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Investors Managers Advisors

MID-QUARTER NEWSLETTER
FROM THE TEAM AT WEIL

JUNE 15, 2021 **SECOND QUARTER 2021**

THE NAMING GAME

Robert Gaan, CFP®

I recently received a phone call from a long-time client. She told me she had a check for $350,000 that she wanted to deposit into her WEIL-managed account for investment. I am always happy to hear a client tell me they want to add money to their account. But I was curious about where this windfall came from and asked her the source of the funds. She replied that her sister had passed away and had an IRA account at an online brokerage firm. The sister did not have a financial advisor and apparently forgot to name a beneficiary when she opened her IRA account. Since she did not have a named beneficiary on her IRA account, the IRA custodian simply issued a check for the full account balance made payable to the deceased sister's estate.

I then told our client something that would make the hair on Chris Weil's head stand on end. I told her, "Do not send us that check!" That payment was a taxable distribution from a retirement account. The full amount would have to be reported as income on her sister's final estate tax return. By my estimate the tax due would be upwards of $150,000.

Our Client Services Team was able to reach out to the online broker and arrange for the closed IRA account to be reopened and the taxable distribution reversed. We then worked with the client's estate attorney to petition the probate court to name our client as the designated beneficiary of the IRA. Armed with the court order, we were able to work with the online broker's legal department to establish a Beneficiary IRA account for our client. The $350,000 in the original IRA account was transferred to the new Beneficiary IRA account in a non-taxable transaction. Now, our client has 10 years over which to distribute funds from the account and either defer or spread out the tax liability.

Many clients are surprised to learn that their will or living trust does not govern the distribution of their retirement accounts. This is why we review our clients beneficiary information for the accounts on our platform on an annual basis. This is as important as making sure the heirs in your trust are current.

Here are some tips for naming beneficiaries for your retirement accounts:

1. For most married couples, naming your spouse as the primary beneficiary of your retirement accounts generally makes the most sense. If you name your spouse as beneficiary, he or she can request a spousal rollover of your retirement account upon your passing. This allows your surviving spouse to use his/her

own age to determine any required minimum distributions from the retirement account. If you have adult children, you can also name them as contingent beneficiaries should your spouse predecease you.

2. If you are married with minor children, you can name your family trust as the contingent beneficiary after your spouse. If you name minor children by name, a conservatorship will have to be established by the court for your child to open a beneficiary IRA account. If you nominate your trust, the successor trustee will have the authority to open a beneficiary IRA on behalf of the trust.

   Nominating a family trust as the beneficiary of a retirement plan if you have minor children makes sense because it is likely the trust will remain in place on behalf of the minor until the child reaches the age of majority or beyond. However, we always recommend that clients nominate adult children, non-spouse family or friends by name as retirement plan beneficiaries. The issue is one of logistics. If you name your trust as beneficiary, the trust will have to remain open for as long as the IRA is open, requiring the successor trustee to remain engaged (and possibly also extending the need to file annual tax returns on behalf of the trust). Unless the trust is needed to protect the interests of the end beneficiary, it seems more practical to simply name the beneficiary outright and eliminate the trust as middleman.

3. If you nominate a non-spouse beneficiary, they have ten years to withdraw funds from their inherited retirement plan accounts (which triggers taxable income). You can take a little bit each year or defer the entire amount until the tenth year. Non-spouse beneficiaries can no longer "stretch out" distributions from their inherited IRA accounts over their life expectancy.

4. Do you plan to leave a portion of your estate to charity upon your passing? Your heirs could be better off if you used your retirement accounts as the source of any charitable gifts. Distributions from traditional retirement accounts (not Roth) are generally taxable to the recipient. Family or friends who inherit your retirement plan account will pay taxes on any withdrawals. However, charities are tax-exempt organizations. They can withdraw from a retirement account and pay no tax. Using your retirement plans to fund charitable estate gifts will leave more after-tax assets for your heirs. We have helped many of our clients prepare a custom beneficiary election form for their IRA accounts that names a charity or two for specific dollar amounts with the balance of the account being divided between family and friends on a percentage basis.

Retirement plan trustees and custodians are required to distribute retirement plan proceeds according to the instructions listed on the decedent's beneficiary election form. That is why it is so important to periodically review your retirement plan beneficiary elections to ensure that your final intentions are honored and your estate can pass to your heirs in the most tax-efficient manner.

SIDE NOTE: GIFTING STRATEGIES FOR GRANDPARENTS

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The Free Application for Federal Student Aid (FAFSA) will be simplified effective October 1, 2021 for the 2023-2024 academic year. The Department of Education plans to remove a number of qualifying questions from the application, including the question relating to cash gifts from grandparents. Under the current rules, students must report gifts from grandparents as untaxed student income. This could reduce the student's aid eligibility by as much as 50% of the amount of cash support. With the new form, the amount of a student's "total income," which includes untaxed income, will come directly from federal income tax returns via the IRS Data Retrieval Tool (DRT). So, a student's total income amount will include only amounts shown on the federal income tax return.

The streamlining of the FAFSA makes grandparent-owned 529 College Savings Plan accounts an interesting option. Distributions from these grandparent-owned accounts will no longer need to be reported on the student's FAFSA. Also, the accounts offer income tax-free distributions if the funds are used for qualified education expenses.

529 Plan accounts also have liberal rollover rules between relatives, and unused assets in accounts may be passed down to future generations in perpetuity. Grandparents looking to reduce the size of their estate for estate tax purposes have considered overfunding 529 Plan accounts for grandchildren with the goal of creating multi-generational, tax free education expense pools for their family. If this is something you would like to explore, please reach out to us.

Reference:
https://www.savingforcollege.com/article/new-fafsa-removes-roadblocks-for-grandparent-529-plans