



Toledo  
Community  
Foundation

Inspiring and Connecting Thoughtful Giving

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Since 1973, **Toledo Community Foundation** has provided individuals, families and businesses interested in the well-being of our community with an *efficient, effective, low-cost, professionally managed* mechanism to achieve their charitable goals.

For philanthropists wishing to maximize the impact and life of their charitable gifts, the Foundation provides *resources for thoughtful giving*. Using its expertise and personalized services, **Toledo Community Foundation** helps donors transform their philanthropic impulse to measurable community impact. Beyond the gifting of assets, the Foundation helps donors identify issues of importance to them and *inspires engagement* with community organizations addressing these issues, thereby maximizing the impact of charitable gifts and creating a greater sense of fulfillment.

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## Heir Loss

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## Financial Planning

William Kennedy might have made a big mistake with a beneficiary designation. When the longtime DuPont employee divorced his wife, Liv, after 23 years of marriage, their divorce decree ended her claim to his pension benefits. But William never changed his beneficiary designation on his savings and investment (SIP) plan.

When he died, seven years after the divorce, DuPont paid the balance of his account—about \$400,000—to his ex-wife. The estate sued, and the case wended its way through the court system, until the U.S. Supreme Court unanimously ruled his error couldn't be corrected. Documents stating a beneficiary control the outcome and can't be overruled by wills or divorces.

For financial planners, the 2009 decision underscores the importance of checking that all clients' documents name beneficiaries correctly. Smart firms review beneficiary confirmation letters or request them for their clients every year. As the Kennedy case showed, beneficiary problems can cause even the best financial plans to go awry.

### BEYOND WILL-POWER

Pension plan documents aren't the only ones that rule the day when it comes to beneficiaries. That is also the case with IRAs, insurance policies and annuities, as well as some investment and savings accounts, which are all payable to a named beneficiary.

Many clients don't realize that a beneficiary designation overrides a will, says Jim Holtzman, a financial planner with Legend Financial Advisors, in Pittsburgh. "We check on their beneficiary designations every year, either by reviewing documents that are sent to our clients or requesting information from firms that do not send out beneficiary confirmation letters."

Although not every forgotten beneficiary designation will lead to a \$400,000 misunderstanding and wind up before the Supreme Court, financial planners may find other problems resulting from flawed formalities. In one case, a client stipulated in a custom beneficiary designation that his spouse, the beneficiary, could disclaim her benefit in his pension and pass it along to a bypass trust in his will, says Lesley Draper, a financial advisor with Regent Atlantic Capital, a wealth management firm in Morristown, N.J.

When the client rolled the retirement plan to an IRA, the IRA custodian required that the client complete the IRA's beneficiary form. This time, he named his spouse as the primary beneficiary and his children as the backups.

However, the new form unintentionally overwrote the custom beneficiary designation from the pension plan. It wasn't until the client died years later that his advisor discovered the custom designation no longer applied to his IRA. "As far as the IRA custodian was concerned, the client had named his children as contingent beneficiaries and that was his intention," Draper says.

The IRA custodian eventually agreed to reinstate the disclaimer strategy, but only after the advisor sent the custodian's legal department correspondence proving that the deceased client intended to allow the surviving spouse to disclaim assets to the bypass trust. The advisor also had to produce the client's will and letters from the children stating that they were giving up their direct right to the assets and they understood that they would ultimately benefit from allowing the assets to flow into the trust.

The message? "Such incidents illustrate the importance of verifying what an advisor believes to be the beneficiary designation, based on what is in the advisor's records, versus what the custodian is seeing," Draper says.

## SIMPLER SOLUTIONS

Naming a trust as IRA beneficiary is a common move when clients want to reduce the risk that beneficiaries will squander the money, be defrauded or withdraw funds so rapidly that tax deferral is lost. "We often suggest that clients name 'trustee under my will' as beneficiary of retirement assets, in order to provide more control over distributing the assets," says Steve Blankenship, principal of Heritage Financial Planning in Grapevine, Texas.

But too often such trusts add layers of unnecessary complexity. Heidi Davis, a financial advisor with Columbia Financial Planning in Bellevue, Wash., is working with a client to change her beneficiary from a revocable living trust to her sister. Her retirement savings are primarily in a Roth IRA. So by switching the beneficiary designation to her sister's name, her sister could draw out the funds based on her life expectancy, stretching out the tax benefits.

"There are times when keeping an entity as a beneficiary may make sense, though," Davis acknowledges. "For example, there could be a concern that the Roth IRA may end up with a brother-in-law (the sister's husband). That is not this client's goal."

One trust that was named as the beneficiary of an IRA listed six people as equal beneficiaries of the trust, called for four specific bequests to other unrelated individuals and instructed that the remaining assets be distributed outright to the other beneficiaries. As Jason Hiley, vice president of investments at Karstens Investment Counsel, in Omaha, Neb., describes the situation, when the client died, the trust beneficiaries wanted to rollover the funds into separate IRAs. The custodian instead required that the IRA be emptied within five years, accelerating tax payments.

