



## WHAT'S IN A NAME?

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## HOW MISTAKES WITH BENEFICIARY DESIGNATIONS CAN COST YOU AND YOUR LOVED ONES PLENTY.

Estate planning can be a process so complex it takes a team of attorneys and a raft of legal documents . . . or it can be as simple as writing in a loved one's name in the space that asks for "beneficiary." Surprised? It's true. Every time you name a beneficiary, you're actually engaged in estate planning. That is, you're deciding how your assets will pass on to others when you die.

So far so good. For simple estates, using the beneficiary designation couldn't be a more convenient way to ensure that your assets go to your chosen beneficiary immediately after your death without the fuss, delay, intrusion, expense, or publicity of such proceedings as probate court. But that's not to say that beneficiary designations are a risk-free proposition.

## HOW BENEFICIARY DESIGNATIONS WORK

Let's review just what you accomplish when you use a beneficiary designation.

Beneficiary designations are used on such financial instruments as annuities, life insurance policies, bank accounts, IRAs, brokerage accounts, and other assets. Your beneficiary designation instructs the financial institution to transfer ownership to a named individual at your death.

Unlike other assets that you may dispose of using a will, there's usually little delay in the transfer. Plus, it is usually private, and there are rarely any of the costs associated with other forms of asset transfer, such as probate or attorney's fees.

But there are disadvantages to using a beneficiary designation to transfer assets. For example:

- You have absolutely no control over how your beneficiary will use the asset once it passes on to him or her.
- The value of the asset will be used to calculate your estate tax liability, even if your estate no longer has ready cash to pay the tax bill.
- If your beneficiary is a minor child or a mentally incapacitated adult, the financial



institution won't transfer the asset directly into his or her name, but will instead, require that a trust be established to hold the funds on the beneficiary's behalf.

- Before you can name someone other than your spouse as beneficiary of your qualified retirement plan, your spouse must provide a written disclaimer of any interest in your plan.
- Improper use of the beneficiary designation may deprive you of better opportunities for implementing estate planning strategies that will help you pay final expenses and better control how loved ones use your legacy.
- Lastly, failure to keep your beneficiary designations up to date can have disastrous consequences. For example, it's not uncommon for an ex-spouse to receive an unexpected windfall because his or her ex failed to change the beneficiary when their divorce became final.

## WHEN TO USE BENEFICIARY DESIGNATIONS

With those caveats in mind, let's look at some situations in which the beneficiary designation can be appropriate:

- Spouses . . . One benefit of naming your spouse the beneficiary of your asset is that the transfer of funds occurs estate tax free, through the unlimited marital deduction. The only problem, however, is that if your estate is large, this tactic deprives you of the opportunity for sheltering part of your estate from taxes when your spouse dies.
- Charities . . . Naming an admired charity as beneficiary of an asset can be a nearly painless way to make a substantial gift. And it provides your estate with a charitable tax deduction.
- Adult children . . . Naming a younger adult as beneficiary of such assets as your IRA (assuming your spouse has disclaimed his or her interest) is a great way to extend your funds and reduce taxes due on distributions. That's because the life expectancy of the new beneficiary is used to determine future payouts.

## WHEN TO USE OTHER STRATEGIES

Think twice before using the beneficiary designation in these circumstances:

- Your Beneficiary is a Minor or Incapacitated . . . Because your financial institution is legally prohibited from paying out funds to a minor child or incapacitated adult, a trust will have to be created on their behalf. But it will be done after you are gone, and without



your input. No one but you, for example, knows how well you would want a disabled loved one to be cared for. And only you know what goals you had in mind for a minor child. By failing to create a trust ahead of time, you miss out on important opportunities to ensure that your loved ones receive the quality of care and the financial support to achieve your most cherished goals. So, if you have a minor child in your life, your best bet is to forgo the beneficiary designation and instead work with your estate planning professional to create a trust that will receive those funds upon your death. As part of the planning process, you can express your goals for the child, such as a college education, and ensure that funds are available to help make this goal a reality. Similarly, your estate planner can help you meet the needs of a disabled loved one with a special needs trust. One of the most important features of these trusts is that they can often help keep your loved one eligible for other available sources of financial support as well.

- Your Beneficiary Is in a High-Risk Situation or Is Financially Inexperienced . . . You probably know the sad statistics that reveal few recipients of financial windfalls have much chance of hanging on to their money for more than a year. Also of concern is the fact that a divorce, law suit, creditor action, unpaid tax bills, etc., can put the funds you provide a loved one at risk. That's why you might be better off using a trust to manage the funds if your beneficiary is:
  - Too financially inexperienced or emotionally immature to manage the funds wisely.
  - In a high-risk occupation that may engender lawsuits.
  - In a shaky marriage that may end in divorce, with your asset becoming marital property split between the parties.
  - Currently facing lawsuits or other creditor action that may endanger your funds once they're transferred to the loved one's estate.

While there are clearly occasions when beneficiary designations are the right approach, your best bet is to review your situation with your estate planning professional to determine the best strategy for you and your loved ones.

## ABOUT DMG FINANCIAL

First established in 1993, DMG Financial was created to help clients achieve their most cherished goals through personalized financial planning services and a wide range of quality financial products. Today, DMG Financial has evolved to include a team of affiliated financial professionals from coast to coast. Working together, the advisors of DMG Financial offer the expertise, planning techniques, and products to serve businesses, individuals, and families.