ADVICE

Name your beneficiaries; it can save taxes

Choosing beneficiaries for your retirement accounts is one of the most important things you can do for your family's financial future. By simply listing your spouse, your children or other family members, you have the opportunity to stretch that account to benefit future generations.

Financial Research Corporation estimates that IRA rollover assets will reach $5 trillion by 2010. That's a lot of untaxed money. Without naming beneficiaries properly, the potential tax implications can be huge.

Here's an example of a situation that could have been avoided. I recently had an individual, we'll call her Mary, contact me regarding her parent's $500,000 IRA. When Mary's father died, the IRA was rolled into a new IRA for her mother who was the beneficiary.

Unfortunately, when her mother's new IRA was opened, the advisor failed to list a beneficiary on the account, and her estate became the beneficiary by default. So, when Mary's mother died this year, the entire $500,000 became taxable income of the estate. At the 35% tax bracket, this amounts to a $175,000 tax bill.

PETER KRULL

This situation should never have happened. When Mary's mother's IRA was opened, there should have been beneficiaries listed. In the rush and confusion of dealing with death, however, details can be overlooked. So, don't assume that everything is in order. Take the time to check and make sure that your beneficiary information is correct.

What would have happened if her mother had listed Mary as the beneficiary? Well, Mary could have "stretched" the IRA out over her own lifetime. This Stretch IRA would accomplish a couple of things:

1. Maintained the tax-deferred status of the account
2. Provided lifetime income for Mary
3. Potentially provided income for Mary's children if Mary dies prematurely.

The basic rules are simple, although you should consult with your tax and financial advisor before implementing a stretch IRA strategy.

First, you should always have both a beneficiary and a contingent beneficiary. I cannot stress this enough. The contingent beneficiary is important, especially for when the beneficiary predeceases the account owner. This puts a plan is in place to maintain the tax-deferred status and potentially stretch the account.

Second, the beneficiary must make minimum required distributions based on his or her life expectancy. Let's say that Mary is 50 years old, so her life expectancy (according to the social security administration) is another 31.6 years. She would have been able to take distributions from the $500,000 account of almost $16,000 per year. The $16,000 would have been taxable, but probably not at the 35% level.

Finally, if Mary dies prematurely, the contingent beneficiary can continue to collect the same amount based on Mary's life expectancy. This little detail of listing a contingent beneficiary helps to prolong the tax-deferred status of the account, and benefit another generation.

My advice to you is to take a few moments and insure that your beneficiaries are listed correctly on your retirement accounts. If you have multiple accounts with multiple providers, each one requires separate beneficiary listings. Call your advisor and discuss your options. Your beneficiaries will be glad you did.

(Peter Krull is President of Krull & Company, a financial services firm. He is a registered principal with and offering securities and financial planning through Linsco/Private Ledger, member NASD/SIPC. He can be reached at 912-289-4212 or pkrull@krullandcompany.com)

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