

Avoid the Top Ten Mistakes Made with Beneficiary Designations



Horn & Johnsen SC

ESTATE PLANNING CENTER OF WISCONSIN

414 D'ONOFRIO DRIVE, SUITE 330
MADISON, WISCONSIN 53719

Telephone: (608) 829-2525

Fax: (608) 829-2527

www.hornjohnsen.com

Copyright © 2014 Horn & Johnsen SC

Estate planning truly is the ultimate gift for your loved ones, and a comprehensive estate plan should *always* include a review of the titles and beneficiary designations for all assets to ensure they are consistent with your estate planning goals. Otherwise, unintended consequences may ensue.

Back to the Basics

Before we begin our “Top Ten” list, let’s first go back to the basics. The manner in which your assets are held will determine whether or not each asset will go through probate upon your death. Any asset titled in your name alone, with no designated beneficiary, will go through probate. Further, any asset designating your *estate* as the named beneficiary will also go through probate.

Assets titled in the following manner will *not* go through probate upon your death:

- Joint Tenancy – If you hold an asset in joint tenancy, then upon your death, title to that asset will pass outside of probate to the surviving owner(s).
- Payable on Death (POD) – If you have designated a “POD” beneficiary on your bank account, then the account will be paid on your death directly to the named beneficiary(ies).
- Transfer on Death (TOD) – If you have designated a “TOD” beneficiary on your investment account or real estate, then that asset will be transferred on your death directly to the named beneficiary(ies).
- Beneficiary Designations – If you have named a direct beneficiary on your life insurance policy or retirement account, then on your death that asset will pass directly to the named beneficiary(ies).
- Living Trust – Any asset titled in the name of your Living Trust will not go through probate. The only documentation your successor trustee will need at the time of your death will be your death certificate and your certificate of trust. The asset will ultimately pass to your beneficiaries privately and according to the terms of your Living Trust.

Top Ten Mistakes

Although avoiding probate sounds great and is often a good idea, it should not *always* be the primary objective when creating ownership arrangements and designating beneficiaries. Thus, after many years of witnessing the disastrous consequences of poor estate planning, here are our TOP TEN MISTAKES made with beneficiary designations and ownership arrangements:

1. **Not Naming a Beneficiary:** By not naming a beneficiary on your life insurance policy or retirement account, you have most likely guaranteed that the asset will go through probate upon your death. Further, for a retirement account, this could create some avoidable tax consequences. The company holding your asset may have contract provisions designating default beneficiaries which could be completely inconsistent with your estate planning goals. Even if your estate is your beneficiary, you should complete a beneficiary designation form.

Avoid the Top Ten Mistakes Made with Beneficiary Designations

Page 1

2. **Not Designating Contingent Beneficiaries:** Often, an account holder will designate a primary beneficiary when an account is initially established but will fail to designate any contingent beneficiaries. If your primary beneficiary (your spouse, for example) predeceases you, or if you die together or before you have had an opportunity to designate a new beneficiary, then the same consequences will result as if you had not named a beneficiary at all.
3. **Failing to Keep Beneficiary Designations Up-To-Date:** First and foremost, if you get divorced, it is *essential* that you immediately review and update all beneficiary designations! If your ex-spouse is still named as your beneficiary upon your death, then the company holding your asset will most likely distribute the asset directly to your ex-spouse – even if you are remarried. Further, if your primary beneficiary predeceases you, then it is essential to review and update your beneficiary designations at that time to ensure your beneficiaries remain consistent with your estate planning goals.
4. **Naming Minors as Direct Beneficiaries:** Many parents establish testamentary trusts within their Wills designating an age at which their children may have control over their assets and naming a trustee (who may or may not be the same person named as the child’s guardian) to manage those assets until each child has reached the designated age. Most often, the assets are available in the meantime at the trustee’s discretion for the child’s health, education, maintenance or support. However, regardless of the provisions contained in your Will, if you name a minor child as the direct beneficiary of your life insurance policy, the proceeds will most likely be paid out to your child outright as soon as he or she reaches the age of 18. Considering that the average inheritance is spent in about 18 *months*, providing an 18-year-old with immediate access to a large sum of money is probably not in his or her best interest. Generally, if you have minor children and no *living* trust, it is better to name your estate as your beneficiary and allow the proceeds to go through the probate process in order to ensure they are distributed to the testamentary trusts established for your children according to the terms of your Will. Note that with the recent adoption of the Uniform Trust Code in Wisconsin, using very specific language when designating a testamentary trust as your beneficiary could potentially save thousands of dollars in court costs.
5. **Naming Special Needs Individuals as Direct Beneficiaries:** If you name a “special needs” individual (i.e., a person who is receiving a governmental benefit such as SSI or Medical Assistance based on a disability) as a direct beneficiary, you could unintentionally disqualify that individual from receiving his or her valuable governmental benefits. The individual must then “spend down” the inheritance and, after virtually all the money has been spent, go through the application process again. This “spend down” effectively defeats the purpose of naming a beneficiary! If you wish to leave an inheritance for a loved one who is receiving this type of assistance, it is much better to create a “special needs trust”, also known as a “supplemental needs trust”, within your Will or Living Trust to hold the inheritance for the benefit of that individual for his or her lifetime without jeopardizing his or her benefits.

