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Beneficiary Designations

Many assets pass outside of a probate or a trust. Which assets are these? They are named beneficiary assets (such as IRA accounts, retirement accounts, life insurance, accidental death insurance, and annuities), payable on death accounts, and joint tenancy assets.

Designated beneficiary assets must be looked at individually because different types of assets require different designations depending on their income tax consequences.

For example, a life insurance policy does not suffer any negative income tax consequences when being distributed upon the death of the insured. Because of this, your revocable living trust can be named as the primary beneficiary of a life insurance policy (there are also estate tax issues that must be considered). The advantages to naming the trust as the primary beneficiary are several:

1) If you are married and have a trust that splits into two or more trusts upon the first spouse's death for death tax planning purposes, the insurance proceeds can be utilized in the allocation of assets between the two trusts so that none of the decedent's estate tax exemption is wasted. If a surviving spouse is named as the primary beneficiary of the life insurance, the proceeds of the policy are not in the trust for allocation purposes and some or all of the decedent's estate tax credit could be wasted.

2) If you have minor children and you name the minor children as the direct beneficiaries of the life insurance policy, the proceeds will be held in a court supervised account, FDIC insured (which limits the account to being held in a banking institution), which will be distributed to a child upon attaining age 18. This limits the growth possibilities, the ability for an adult to use those assets during that child's lifetime, and it gives a windfall to a child at age 18 when they may not be mature enough to manage money or get assistance managing money. It is important to remember that if minor children are direct beneficiaries of any asset, there will be a Court Guardianship proceeding which is expensive and time consuming. It is better to name your trust as the beneficiary of life insurance for children so that the problems discussed in this Paragraph do not occur. You may consider using a life insurance trust for the same reasons mentioned above, as well as for estate tax planning purposes (the life insurance trust will keep the proceeds of death benefit out of your taxable estate upon your death).

IRA and retirement assets pose a different set of problems. IRA and retirement assets passing to a spouse generally continue in the same manner as they did for the person who established these assets. There are no estate tax or negative income consequences when passing an IRA or retirement asset to a spouse. However, if an IRA or income tax deferred retirement asset is transferred not to a spouse, but directly to a trust for beneficiaries (other than a special IRA trust), there will be negative income consequences. Generally, when an IRA is distributed

to an individual, they have the option of taking the entire IRA at that time (in which case the whole IRA is subject to income tax) or they can opt to roll it over into an IRA for themselves (for a specific period of time), or to a special trust where it is then it is distributed to them based upon their age and life expectancy (this allows the income taxes to be paid only as distributions are taken out each year, rather than all at once). The second option provides an opportunity to pay the income tax over a specified period of time, rather than all at once when the IRA is withdrawn. The last option allows the IRA to continue to earn income on the principal and pay the income tax from the earnings, rather than from the principal of the IRA.

For a married couple, when both spouses have passed away, the IRA or retirement asset will also be included in the surviving spouse's estate for estate tax purposes. Looking at the value of the IRA and retirement assets is important when considering income tax consequences and estate tax consequences. A large retirement asset may warrant some special estate tax planning to be done in advance so that the children are not forced to have negative income tax consequences because they have to use the IRA or retirement asset to pay estate tax.

The same issues discussed above apply to IRA and retirement assets (as they do for the life insurance assets) with respect to naming minor children as direct beneficiaries of these assets.

It is very important to plan the beneficiary designations of these types of assets while also planning for the distribution of trust assets so that these potential problems are avoided.

Payable on death assets (savings accounts, CDs, some brokerage accounts) should have beneficiaries designated who are not minor children (for the same reasons discussed above), but instead, a beneficiary who you want to have immediate access to the account and not have to wait for the administration of your estate. It is important to remember that these payable upon death assets will be included in your estate for estate tax purposes, but will not be available to the Trustee of your trust or to the Executor of your estate for the purpose of paying estate tax. Your estate planning attorney and financial professionals need to be advised of these accounts and the goal you desire for these assets in order to properly advise you with respect to their consequences in your estate.

Lastly, joint tenancy assets will pass outside of your trust or estate to the surviving joint tenant or tenants. If you own a piece of land with your brother and you pass away, your spouse and your children will not receive your interest in this asset. It will pass 100% to your brother. If this is NOT what you want to happen, you need to sever the joint tenancy and create ownership between your brother and yourself as tenants in common. Owning the property as tenants in common allows your ½ of the property to be distributed to your beneficiaries pursuant to your directions in your will or trust.

When completing your estate planning, coordinating the beneficiary designations, the payable on death assets and joint tenancy assets, as well as creating the trust, is all equally important. Consulting with your various professional advisors (your accountant, financial planner, insurance agent and estate planning attorney) is also very important so that all of the various issues can be addressed and the correct beneficiary designations made.