
"Beneficiaries Important To Name"

by Mary Fricker, Staff Writer © 2004- The Press Democrat, July 19, 2004

HARRY RUBINS, financial consultant with Foothill Securities and owner of Rubins Financial Strategies in Santa Rosa for 18 years, discusses the importance of naming the correct 401(k) beneficiaries and of making timely changes when needed.

PRESS DEMOCRAT: Here at the end of the second quarter, when many companies offer their employees an opportunity to sign up for the company's 401(k) plan, why is it important to remind people to name beneficiaries?

RUBINS: Because beneficiaries are the estate plan for tax-deferred retirement accounts like the 401(k). Unfortunately, mistakes are easy to make that can mess up a person's estate plan for their heirs in terms of probate expenses, confusion, controversy and income taxes.

PRESS DEMOCRAT: Why have you said that people have two estate plans?

RUBINS: One estate plan is the beneficiary that is listed on each tax-deferred retirement plan. The second estate plan includes wills and trusts that control who will inherit assets outside of the retirement account. Even if your sister is identified to receive your house, bank accounts and all other assets in your will or living trust, she won't get the 401(k) or IRA unless she is listed correctly as the beneficiary on each account. It is important that these two different estate plans be coordinated so that your wishes are carried out as you had intended.

PRESS DEMOCRAT: What is the most common estate-planning mistake people make involving their 401(k) plan?

RUBINS: There are many mistakes, because beneficiary planning involves many complex issues. I would say that the biggest mistake is making quick and uninformed decisions without professional help when completing the beneficiary designation form. Mistakes can be very "taxing" and may create long-lasting problems and unanswered questions for heirs.

PRESS DEMOCRAT: How often should people update their 401(k) beneficiary?

RUBINS: Always when their life changes -- for example, marriage, divorce, separation, kids, more kids, grandkids, death of beneficiary, change of mind. They should review at least every few years, to check that they haven't overlooked something. And they shouldn't forget their other retirement accounts, such as 403(b), IRA, SEP-IRA, and Roth-IRA.

PRESS DEMOCRAT: What's a contingent beneficiary and why do people need one?

RUBINS: A contingent beneficiary is in line to become primary beneficiary in the event the primary beneficiary dies. If you have no contingent beneficiary and the primary beneficiary dies, your retirement account may end up going to the wrong person based on the 401(k) plan document or probate code. There can also be delays, confusion and legal expenses, and income taxes may come due immediately without the benefit of being able to stretch them out over the beneficiary's life expectancy.

PRESS DEMOCRAT: When beneficiaries inherit the 401(k) account, they also inherit the income taxes that the decedent deferred. How can income taxes be postponed?

RUBINS: The spouse beneficiary is the most advantageous, as he or she can roll over the 401(k) account to an IRA and keep the account tax deferred until age 70 1/2, when required minimum distributions must begin. Non-spouse beneficiaries must keep the account in the 401(k) plan, as they cannot roll over to an IRA, but they can arrange to withdraw the money over their life expectancies and stretch out the income taxes over time. The big question here is whether the 401(k) plan will allow distributions to be stretched out, or does it require that the account be paid out in a lump sum and therefore is fully taxable to the heir. This is a problem for single parents with children or anyone not married.

PRESS DEMOCRAT: What do heirs need to know about the 401(k) they may inherit?

RUBINS: Decisions need to be made on a timely basis to avoid problems, penalties and loss of tax deferral. Heirs need to contact the company, find out what the plan allows, name new beneficiaries and begin working with their professional advisers. I recommend that people have a discussion with their beneficiaries -- or custodians who may manage the account for their young children -- as to why they made these decisions and what's important, and I recommend that they suggest that their beneficiaries obtain professional help to assist them at that time.

PRESS DEMOCRAT: What beneficiary problems are created by divorce?

RUBINS: There is a federal regulation that the primary beneficiary for 401(k) plans is the current spouse, regardless of what is written on the beneficiary form. This is a benefit to nonworking spouses, so they cannot be disinherited without their written approval. Unfortunately this can be a problem for someone going through a divorce, being separated or someone happily getting married for the second time. Until the divorce is finalized, the future ex-spouse is the primary beneficiary and can only be removed if that individual signs a Consent of Spouse Waiver form. People may need help from their attorney on this one.

PRESS DEMOCRAT: 401(k) plans generally provide education on savings and investments. Why is there so little information on the importance of the beneficiary?

RUBINS: I think the answer is that so much attention is focused on investment offerings and investment education. These are areas mandated by law and regulations. Beneficiary education is not mandated. From my experience advising clients and teaching classes, including brown-bag lunches at companies with 401(k) plans, this kind of education is needed.

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