Hiley eventually convinced the IRA custodian to create separate IRAs, but only after engaging the attorney who originally drafted the trust and obtaining an opinion letter from a CPA firm citing precedents in similar cases. In the end, the beneficiaries were required to stretch the payouts over the life expectancy of the oldest trust beneficiary rather than their own. The youngest beneficiary lost 30 years of tax savings.

This outcome was good but not great. "Everyone would have been better served had the deceased named the individuals directly as beneficiaries rather than naming the trust," Hiley says. In this case, a simpler plan would have been better.

Blankenship says that one company in his area does not allow trusts to be named as beneficiaries of its retirement plan. This is becoming more common.

When they leave the company, pension plan participants can roll their funds into an IRA and name a trust as beneficiary, if they wish. However, as Blankenship points out, that strategy fails if a client dies while still a plan participant. An advisor in this situation might have little choice

but to wait until the client is eligible for an IRA rollover and then revisit the topic of beneficiary designation.

## ALL IN THE FAMILY

Human errors, of course, can arise even in simple situations. "I saw a situation where someone with six children had an annuity and only listed five of them as beneficiaries," says Deborah Hoskins, who heads Pikes Peak Financial Planning in Colorado Springs, Colo.

There was no apparent reason for the omission, and the beneficiaries might give the sixth sibling an equal share. "But mistakes like these can leave a legacy of uncertainty, confusion and hard feelings, which could have been avoided by going back to see the beneficiary designation," Hoskins says.

But what if a client wants to protect a financially hapless child by leaving control of an inheritance to a sibling? Hiley recalls a case where his client inherited a variable annuity from her mother, who intended her to dole out half the proceeds to her sister, using her judgment. Although the plan was designed to protect the sister, "it was a very poor and cumbersome version of an estate plan," Hiley says.

"If this asset qualified for a stepped-up basis, my client could have just given her sister half the assets," he says. Unfortunately, this annuity had a paid-in principal amount of \$70,000 and a value of \$200,000, for a \$130,000 gain. Distributions from a VA are considered to be earnings first, taxed at ordinary income rates. "Therefore, we have spent the last two years taking distributions and estimating the tax impact on my client before ultimately gifting the funds to her sister."

Hiley's client is in a higher tax bracket than her sister, so her sister will ultimately get about \$10,000 less from the annuity than if she been named a co-beneficiary. "If the mother was truly worried about one daughter squandering the money, leaving the assets to a trust would have made sense," he says. "A trust might allow some discretion on the part of the trustee to take funds if it was in the best interest of the beneficiary."

## DIRECT ACTION

While many people know that retirement accounts and annuities typically pass to a named beneficiary, some clients aren't aware that they also have that option with savings and investment accounts. These can be structured as transfer-on-death (TOD) or payable-on-death (POD) accounts, although bank accounts may carry titles such as "Totten trusts" or "in trust for" accounts. By any name, such arrangements are easy to create; assets pass directly to the named beneficiary at the owner's death, bypassing probate.

"I suggest TOD and POD accounts for many clients, for various reasons," says Michael Helffrich, a planner with PFP Advisors in Minneapolis. "For example, years ago I had a client who was procrastinating about doing a will, so I convinced her to use TODs and PODs. She was hit by a school bus and killed. Her sister (the only beneficiary on the TODs and PODs) lived in another state. The sister received those assets, and she only had to make one trip to Minnesota to resolve a simple probate for the client's condo."

TODs and PODs often work extremely well where no taxable estate exists, Helffrich says. They allow clients to control the money during their lifetime, they're inexpensive and they're easy to set up.

However, they may not be the best approach for clients with large estates. Also, if there are multiple beneficiaries or large tax-deferred accounts with taxes due, there can be conflicts. "It depends on the liabilities of the estate and if there is enough money available to pay final expenses," Helffrich explains.

Until the new tax law, spouses couldn't take advantage of an estate tax exemption if they

inherited money directly from a TOD or POD account. The new exemption portability between spouses will help solve this problem and may make TODs and PODs more popular.

For clients with large estates, multiple beneficiaries or large tax-deferred accounts with taxes due, TODs and PODS can still be unwieldy. The choice often hinges on whether there is enough money available to pay for funeral costs and other final expenses. Who pays estate taxes? Who pays the cost of selling a house?

Some states will reserve POD or TOD funds until those issues are resolved, says Robert DiQuollo, president of Brinton Eaton Wealth Advisors, in Morristown, N.J. Therefore, when planners are checking on clients' beneficiary designations. It may be important to check state law.

"It's very important that clients understand what will happen at their death," Draper says. For example, a client named his daughters on TOD bank accounts, to ensure full federal deposit insurance. However, he didn't realize that should he die, he would transfer millions of dollars to his teenage daughters, bypassing his wife completely, which was not his intention.

## BUILDING TRUST

Know thy client; know his or her heirs. One advantage of checking beneficiaries is to be sure that as a planner you know your clients' intentions and, in the best of circumstances, have a personal acquaintance with the people who will inherit your client's money. They may become your clients, and in either case, a personal relationship will help you resolve any problems that arise.

The bottom line? It is much easier to fix mistakes in beneficiary designations while the client is still alive.

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