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May 2016

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CHOOSING A BENEFICIARY FOR YOUR IRA OR 401(k) [1]

Selecting beneficiaries for retirement benefits is different from choosing beneficiaries for other assets such as life insurance. With retirement benefits, you need to know the impact of income tax and estate tax laws when selecting your beneficiaries. Although taxes shouldn't be the sole determining factor in naming your beneficiaries, the impact of taxes should not be ignored when making your choice.

In addition, if you're married, beneficiary designations may affect the size of minimum required distributions to you from your IRAs and retirement plans while you're alive

Paying income tax on most retirement distributions
Most inherited assets such as bank accounts, stocks, and real estate can pass to your beneficiaries without income tax being due. However, that's not usually the case with 401(k) plans and IRAs.

Beneficiaries pay ordinary income tax on distributions from pretax 401(k) accounts and traditional IRAs. With Roth IRAs and Roth 401(k) accounts, however, your beneficiaries can receive the benefits free from income tax if all of the tax requirements are met. That means you need to consider the impact of income taxes when designating beneficiaries for your 401(k) and IRA assets.

For example, if one of your children inherits $100,000 cash from you and another child receives your pretax 401(k) account worth $100,000, they aren't receiving the same amount. The reason is that all distributions from the 401(k) plan will be subject to income tax at ordinary income tax rates, while the cash isn't subject to income tax when it passes to your child upon your death.

Similarly, if one of your children inherits your taxable traditional IRA and another child receives your income-tax-free Roth IRA, the bottom line is different for each of them.

Naming or changing beneficiaries
When you open up an IRA or begin participating in a 401(k), you are given a form to complete in order to name your beneficiaries. Changes are made in the same way--you complete a new beneficiary designation form. A will or trust does not override your beneficiary designation form. However, spouses may have special rights under federal or state law.

It's a good idea to review your beneficiary designation form at least every two to three years. Also, be sure to update your form to reflect changes in financial circumstances. Beneficiary designations are important estate planning documents. Seek legal advice as needed.

Designating primary and secondary beneficiaries
When it comes to beneficiary designation forms, you want to avoid gaps. If you don't have a named beneficiary who survives you, your estate may end up as the beneficiary, which is not always the best result.

Your primary beneficiary is your first choice to receive retirement benefits. You can name more than one person or entity as your primary beneficiary. If your primary beneficiary doesn't survive you or decides to decline the benefits (the tax term for this is a disclaimer), then your secondary (or "contingent") beneficiaries receive the benefits.

Having multiple beneficiaries
You can name more than one beneficiary to share in the proceeds. You just need to specify the percentage each beneficiary will receive (the shares do not have to be equal). You should also state who will receive the proceeds should a beneficiary not survive you.

In some cases, you'll want to designate a different beneficiary for each account or have one account divided into subaccounts (with a beneficiary for each subaccount). You'd do this to allow each beneficiary to use his or her own life expectancy in calculating required distributions after your death. This, in turn, can permit greater tax deferral (delay) and flexibility for your beneficiaries in paying income tax on distributions.

Avoiding gaps or naming your estate as a beneficiary
There are two ways your retirement benefits could end up in your probate estate. Probate is the court process by which assets are transferred from someone who has died to the heirs or beneficiaries entitled to those assets.

First, you might name your estate as the beneficiary. Second, if no named beneficiary survives you, your probate estate may end up as the beneficiary by default. If your probate estate is your beneficiary, several problems can arise.

If your estate receives your retirement benefits, the opportunity to maximize tax deferral by spreading out distributions may be lost. In addition, probate can mean paying attorney's and executor's fees and delaying the distribution of benefits.

Naming your spouse as a beneficiary
When it comes to taxes, your spouse is usually the best choice for a primary beneficiary.

A spousal beneficiary has the greatest flexibility for delaying distributions that are subject to income tax. In addition to rolling over your 401(k) or IRA to his or her IRA or plan, a surviving spouse can generally decide to treat your IRA as his or her own IRA. This can provide more tax and planning options.

If your spouse is more than 10 years younger than you, then naming your spouse can also reduce the size of any required taxable distributions to you from retirement assets while you're alive. This can allow more assets to stay in the retirement account longer and delay the payment of income tax on distributions.

Although naming a surviving spouse can produce the best income tax result, that isn't necessarily the case with death taxes. At your death, your spouse can inherit an unlimited amount of assets and defer federal death tax until both of you are deceased (note: special tax rules and requirements apply for a surviving spouse who is not a U.S. citizen). If your spouse's taxable estate for federal tax purposes at his or her death exceeds the applicable exclusion amount, then federal death tax may be due. One possible downside to naming your spouse as the primary beneficiary is that it may increase the size of your spouse's estate for death tax purposes, which in turn may result in death tax or increased death tax when your spouse dies.

