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# The Importance of Updating Retirement Account Beneficiaries



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Have you checked your beneficiary designation for your retirement account recently? If not, you may find that your designated beneficiary is not who or what you think it should be, especially if you have divorced, remarried or had children since your retirement plan account was established. Or if you named a charity as your beneficiary a long time ago, the charity may no longer exist.

While many of us ensure that other important documents such as wills are updated on a frequent basis, we tend to neglect our retirement account beneficiary designations. Your retirement accounts are not part of your estate and generally not governed by the provisions of your will, so it is important to keep these retirement documents updated.



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## Problems Caused Outdated Beneficiary Designations

There have been numerous cases of retirement account owners who have been divorced and remarried but have neglected to update their beneficiary designations accordingly. This can be quite frustrating for their survivors, who must battle in court for a legal determination of the true beneficiary. And the court's ultimate decision may not be what the deceased would have wanted. A similar dilemma arises if some children are named as beneficiaries but the document isn't updated to include those who were born after the initial designation. To prevent these situations, you should update your beneficiary designation immediately after you experience a change in family status and review it periodically so they never become outdated or incorrect.

You can also draft customized beneficiary designations to address "what-if" situations. For instance, what if your primary beneficiary predeceases you and you fail to update the designation? What if the organization to which you leave your assets becomes defunct before it inherits the assets? Should you need to, you may revoke your existing beneficiary designation and designate a new beneficiary by submitting a change-of-beneficiary form.

### **Default Beneficiaries**

If you fail to document your beneficiary designation, your beneficiary may be determined by federal or state law or by the plan document that governs your retirement accounts.

For qualified plans such as profit-sharing plans, 401(k)s and money purchase pension plans, federal regulations automatically designate the spouse of the account owner as the beneficiary. No one else may be designated as the primary beneficiary unless the spouse signs a document approving the designation and has it notarized. If the retirement account owner is not married, then his or her estate may be the default beneficiary.

State law determines the treatments of IRAs. Some states, known as community or marital property states, require written spousal consent if the IRA owner designates anyone other than, or in addition to, his or her spouse. The following states require the consent to be notarized: Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. In other states, the default provision of the IRA plan determines the beneficiary if one is not designated by the plan holder.

An IRA plan's documents also default the designation if the designated beneficiary predeceases the IRA owner. The default options vary among IRA custodians and trustees. While the default options alleviate administrative responsibilities from account owners, they may not reflect their preferences. This is why account owners should check the plan document and be sure they update their beneficiary designations frequently.

### **Provisions for Simultaneous Death**

Many spouses, expecting that one will predecease the other, name each other as their designated beneficiaries. The issue of simultaneous death is then addressed by state law, which will determine that one spouse died first, even though both deaths occurred at the same time. This determination is critical, especially if there are children from a previous marriage: Will all the children be included? Or will children from a previous marriage be excluded? Proper documentation designating successor beneficiaries for normal and extenuating circumstances will keep this kind of situation from arising.

### **Consider a Customized Beneficiary Designation**

Most IRA plan documents provide default beneficiary options. For instance, if you name two individuals as your designated beneficiaries and one predeceases you, the share that belonged to the deceased beneficiary automatically goes to the surviving beneficiary. With a customized designation, you can choose how that portion would be distributed instead of having it default to the surviving beneficiary. For example, if one of your beneficiaries has children, you can designate them to receive the primary beneficiary's share if he or she passes before you do (see per stirpes designation below).

When drafting your customized beneficiary designations, you can explore various options to determine the one that meets your needs. The beneficiary designation you choose may determine if your elections are carried over to the next generation. The following are some basic beneficiary designation designs:

## **Per-Stirpes Designation**

In the event your primary beneficiary predeceases you, a per stirpes beneficiary designation provides that the share he or she would have received goes to his or her heirs. For instance, assume you name your two children, Mary and John, as your primary beneficiaries. Mary's share is 80% of the assets while John's share is 20%. Should Mary predecease you, her share would go to her heirs upon your death.

## **Per Capita Designation**

Per capita beneficiary designations also provide that your primary beneficiary's share will go to his or her heirs. However, the allocations are not handled in the same manner as they are under the per stirpes designation. Should your primary beneficiary predecease you, his or her share would be divided equally among your successor heirs. For instance, assume Mary and John from the previous example both predecease you. The assets will be allocated among their children equally, even though the beneficiary designation provides Mary with a larger portion of the assets. If Mary and John had two children each, each child would receive a 25% share.

## **Trust Beneficiaries**

If you feel you need to retain some degree of control over the disposition of the retirement assets after your death, you may consider designating a trust as your beneficiary. There are various trust options to choose from, including qualified terminable interest property (QTIP) and qualified domestic trust (QDOT).

Designating the right type of trust as your beneficiary can allow you to provide financial support for your surviving spouse and children from a previous marriage. To ensure the spouse has enough to last his or her remaining years, the provisions of some trusts restrict the surviving spouse's access to the assets; this can come in handy for beneficiaries who may not be financially responsible. Choosing the wrong type of trust, however, could result in disastrous tax consequences. Trusts are complex and require the expertise of an expert financial planner. Be sure to seek competent professional advice before you make any decisions regarding customized or trust beneficiary designations.

## **Beneficiary Designation Checklist**

- Check the default provisions of the document governing your retirement account, as it may come into effect if your beneficiary predeceases you and you fail to make subsequent changes.
- Look into the tax implications for the kind of beneficiary you choose, such as a spouse or non-spouse, a charity, your estate or a trust.
- Request a confirmation of receipt of the designation from your retirement account trustee, custodian or administrator. Documents do not always reach their intended recipient. Beneficiary designations are considered in effect only if they are received by the responsible party (e.g. trustee, custodian or administrator) before the account owner dies.
- If you prefer to use a customized beneficiary designation, make sure your trustee, custodian or administrator finds it acceptable. Not all financial institutions or qualified plans will accept customized designations.
- Check your beneficiary designations periodically. You may need to make changes if you had a change in your family such as a birth, death, divorce or marriage.
- Consult with your financial planner to determine if your current beneficiary designation is the one best suited for you or if you need to make changes.

Making a proper beneficiary designation is a very important part of your

financial planning. Be sure to seek competent professional advice regarding your beneficiary designations.

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