Estate planning

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Choosing beneficiaries for your traditional IRA

The beneficiaries you choose for your IRA can have a significant impact on the overall income tax consequences for your family. Retirement planning that includes the selection of beneficiaries can help you meet your financial needs as well as contribute to the financial well-being of your heirs.

By the numbers

- IRA distributions made to you — or your surviving spouse — before age **59½** may be subject to penalties.*
- IRA assets must start to be distributed by April 1 of the calendar year following the year in which the account owner reaches age **70½**.*
- Meet with your investment professional at least **two** times a year to make sure your IRA investments, beneficiaries, and overall financial plan are set up to meet your needs.

*Source: Publication 590, irs.gov

Shifting assets with care

Most people have the majority of their retirement savings in tax-deferred workplace plans, such as 401(k)s and 403(b)s. At retirement or after changing jobs, the investment vehicle most often chosen for transferring or consolidating these assets is an Individual Retirement Account, or IRA. You can roll a 401(k) plan tax free directly into a traditional IRA and continue growing retirement savings tax deferred until you start taking distributions.

During your lifetime, the funds you withdraw from a traditional IRA generally are taxable as ordinary income and may be taken without penalty after age 59½. Traditional IRAs are also subject to required minimum distribution (RMD) rules established by the Internal Revenue Service. Under these rules, IRA assets must start to be withdrawn by April 1 of the calendar year after the year the IRA account owner turns 70½. Annual distribution minimums are calculated according to an individual's life expectancy. If you do not take the RMD in any calendar year after age 70½, a 50% tax penalty may be assessed on the difference between the amount that should have been withdrawn and the amount that actually was.

Surviving spouse as beneficiary

Federal law states that a spouse is the automatic beneficiary of your 401(k) or other pension plan, unless your spouse signs a waiver authorizing you to choose a different beneficiary. If your spouse is the beneficiary of your workplace plan, and you die before reaching retirement age or before you've transferred your retirement assets to an IRA, he or she will be able to roll the assets tax free into a traditional IRA in his or her own name.

In contrast to an employer plan, your spouse is not the automatic beneficiary of your IRA — he or she must be explicitly

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Key points

- What your beneficiaries do with your IRA assets can be as important as what you do with the assets. You may want to include them in your planning.
- All traditional IRAs are subject to required minimum distribution (RMD) rules. It is important to understand these rules.
- A legal and tax adviser can help you designate beneficiaries for an IRA so that your decision fits with your own financial and estate plan.

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designated. If you have established a rollover IRA, named your spouse as sole beneficiary, and you die before withdrawing the entire balance, your spouse can

1) roll over the assets tax free into his or her own IRA and continue to make contributions to the IRA, if eligible, until distributions are required at age 70½. Required minimum distributions will be based on the the new IRA owner's life expectancy from the Uniform Distribution Table*. If your spouse is already 70½ when you die, distributions must start in the year after your year of death.

Or:

2) rename the IRA as a beneficiary distribution account, commonly known as a Beneficiary IRA or Inherited IRA. With a Beneficiary IRA, your spouse will be required to take minimum distributions calculated over his or her own single life expectancy beginning on or before the later of

- December 31 of the calendar year immediately following the calendar year in which the IRA owner died; or
- December 31 of the calendar year in which the IRA owner would have turned 70½.

If your spouse needs income right away, distributions may be taken from either his or her own IRA or a Beneficiary IRA. However, if he or she is younger than 59½, distributions from his or her IRA may be subject to penalty taxes for early withdrawal. In this case, your spouse may want to consider renaming the IRA as a Beneficiary IRA, as those distributions will be exempt from penalty taxes.

Multiple beneficiaries and segregated accounts

You may wish to name more than one beneficiary for your IRA. Generally, if you name more than one beneficiary, the life expectancy of the oldest beneficiary will be used for determining the distribution period. However, the account may be split up into separate accounts for each of the beneficiaries. Then each beneficiary would be able to take distributions based on his or her own life expectancy from his or her own portion of the IRA.

Spouse as primary beneficiary and family trust as secondary beneficiary

Under this type of designation, your surviving spouse can keep part or all of the IRA if he or she needs it, or disclaim part or all of the IRA in order to fund the family trust.

In turn, the family trust can name all the children as beneficiaries and calculate the required minimum distributions based on the life expectancy of the oldest beneficiary.

Conclusion

Determining the beneficiaries for your retirement assets is a crucial part of any estate plan. Check with your legal and tax advisers about the beneficiary options that are right for your estate planning needs.

* Distributions based on the Uniform Distribution Table are based on the joint life expectancy of the IRA owner and a hypothetical beneficiary exactly 10 years younger.

Resources

Chopp, Joseph M., *Beneficiary Basics: What You Don't Know Now May Hurt Someone You Love Later* (Authorhouse, 2002)

Gallea, Anthony M., *The Lump Sum Advisor* (Prentice Hall, 1999)

Rottenberg, Dan., *The Inheritor's Handbook: A Definitive Guide for Beneficiaries* (Fireside, 2000)

Slesnick, Twila and Suttle, John C., *IRAs, 401(k)s, and other Retirement Plans: Taking Your Money Out* (Nolo Press, 6th edition, 2004)

For more information about estate planning, contact your investment professional or visit **mfs.com**.

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