

# IRA Beneficiary Planning

Who should be the beneficiary of your IRA? The simple answer to this question is the person or entity to whom you wish to give your money. However, it is important to look beyond the simple answer to determine the best way to ensure that your assets are distributed according to your wishes.

## FOUR REASONS WHY IT IS IMPORTANT TO NAME

### A BENEFICIARY ON YOUR IRA

- 1) Your beneficiary designation determines how your IRA assets will be distributed when you pass away.
- 2) Naming a beneficiary will help mitigate the risks of leaving your assets to unintended individuals or entities.
- 3) Your beneficiary designation may impact the distribution options available to your heirs.
- 4) Failing to name a beneficiary may result in unnecessary probate expenses and/or delays.

If you do not name a beneficiary for your IRA assets, your IRA Custodian, through an IRA agreement, will provide for a “default” beneficiary. This “default” beneficiary may not be your intended beneficiary, may expose your heirs to an unnecessary large tax bill and may cost them years of tax-deferred growth.

The default beneficiary on your RBC Wealth Management® IRA is your spouse. If you do not have a spouse, the default beneficiary would be your estate.

You can, and usually should, name both primary and contingent beneficiaries for your IRA. If you name multiple primary or contingent beneficiaries you should indicate how much of your IRA each beneficiary should receive. As account owner you may change your beneficiaries as often as you like. Keep in mind: You can make different beneficiary designations on each of your retirement accounts.

## TYPES OF BENEFICIARIES

A primary beneficiary will be the first in line to receive your IRA assets. Contingent beneficiaries are also important because they will receive your assets if none of your primary beneficiaries survive you, or they disclaim the assets.

A beneficiary can disclaim all or a portion of his or her inherited IRA benefit. By disclaiming, the beneficiary is giving up rights to the assets, which then pass to the other beneficiaries. A valid disclaimer must meet specific requirements and generally must be executed within nine months of an account owner’s death.

## DESIGNATED BENEFICIARIES

Beneficiary designations, for distribution purposes, do not become fixed until September 30th of the year following the year of an account owner’s death. Obviously no new beneficiaries can be named after the death of an account owner. But, beneficiaries who disclaim, or have had their benefits paid out to them in full prior to this date, will not be considered when determining death distribution options.

## SPOUSE BENEFICIARY

Most married account owners name their spouse as beneficiary of their IRA. When a spouse is the sole primary beneficiary of an IRA, he or she can choose to take ownership of the IRA by transferring it into an IRA in his or her own name. This gives a spouse the right to name his or her own beneficiaries, delay distributions until age 70½ and potentially make additional contributions to the IRA. However, the IRA will be subject to all traditional IRA rules including the additional 10% penalty for distributions taken prior to attaining age 59½.



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## *IRA Beneficiary Planning, continued*

A spouse beneficiary also has the right to leave inherited IRA assets in a “decendent” status, and will not be required to begin taking required minimum distributions until the original owner would have reached age 70½. If a surviving spouse is under age 59½ at the time of inheritance this could be an attractive option.

### **NON-SPOUSE BENEFICIARIES**

If non-spouse individuals are named as beneficiaries each will be required to take distributions over his or her single life expectancy. A separate account for each beneficiary will need to be established and distributions must begin by December 31st of the year following the year of death. “Stretching” distributions over a beneficiary’s life expectancy keeps the assets growing tax-deferred and can result in significant accumulation over a beneficiary’s lifetime. A beneficiary has the right to take more than the minimum in any given year, including the right to take a complete distribution. All distributions are taxed at a beneficiary’s ordinary income tax rate and are not subject to a 10% pre-mature distribution penalty, regardless of a beneficiary’s age.

Upon inheriting an IRA, a beneficiary can name subsequent beneficiaries. If a beneficiary dies before the assets are fully distributed, the subsequent beneficiary may take a lump sum distribution of the IRA assets or can also maximize tax-deferral and growth by continuing to take distributions over the remaining life expectancy of the original beneficiary.

### **ADDITIONAL BENEFICIARY ELECTION**

When designating non-spouse beneficiaries, there are options available to you regarding the methods of distributing retirement assets should one of the beneficiaries pre-decease you. We will review two options you have.