Naming a charity as a beneficiary
In general, naming a charity as the primary beneficiary will not affect required distributions to you during your lifetime. However, after your death, having a charity named with other beneficiaries on the same asset could affect the tax-deferral possibilities of the noncharitable beneficiaries, depending on how soon after your death the charity receives its share of the benefits.

WHAT DOES THE TERM "QUALIFIED PLAN" MEAN? [2]

A qualified plan is an employer-sponsored retirement plan that qualifies for special tax treatment under Section 401(a) of the Internal Revenue Code.

There are many different types of qualified plans, but they all fall into two categories. A defined benefit plan (e.g., a traditional pension plan) is generally funded solely by employer contributions and provides you with a specified level of retirement benefits. A defined contribution plan (e.g., a profit-sharing or 401(k) plan) is funded by employer and/or employee contributions. The benefits you receive from the plan depend on investment performance.

The annual contribution limits and other rules vary among specific types of plans. However, most qualified plans share certain key features, including:

- **Pretax contributions:** Employer contributions to a qualified plan are generally able to be made on a pretax basis. That is, you don't pay income tax on amounts contributed by your employer until you withdraw money from the plan. Your contributions to a 401(k) plan may also be made on a pretax basis.
- **Tax-deferred growth:** Investment earnings (e.g., dividends and interest) on all contributions are tax deferred. Again, you don't pay income tax on those earnings until you withdraw money from the plan.
- **Vesting:** If the plan provides for employer contributions, those amounts (and related investment earnings) must vest before you're entitled to them. Check with your employer to find out when this happens.
- **Creditor protection:** In most cases, your creditors cannot reach your qualified retirement plan funds to satisfy your debts.
- **Roth contributions:** Your employer may also allow you to make after-tax Roth contributions to the 401(k) plan. While there's no up-front tax benefit, qualified distributions are totally free from federal income taxes.

If you have access to a qualified retirement plan, strongly consider taking advantage of it. Over time, these plans can provide you with substantial retirement savings.

CONSERVING WHAT YOU HAVE SAVED [3]

Most of our adult life, we have focused on accumulating wealth for retirement. To do that, we often invest in riskier investments with the hope of growing our nest egg more. As you get closer to retirement, the preservation of your nest egg can become more important than the growth of it.

Our firm uses a simple tool called the Rule of 100 to help you decide how much of your money should be exposed to risk and how much of your money should be in more conservative assets.

Call us at **(651) 209-1907** to request your Rule of 100 Report, which can help you figure out what risk level you should have with your assets.

FAST FACTS TO CELEBRATE INTERNATIONAL MUSEUM DAY ON MAY 18 [4]

- The Musee du Louvre in Paris is 60,000 square feet.
- The Vasa Museum in Stockholm is home to the best-preserved shipwreck in the world.
- The National Gallery started with only 38 paintings. It now has 2,300 works.
- The National WWII Museum has a collection of more than 100,000 items, many of which were donated by War Veterans.
- The Metropolitan Museum of Art is the largest art museum in the US.
- The Smithsonian National Air and Space Museum in Washington has a rock from the moon – that you can touch!
- The National Gallery of Art owns the only painting by Leonardo da Vinci in the Western Hemisphere.
- The Art Institute of Chicago has 300,000 works of art in its permanent collection – including the famous “American Gothic” painting.

RECIPE OF THE MONTH:

CHOCOLATE CHIP MUFFINS [5]

These simple chocolate chip muffins are a great way to celebrate National Chocolate Chip Day on May 15!

Ingredients

- 2 cups all-purpose flour
- 1/2 cup sugar
- 1 tablespoon baking powder
- 1/2 teaspoon salt
- 1 egg
- 3/4 cup milk
- 1/3 cup vegetable oil
- 3/4 cup miniature semisweet chocolate chips

Directions

In a large bowl, combine the first four ingredients. In a small bowl, beat egg, milk and oil. Stir into dry ingredients just until moistened. Fold in chocolate chips.

Fill greased or paper-lined muffin cups three-fourths full. Bake at 400° for 18-20 minutes or until a toothpick comes out clean. Cool for 5 minutes before removing to a wire rack.

Yield: 1 dozen.

[1] [2] *Broadridge Investor Communication Solutions, Inc. Copyright 2015.*
[3] *http://www.businessinsider.com/top-25-museums-in-the-world-2014-10#no-25-the-gold-museum-in-bogota-colombia-has-the-largest-collection-of-pre-hispanic-gold-1*
[4] *http://www.tasteofhome.com/recipes/chocolate-chip-muffins*

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