (particularly children or more remote descendants), amounts distributed in excess of the exemptions may result in increased estate tax owed on the death of the spouse or immediately upon the Owner's death.

CONCLUSION

As seen in the examples above, having accurate and estate-plan-consistent beneficiary designations can save time, money and effort on behalf of your loved ones after your death. The list above is not exhaustive, and changes to beneficiary designations should be considered with the assistance of a professional in the context of your full estate plan.

Attorneys in the Phillips Lytle LLP Family Wealth Planning Group provide advice and guidance to corporate and individual executors and trustees, as well as beneficiaries regarding all aspects of estate and trust administration and litigation. Holly A. Beecher, partner and leader of the firm's Family Wealth Planning Group can be reached at (585) 238-2057, hbeecher@phillipslytle.com. Benjamin S. Cranston, attorney, can be reached at bcranston@phillipslytle.com