6. **Naming Financially Irresponsible Beneficiaries:** Many of us have loved ones who have repeatedly demonstrated that they will never be financially responsible. Clearly, naming this type of individual as a direct beneficiary may serve only to contribute to a gambling or drug addiction, or may be claimed by creditors in a bankruptcy or income tax proceeding. Often, it is better to create a lifetime “spendthrift trust” to hold the inheritance for the benefit of that individual for his or her lifetime while protecting the assets from creditors.
7. **Naming Direct Beneficiaries on All Assets Other than Real Estate:** As probate attorneys, we have witnessed this troublesome scenario on numerous occasions. If you own real estate titled solely in your name (or titled as a tenant in common) upon your death, then that real estate interest will need to go through the probate process before it can pass to your beneficiaries – *even if you have a Will in place*. On average, the death probate process in Wisconsin will take about 11 months. In the meantime, before your real estate can be sold or distributed, your estate is responsible for paying maintenance expenses including, but not limited to, real estate taxes, insurance, utilities, maintenance and general upkeep of the property. Your estate is also responsible for your final debts and expenses, including your funeral bill, court costs, and attorney’s fees. If you have insufficient *cash* available within your estate, then your children or other beneficiaries will need to find a way to pay these costs. However, they are under no legal obligation to pay these costs from life insurance proceeds, cash received through POD designations, etc. Thus, a serious dilemma... Therefore, if you own real estate that will go through probate upon your death, it is generally advisable to also allow your cash accounts and/or life insurance proceeds to go through probate as well in order to eliminate situations such as the one described above.
8. **Naming Multiple Beneficiaries on a Transfer on Death Deed:** Wisconsin law now allows a special type of deed known as “Transfer on Death Deed” or “TOD Deed” for short, and similar to a “Lady Bird Deed” in other states. Through this type of deed, you can designate a beneficiary or beneficiaries who will inherit your real estate outside of probate upon your death. If you have only one child who is a responsible adult, and who is not a special needs individual, then this strategy may work well. However, if you have multiple beneficiaries, then a Transfer on Death Deed is most likely not a good option. If multiple individuals own a single piece of real estate, they all must agree on the realtor and the sale price, and until the property is sold, all owners should contribute equally to the maintenance of the property as described in #7 above. For obvious reasons, this arrangement can create more trouble and family disputes than might have occurred had the property gone through an organized probate proceeding and remained in the control of a single designated personal representative.
9. **Naming a Child as a Co-Owner of a Deposit or Investment Account:** In his or her later years, a parent will sometimes add a trusted adult child as the co-owner of his or her bank account(s). The purpose of this arrangement is usually to allow the child to assist the parent in managing his or her finances, signing checks, etc. Generally, the intent is *not* for this child to inherit the entire balance of the account upon the parent’s death to the

exclusion of the other children. There are numerous potential issues with this arrangement, some of which are outlined below:

- **Giftng** – When you add your child (or anyone else) as the co-owner of your asset, you have just legally gifted them half the value of the asset. Presently, you can gift up to \$14,000 per year per beneficiary without incurring any gift tax consequences. If the value you have “gifted” is greater than this amount, then you are legally required to file a gift tax return and incur any gift tax consequences associated with the transfer.
- **Creditor Issues** – Once your child (or anyone else) becomes the co-owner of your account, half of your account will then become subject to the claims of that person’s creditors. Therefore, if the co-owner gets sued or files for bankruptcy, then half of your account could end up in the hands of his or her creditors. Your account could even become an issue within your child’s divorce proceeding!
- **Final Expenses** – Even if your intent is for the money in your account to be used to pay your funeral expenses after your death, the child you have named as a co-owner of your account is under no legal obligation to use this money for its intended purpose. He or she could simply walk away with the account balance, leaving the other assets in your estate to pay for these expenses, resulting in a “windfall” for that child.

By employing other estate planning techniques, you can better accomplish your estate planning objectives without putting your account at risk. For example, you can create a durable power of attorney naming your trusted child as the agent to manage your account during your lifetime. You can then either add a POD designation to the account, or allow the account to go through probate upon your death with the rest of your probate estate. As a final alternative, you could create a Living Trust and title the account in the name of your Living Trust.

10. **Naming One Child as the Sole Beneficiary of a Life Insurance Policy or Deposit Account:** A parent with multiple adult children will sometimes designate one child as the sole beneficiary of a life insurance policy or deposit account, with the intent that this child will use the proceeds to pay for funeral and other final expenses and then distribute the remaining balance equally among his or her siblings. However, similar to the co-owner situation referenced above, the child you have named as your beneficiary is under no legal obligation to use this money for its intended purpose and could simply walk away with the account balance. Further, your child may be unable to distribute the account balance to his or her siblings without incurring his or her own gift tax consequences.

Bonus: the Eleventh Mistake. Sometimes, creating an IRA beneficiary trust may be a good option. Such a trust is designed to be named as the beneficiary of an IRA, and upon the death of the IRA owner, to hold the IRA assets in trust for the protection and benefit of another family member. However, this type of trust may create unnecessary complexities rather than easing the post-death administration process for your loved ones. Ask: “Is there a strong reason to name a

trust as the IRA beneficiary; or is there a way to achieve planning goals without the risks and complexities of naming a trust?” Without a strong reason, don’t do it!

Regardless of your particular estate planning objectives, it is important that all of the pieces to your estate planning puzzle fit together. Your beneficiary designations are an important piece to this puzzle, and the most effective means to ensure that your assets are passed on in the manner you choose.

Attorneys Dera L. Johnsen-Tracy and John Horn of Horn & Johnsen SC have a true passion for helping individuals and families plan. If you are interested in a no cost, no obligation consultation regarding your own estate planning needs please call our office at (608) 829-2525 or send us an email at info@hornjohnsen.com. For additional information, please visit our website at www.hornjohnsen.com.