The Importance of Properly Naming Beneficiaries of Your IRA

Beneficiary designations are an essential part of your estate plan, especially if you have an IRA.

When planning your estate, it is very critical to understand the role beneficiary designations play in how your estate will be distributed when you die. A beneficiary designation listed on an investment or asset will dictate the ultimate distribution of that investment upon your passing, *regardless of the wording of your Last Will & Testament.* Incorrect beneficiaries listed or a failure to list beneficiaries on an investment can have dramatic and dire consequences to your estate. One type of investment that requires extra careful attention when naming your beneficiaries is your IRA. Properly listing your beneficiaries on the IRA is an effective way to avoid probate and to ensure that your loved ones become the direct recipients of the account. Properly designating your IRA beneficiaries will also lead to better tax consequences for your heirs; therefore, it is important to understand and carefully consider your options.

To many it may seem like a simple solution to name your estate as beneficiary of your IRA (i.e. "The Estate of Joe Smith") – or to not name a beneficiary at all; however, this will most likely result in unfavorable tax consequences. Some suggested and/or more favorable beneficiary designation strategies are as follows:

1. Designate your spouse as beneficiary.

Many individuals will simply name their spouse as beneficiary of their IRAs. This means that upon the account owner's death, the spouse may roll over the funds from the deceased spouse's IRA into his or her own IRA. The spouse may then begin taking distributions based on his or her own life expectancy when reaching age 70½ (if the deceased spouse had already reached that age) or the year the deceased spouse would have reached age 70½.

2. Designate another individual (who is not your spouse) as beneficiary.

If you designate an individual who is not your spouse, that individual may take distributions from the inherited IRA based on his or her own life expectancy. This generally allows the individual to "stretch" distributions for a longer time period, extending the potential tax-deferred growth of the assets in the account. Note that if the account owner dies before his or her "required beginning date," however, then the individual who inherits the IRA may be required to withdraw all of the assets over a period of five years.

3. Designate a trust as beneficiary.

Depending on family dynamics and a host of other factors, sometimes it's not the best idea to leave an IRA to an individual outright. If the person you would like to name as a beneficiary is a minor, a spendthrift, or a recipient of SSI or Medicaid, for example, then the IRA most likely should be left to a trust for the benefit of that individual rather than to the individual outright. There are special rules relating to naming a trust as beneficiary of an IRA.

4. Designate multiple beneficiaries.

If you name multiple individuals as primary beneficiaries of your IRA (for example, your children), the life expectancy of the oldest will typically be used to determine the timing and amount of distributions to all beneficiaries after the account owner's death. It is possible for each beneficiary, however, to create his or her own IRA ("Inherited IRA") after the original owner's death. If done by December 31 of the year following the owner's death, each Inherited IRA owner will be able to take distributions based on his or her own life expectancy.

Regardless of your choice of primary beneficiary, be sure to name a contingent beneficiary to ensure that if something happens to your primary beneficiary, the IRA goes to the individual(s) you want to receive it.

From favorable tax consequences to the possibility of the Commonwealth of Pennsylvania having a claim against an asset for which you failed to designate a beneficiary, properly identifying your beneficiaries is critical in preparing your overall estate and elder care plan.

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