

# Beneficiary Designation Options

Beneficiary designations on IRAs should be reviewed periodically – not only to ensure the appropriate individual or entity receives the IRA after the owner's death, but also to maximize the estate and income tax benefits available to these accounts.

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The following sections explain some of the planning considerations associated with naming different individuals or entities as the beneficiary of your IRA. The planning concepts discussed below are specific to IRAs. Some of these concepts may not apply to other retirement accounts, such as 401(k)s or those used by self-employed individuals.

## ESTATE

If the IRA owner fails to designate a beneficiary or the beneficiary and contingent beneficiaries designated predecease the IRA owner, the IRA will pass to the IRA owner's estate. As a result, the account must be distributed and taxed to the beneficiaries of the estate within five years of the IRA owner's death. To prevent this situation, it is very important that an IRA owner name both primary and contingent beneficiaries and that those designations be kept current.

## SPOUSE

Naming the IRA owner's spouse as beneficiary allows the spouse to choose the most efficient way of handling the IRA after the owner's death. In most cases, the surviving spouse will elect to treat the IRA as his or her own. This is an option that is only available to a spousal beneficiary and will permit the maximum potential income tax deferral. If this election is made the IRA is treated as if it was always the spouse's, and he or she does not need to take Required Minimum Distributions (RMD) until they reach age 72. The surviving spouse may name designated beneficiaries on the account who may, upon the spouse's death, withdraw the balance of the account over their own life expectancies. If the surviving spouse is under age 59½ and chooses to take a distribution from the IRA, he or she will be assessed a 10% penalty for early distributions from an IRA.

In order to avoid this penalty on early distributions, the surviving spouse could allow the IRA to convert to a Decedent IRA. By doing this, the spouse must take required minimum distributions from the IRA starting in the year after the IRA owner's death. The surviving spouse can also take more than the RMD amount from the IRA and avoid the 10% early withdrawal penalty. For spouses who want the flexibility of being able to access the IRA without a penalty, and don't mind having to take RMDs from the Decedent IRA, this option may be the most appropriate.

## TRUST

An IRA owner may have an estate that is large enough to be subject to the estate tax but have insufficient assets outside the IRA to fund the estate tax exemption. Although designating a spouse as the beneficiary will qualify the assets for the marital deduction, it will not permit the assets to be used to fund the estate tax exemption. Therefore, the IRA owner's bypass trust can be designated as the beneficiary of the IRA. At the IRA owner's death, the value of the IRA will be assigned to the bypass trust. The annual RMD will be paid to the bypass trust from a Decedent IRA. Although the trust is officially the beneficiary of the IRA, the RMD calculation is based on the life expectancy of the oldest beneficiary of the trust, starting in the year following the IRA owner's death.

An IRA owner may also name a Trust as the IRA beneficiary if the IRA owner's spouse is from a second marriage and the IRA owner wants to protect children from a prior marriage. In this case, the trust terms (and not the surviving spouse) will govern the distribution or accumulation of the assets.

Lastly, if a spouse is not expected to survive the IRA owner, naming a trust as the IRA beneficiary may be appropriate.

### **CHARITY**

Individuals planning to leave some assets to charity after their death will find that IRAs can be an ideal charitable gifting tool. If a charity is designated as the beneficiary of the IRA, the benefits will pass to the charity with no income or estate tax assessed against the IRA. Individual beneficiaries, on the other hand, will be subject to income tax on the IRA funds. Lastly, because charities will not benefit from the basis adjustment that can apply to assets in taxable accounts, these types of investments are often best left to individuals.

However, if a Charity is being named as co beneficiary with an individual beneficiary, careful consideration should be given to creating separate IRAs or making sure that the Charity receives their portion prior to September 30th of the year after the IRA owner's death. Failure to distribute the IRA to a Charity prior to September 30th of the year after the IRA owner's death would result in a maximum 5 year payout of the remaining IRA balance to the individual beneficiary.

