How to Avoid Mistakes With Beneficiaries

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Most likely, you have a beneficiary, as beneficiary designations are common in retirement accounts, wills, and trusts. A beneficiary is an individual (or legal entity) to receive the proceeds from a financial product or vehicle when the owner passes away. What begins as a simple directive in naming a beneficiary can suddenly become complex with life changes like divorce, death, wealth accumulation, threshold qualifications for government programs, etc.

Updating your beneficiaries is a part of your estate planning and financial wellness routines. However, reviewing your plans may

be overlooked during emotional challenges, such as in a divorce case. Existing policies for life insurance, IRA, or an old 401(k) may still list your ex-spouse as the beneficiary. Some states now automatically terminate a former spouse's beneficiary status when the marriage is legally dissolved, but others do not.

After a Divorce

If you are or plan on becoming divorced, the accumulation of wealth in these account types may be best to use as a supplement to your retirement, or the account may have a death benefit that increases over time, and you prefer to keep it. Also, check for employer-provided policies that may have a former spouse designated as a beneficiary, as many people forget about them.

Distributing Assets Among Beneficiaries

When naming your beneficiaries, consider if receiving the money is genuinely beneficial, as there are cases when it may inadvertently have negative financial impacts. One example is the case of a special-needs individual. A beneficiary status and eventual inheritance may disqualify them from government support programs. Or a person on Medicaid may have to leave the program until the asset is spent down, and then they re-apply for the benefits program.

Another example of a negative financial impact is inheritance by multiple siblings where one is affluent and the others are not. While equally splitting your estate among the three siblings may

seem the fairest option, it may not be the case. The affluent sibling may see an increase in their tax liability because of the inheritance and lose money if moving into a higher tax bracket. Meanwhile, the other two siblings may have greatly appreciated and benefitted from inheriting extra money. The wealthier child can receive a family heirloom or other physical asset to offset the others' additional payout.

Some estate plans are very straightforward with a single-person beneficiary. For example, this individual can receive a death benefit tax-free, or a retirement account switches directly into the surviving spouse's name. But personal situations and families are often more complicated. Or you may want to distribute assets unevenly or differently.

Life Insurance Beneficiaries

An estate planning attorney can help you understand how to use a life insurance policy as a benefit to your estate. Without careful planning, a life insurance death benefit left to an estate may trigger probate and tax issues and become attachable by creditors. It can become even more complex to include retirement accounts or other financial assets, especially if they exceed the federal estate tax exemption threshold of $12.06 million in 2022.

Using Trusts to Protect Beneficiaries

Naming your children as beneficiaries, particularly on life insurance policies, is very standard, yet there are potentially negative consequences without proper planning. If your children are 18 to 21 years old (depending on the state), they may directly inherit a benefit. Often a younger individual does not know how to handle a sudden inheritance of a large sum of money. Legal oversight through a trust can be a beneficial solution.

A trust can also permit children who are not of age to inherit the death benefit later. A trust can properly structure your minor childrens' finances with a named trustee, much like a will names a legal guardian. A legal entity to provide for your minor children is far better than leaving money to another family member to care for your children. There is no legal guarantee the individual with the inherited money will use it for the benefit of your children.

Communicating with Beneficiaries

A lack of communication creates problems. Make family members and loved ones aware that you are making them a beneficiary as it can increase a tax bill or disqualify a loved one from a government support program. Financially well-off inheritors may prefer that family heirloom over money.

Advising inheritors of beneficiary status and subsequent changes also manages their expectations. If someone you love believes

they will receive a death benefit but do not, they are generally upset by the change. Communicating changes in beneficiary status will help avert hurt feelings and family conflict.

As the value of your assets grows, questions as to who is beneficiary to what and how your estate plan complements your family system grow increasingly complex and often require changes. Make sure to arrange beneficiary status in your estate plan in a truly beneficial way and review it often to be sure it reflects changes in your life circumstances.