- Your IRA assets are divided among the surviving beneficiaries only, with no representation by the descendants of the deceased beneficiary.
- Per stirpes designation. Per stirpes means “by the branch in equal shares.” If a beneficiary predeceases an account owner, that beneficiary’s share goes to his or her lineal descendants. The descendants do not need to be individually named on the beneficiary form. This can be an advantage if the beneficiaries are young and are still having children. The beneficiary forms would not need to be updated each time a child is born.

### **The following scenarios will help illustrate how each is applied:**

John has an IRA with three beneficiaries: Mary, Bill and Suzanne. Each of John’s beneficiaries is to inherit equally. Mary, Bill and Suzanne each have two children. One of John’s beneficiaries, Mary, predeceases him. How does the beneficiary designation affect the children’s inheritance?

- In the standard designation, Mary’s share will go to the remaining named primary beneficiaries. Her two siblings, Bill and Suzanne, will each inherit half of John’s IRA.
- If John’s IRA passes per stirpes, Mary’s one-third share will go to her children equally (1/6 each) and her two siblings each get their one-third. Mary’s share of the IRA stays with her family.

To provide you with greater flexibility in your estate planning, the RBC Wealth Management® IRA agreements allow you to choose between a standard designation (this is the default under our agreements) and a per stirpes designation when naming non-spouse beneficiaries.

## *IRA Beneficiary Planning, continued*

### **ESTATES, ORGANIZATIONS AND TRUSTS AS BENEFICIARIES**

Entities may be entitled to IRA proceeds as beneficiaries, but they cannot be considered “Designated Beneficiaries” because they are not people and therefore, do not have a life expectancy. If one of these entities is listed as the IRA beneficiary and an account owner dies before he or she was required to begin taking minimum distributions from an IRA (April 1st of the year following the year an account owner turns 70½) the IRA must be distributed within five years. If death occurs after an account owner was required to begin taking minimum distributions, the IRA must be distributed to the beneficiaries over the account owner’s remaining single life expectancy.

#### **ESTATE**

Leaving your IRA to your estate has the additional disadvantage of subjecting the IRA assets to probate. Probate can be expensive, time consuming and leave your assets inaccessible for a period of time. Also, it is a matter of public record. Even if your spouse or children are the heirs of your estate, they will not have the same distribution options available to them as they would if they had been the named beneficiary(ies) of your IRA. Being forced to withdraw the money at a faster rate could severely penalize a beneficiary who would have kept the assets growing tax-deferred in an IRA.

#### **ORGANIZATION**

Naming a charity as beneficiary will remove the IRA assets from your taxable estate for estate tax purposes. Also, neither your estate nor heirs will be subject to income taxes on the amount the charity receives.

If a charity or an estate is a beneficiary of only a portion of an IRA, the other beneficiary(ies) of the

IRA may be the “Designated Beneficiary” if, by September 30th of the year following the year of the IRA owner’s death:

- The charity or estate “cashes out” its share of the IRA; or
- The IRA is divided into separate accounts for each beneficiary.

#### **TRUST**

A trust as beneficiary can be a useful estate-planning tool if properly structured. A trust, as beneficiary, can provide control over how IRA assets are managed and distributed after an account owner’s death.

Even though a trust is a non-living entity, a special rule may be applied to trusts. Under this rule, the oldest person who is a trust beneficiary will be treated as the “Designated Beneficiary” if the following requirements are met:

- The trust is valid under state law and is irrevocable or will, by its terms, become irrevocable upon the death of the IRA owner;
- The trust beneficiaries must be individuals clearly identifiable (from the trust document) as “Designated Beneficiaries” as of September 30th following the year of the IRA owner’s death;
- The IRA Custodian is provided with a list of beneficiaries (including contingent and remainder beneficiaries) along with a certification that the list is accurate and the trust is a valid “look through” trust by meeting the above requirements, by October 31st of the year following the year of the IRA owner’s death; and
- A copy of the trust instrument is provided to the IRA custodian upon demand.

## *IRA Beneficiary Planning, continued*

### **CONCLUSION**

Your beneficiary designation can make a significant difference in your IRA's effectiveness over the long run. It is important to periodically review your beneficiary designations to ensure that they meet your wealth planning objectives. Your RBC Wealth Management® Financial Advisor will work with you and your independent tax/legal advisor to maximize the benefits of your IRA for you and your beneficiaries.

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