### **NON SPOUSAL INDIVIDUALS**

Naming individuals, such as children or other family members, has changed since the passing of the SECURE Act. Non-Spouse IRA beneficiaries have now been placed into two categories, Eligible Designated Beneficiaries and Non-Eligible Designated Beneficiaries. The distribution rules for the IRA depend on which category the beneficiary falls into. An Eligible Designated Beneficiary includes any minor children, a disabled individual, chronically ill individual, and any other individual who is not more than 10 years younger than the deceased IRA owner. All other individuals fall into the Non-Eligible Beneficiary category. For Eligible Designated Beneficiaries, RMDs begin in the year after the owner's death and are based on the beneficiary's life expectancy according to the Single Life Table. Non-Eligible Designated Beneficiaries are subject to the 10-Year Rule and must distribute the entire IRA balance by December 31st of the 10th year following the IRA owner's death.

### **PER CAPITA OR PER STIRPES**

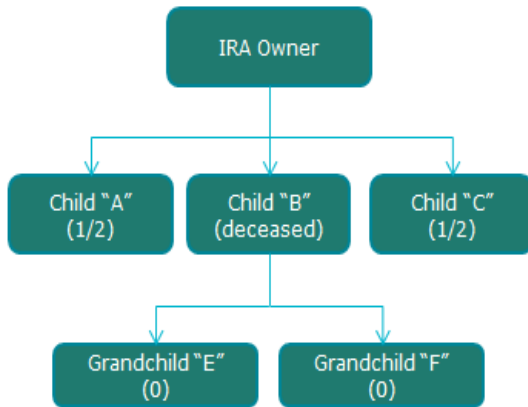
If an individual beneficiary, spouse or non spouse, is being named, then consideration should be given to replacement beneficiaries in the event the individual beneficiary predeceases the IRA owner. It is extremely important to understand how the IRA will be distributed to the remaining beneficiaries and children of a deceased beneficiary under Per Capita and Per Stirpes.

A per capita distribution after death means the IRA is divided amongst the surviving primary beneficiaries. An example of per capita: Jim names his three adult children as primary beneficiaries. A few years later Jim and one of his children, Jane, die in a car accident. Because this is per capita, the share belonging to Jane is divided amongst the two remaining primary beneficiaries.

Compare this to per stirpes, which will allow lineal descendants of a deceased beneficiary to receive that beneficiary's share. If Jim would have chosen per stirpes, Jane's share would go to her children, and not be divided amongst the other two primary beneficiaries.

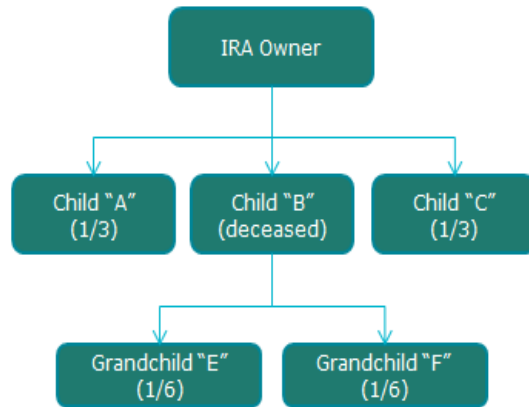
The default for Baird's IRA document is per capita distributions, but you have the option to elect per stirpes by checking the box under the designation of beneficiaries heading on the Baird Traditional IRA or Roth IRA simplifier. Here is a summary of Per Capita vs. Per Stirpes: *(See the illustration on page 3.)*

### Standard Per Capita



Child "B" predeceased the IRA Owner. The IRA Owner has disinherited the issue of Child "B", Grandchild "E" and Grandchild "F".

### Per Stirpes



Child "B" predeceased the IRA Owner. The issue of Child "B", Grandchild "E" and Grandchild "F", equally share the portion designated for Child "B".