KAVAR Inflection Points

The science of investing. The art of integration.

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Issue I

Time for a Beneficiary Review

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Welcome to the first installment of *Kavar Inflection Points*. As a complement to the quarterly *Kavar Canvas* our goal is to provide timely commentary on topics that affect various facets of your personal wealth. *Inflection Points* arise along the path of an investor's lifecycle. Careful planning is needed as you work toward achieving your financial goals. Our mission is to assist in re-calibrating your financial plan at each such Inflection Point, angling to optimize your short, medium and long-term financial goals. *Kavar Canvas* is about the SCIENCE of the investment framework and *Inflection Points* is about the ART of integrating with your financial plan.

I would like to spend some time on a simple yet often over looked activity: reviewing beneficiary designations. We continue to witness the unintended consequences of neglecting this task. Some of the common mistakes are as follows:

- Failure to list a primary beneficiary or contingent beneficiaries,
- Designating your trust as primary beneficiary instead of your spouse,
- Forgetting to update beneficiary designations after a divorce or death,
- Minor children listed as beneficiaries.

As you may know, financial assets transfer at death via one of 3 ways: through probate, by operation of law and by contract. Life insurance, annuity contracts and retirement plans are examples of property that transfer by contract through beneficiary designations. A carefully crafted will or trust plan can be negated without thoughtful consideration to these designations.

Let's dive into a few examples.

Failure to list a primary beneficiary or contingent beneficiaries. There are a number of consequences to this mistake. First, the funds will have to proceed through probate which can be expensive and tedious. In addition, the funds are now exposed to potential creditors. Second, the ability to "stretch" the distributions from a retirement account is negated. The "stretch" term refers to the option of taking smaller yearly distributions based on the life expectancy of the beneficiary.

Once the beneficiaries of the estate receive the funds they have the following options: either take a lump sum distribution and pay income taxes on the full amount in the case of pre-tax retirement accounts ***or*** take distributions over a 5 year period (if the account owner was under age 70 ½). For traditional IRAs, the distribution schedule can be the remaining life expectancy of the owner if they happened to be over age 70 ½ at the time of death. In the case of minor children, there can be additional considerations (see below).

Designating your trust as primary instead of your spouse. This is a common mistake among those that have established revocable living trusts. After all, you have devoted the time and expense toward establishing an estate plan that details the transfer of your assets. However, even if your spouse is the beneficiary of your trust you will eliminate a key option only available to spouses. This option involves the ability to roll inherited IRA assets into the surviving spouse's own IRA. By doing so, the surviving spouse can delay mandatory withdrawals until they reach age 70 ½. In addition, if your trust does not meet the requirements of a

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"qualified trust" your beneficiaries will lose the ability to stretch their withdrawals over their lifetime. A trust is a "qualified trust" if the following conditions are met: must be valid under state law, must be irrevocable (upon the death of the grantor) and must name identifiable beneficiaries.

Failure to update beneficiaries after a death or divorce. This may seem simple or fall into the category of "hard to believe this really happens." It is more common than you think. Think about the stress involved when there is a death or divorce in the family. It's easy to forget about updating the beneficiaries across all of your accounts. The negative consequences are clear in the case of divorce but think about what might be missed when a spouse passes away. If there were no contingent beneficiaries listed and the surviving spouse passes away the asset will go to the estate. As we discussed, this brings probate into the fold and minimizes the options of the ultimate beneficiary.

Minor children as beneficiaries. If you list children or grandchildren as your beneficiaries, there are a few things you should consider. First, most plans will not transfer money directly to a minor and will require a trustee or guardian to receive the money on the child's behalf. If the trustee or guardian was not established prior to the death of the account holder, a court will have to appoint one. This can take time and involve additional expense. Once the guardian is established, the funds will be used at the discretion of the guardian for the benefit of the minor child. However, at age 18 or 21 in some states the funds will be released to the minor child without restriction. The alternate approach would be to establish a trust for the benefit of the minor children which spells out your intentions on how and when the money should be distributed.

Year End Tax and Financial Planning Checklist

- *Open enrollment for Medicare Part C & D (October 15 – December 7)*
- *Open enrollment for the Healthcare Marketplace (November 15 – December 31)*
- *Income tax return deadline with extensions -10/15*
- *Re-characterize Roth Conversions from prior year by 10/15*
- *IRA Required Minimum Distributions (70 ½ and Inherited)*
- *Plan Itemized Deductions*
    - ◊ *Accelerate 4th Quarter State Income and Property Taxes (Non-AMT taxpayers)*
    - ◊ *Consider donating appreciated securities to charity*
    - ◊ *Pay January Mortgage payment in December*
- *Harvest Investment Losses*
- *Maximize Retirement Plan Contributions*

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IMPORTANT DISCLOSURES:

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