Common beneficiary mistakes that can wreck your estate plan

Most people know they should name beneficiaries on certain accounts like their retirement accounts and life insurance policies. But what many don't realize is that these designations override what's written in a Will or Trust. Whoever is listed as the beneficiary on the account generally gets the money, regardless of what your estate plan says. That's why it's important to review your designations regularly and ensure they align with your overall plan.

In this document, we'll provide a brief overview of some common mistakes to avoid.

Forgetting to update beneficiaries

Life happens—marriages, divorces, births, and deaths—but people don't always update their beneficiaries accordingly. One major mistake is forgetting to remove your ex-spouse as a beneficiary after a divorce. If you pass away, they could still receive the payout, even if your Will says otherwise. Likewise, if you list your first child but don't update your designations after having more children, they could be unintentionally left out.

Naming a minor as a beneficiary

Most people want to leave money to their children, but naming a minor as a direct beneficiary can create serious legal and financial complications. A child under 18, or 21 in some states, can't legally inherit assets, meaning they will need a guardian to manage the funds. If you haven't designated a guardian, there could be disputes over who should take on that role, delaying access to funds and reducing the inheritance through legal fees.

Even when a guardian is appointed, they have discretion over how the funds are used. While they're required to act in the child's best interest, their decisions may not align with your wishes. Court-appointed guardians are also entitled to compensation, which can further reduce the inheritance.

If your child has a disability that prevents them from becoming legally independent, they may require long-term financial management. A simple beneficiary designation won't provide the protections they need and could even disqualify them from receiving government benefits.

Even if everything goes smoothly, once your child reaches legal adulthood, the money is theirs to control outright. And at 18 or 21, many young adults aren't equipped to manage a large sum, putting the funds at risk from creditors, lawsuits, or even divorce.

The better approach: a Trust

Rather than naming your child as a direct beneficiary, a Trust can offer more protection and control. When you set up a Trust

- You decide who will manage the funds rather than leaving it up to the courts.
- You can establish clear guidelines for how and when the money is used.
- You control when your child gains full access and can stagger distributions over time.

You can potentially shield the inheritance from creditors, lawsuits, and divorce proceedings, depending on the structure and type of Trust.

And the Trust doesn't have to be complicated or expensive. Even a simple revocable Trust can provide many of these protections while keeping you in control during your lifetime. But for stronger asset protection, certain irrevocable Trust provisions may be necessary. Work with an estate planning attorney to ensure your Trust is properly structured to meet your specific needs and goals.

Failing to name backup beneficiaries

Your primary beneficiary is first in line to inherit, but what happens if they pass away before you? If you haven't named a backup beneficiary, your assets could end up in probate, where the courts decide who inherits them. This can be costly, time-consuming, and delay access to funds your loved ones may need. Naming at least one backup beneficiary helps avoid these issues.

Ignoring tax consequences

Certain assets, like traditional IRAs and 401(k)s, come with tax implications when passed down. If a non-spouse beneficiary inherits these accounts, they may have to take required minimum distributions and withdraw the full balance within 10 years, potentially triggering a significant tax bill.

Naming a spouse, on the other hand, gives them more flexibility in how they withdraw the funds. Either way, it's important to discuss your plans with your desired beneficiaries, a tax professional, and an estate attorney to minimize tax consequences for your heirs.

Listing "my estate" as a beneficiary

Listing your estate as the beneficiary of your assets is almost always a mistake. It forces those assets into probate, which can be a long, expensive court process that delays access for your heirs. Also, certain assets, like retirement accounts, come with tax advantages when passed directly to a beneficiary like your spouse, but naming your estate as beneficiary can eliminate those benefits and lead to higher taxes.

It's important to note that naming a Trust as a beneficiary is very different from naming your estate - even though many people confuse the terms. A properly structured Trust allows assets to bypass probate, provides greater control over how the funds are distributed, and can offer protections from creditors, depending on how it's set up.

In a nutshell, naming individuals or a Trust as your beneficiary is usually a better option.

Failing to align all components of your estate plan

Beneficiary designations, Wills, and Trusts are separate parts of a solid estate plan, but they don't automatically work together. Beneficiary designations override both Wills and Trusts, so if they contradict one another, the beneficiary designation generally wins.

The bottom line is that you need to keep an eye on the details. Regularly check all the components of your estate plan to ensure they still reflect your wishes and work together. And if you make changes to one document, ensure you update the others to keep everything aligned.

Avoid unintended consequences: review your plan

A well-thought-out estate plan isn't just about drafting a Will—it's about making sure all the moving pieces fit together. Beneficiary designations are great estate planning tools, but if they're not handled carefully, they can lead to unintended consequences, family disputes, and tax issues.

Next Step

If it's been a while since you reviewed your beneficiaries—or if you're unsure whether they align with your estate plan—now's the time to take a closer look. A quick review can prevent costly mistakes and ensure your assets go exactly where you want them to.

To ensure you're taking the best approach for your specific situation, please contact our office.

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