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Thousands of retirement accounts are 'ticking time bombs'

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Americans have more than $12 trillion stashed away in IRAs, 401(k) plans, and similar retirement accounts. Yet very few people have given careful thought to what will happen to the assets in those accounts if they should pass away unexpectedly. In a surprising number of cases, what would happen is not at all what they would expect – or want.

Over the next decade, as the Baby Boomers continue to age, we will hear many stories of "inheritance disasters" as heirs are surprised by the laws surrounding these accounts. That's why it's important to make sure your retirement accounts have been considered as part of a complete estate plan for your family.

Many people assume that if they've written a will, then the people they named as heirs in the will are entitled to the assets in their retirement accounts.

Not true! Generally, a will has no effect whatsoever on a retirement account. Who gets the assets in an IRA or 401(k) is determined by a combination of state and federal laws and the "beneficiary designation" form that the owner filled out when the account was first set up, often many years earlier.

The problem with these beneficiary forms is that most people fill them out in a hurry when they're starting a new job or rolling over an account. They're not thinking carefully about estate planning considerations at the time.

Once the form is checked off, people tend to forget to update it when they have a change in their life, such as marriage, divorce, the birth of a child, etc. And even if people think to update the form, the plan provider doesn't always make it easy to do so.

Plus, the forms themselves often make it difficult for people to accomplish what they want. Many 401(k) forms allow only a single primary and contingent beneficiary. What if you want to divide the funds equally among four children?

If a beneficiary form isn't updated regularly, there are numerous things that can go wrong. For instance:

- A person gets married (or remarried) and doesn't update the form to include the new spouse. The assets go to someone else.
- A person names their first child as a beneficiary, but doesn't change the form when a new child is born. All the funds go to the first child and nothing goes to the sibling.
- A person names a minor child as a beneficiary, and since the child can't inherit the

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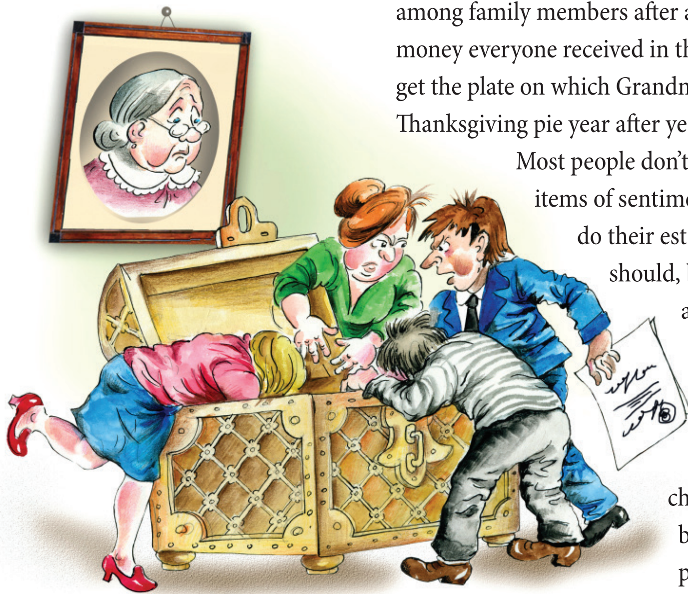
How to leave items of sentimental value to your heirs



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Often, the issue that causes the most hard feelings among family members after a death isn't how much money everyone received in the will, but who should get the plate on which Grandma served her famous Thanksgiving pie year after year.

Most people don't think much about items of sentimental value when they do their estate planning. But they should, because doing so can avoid a lot of awkward situations.

For instance, you might plan to leave everything to your children in equal shares, but what about the piece of jewelry that you always promised to your eldest daughter, or the antique vase your cousin loved that no one else in the family liked? Or what if you have a valuable item such as a piano that can't be divided equally?

It's definitely a good idea to make provisions for items such as these in your will.

In most (but not all) states, you can write a "personal property memorandum" that's separate from your will and that covers how personal items will be distributed. It's valid as long as your will specifically refers to it, and an advantage is that you can change it yourself whenever you want without having to revise the entire will.

Usually, the memorandum can cover items such as furniture, artwork, jewelry, and so on. Some states let you include cars, but you can't use it for financial instruments such as bank accounts or stocks and bonds.

What happens if someone dies and doesn't make any plan for personal property, and the children or other heirs can't agree on how to divide it? Some families have come up with creative solutions.

For instance, they might assemble all the personal items and take turns picking one item each. Or each child might be given an equal amount of Monopoly money, which they can use to "bid" for each item at an auction.

In some cases where the children simply couldn't agree, the executor or trustee has ended up selling all the items and dividing the cash.

What you can learn from Philip Seymour Hoffman's will

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When actor Philip Seymour Hoffman died unexpectedly this past February, he hadn't updated his will in about 10 years, and his estate planning left something to be desired.

Hoffman's will created a trust for his son Cooper, and left the rest of his roughly $35 million fortune to his longtime companion Mimi O'Donnell.

It's worth taking a look at what Hoffman might have done differently:

► First of all, apart from the trust for his son, everything passed through probate, which tied up the assets and caused the estate distribution to be made public (which is how we know these details). If Hoffman had used additional trusts, the world wouldn't know the extent of his wealth or how he planned to distribute it.

► Second, Hoffman never updated his will after his other two children were born. So while Cooper will benefit from a trust, Hoffman's other children will get nothing. Presumably, O'Donnell (the mother of all three children) will take care of them. But if O'Donnell remarries and becomes part of another family, she could eventually leave a big chunk of Hoffman's wealth to complete strangers rather than to his own children. Hoffman could have largely avoided this prospect through the use of trusts.

► Third, although Hoffman and O'Donnell were a couple for 14 years and had three children together, they never formally married. As a result, his estate will probably have to pay about $15 million in federal and state taxes – whereas if the couple had tied the knot at some point, the entire estate would probably have been tax-free.

Of course, the decision to marry is complex and involves many considerations other than estate taxes. Still, one has to wonder whether Hoffman might have felt differently about marriage if he had known that remaining legally single would be so costly to his partner and his children. It's also worth noting that even if Hoffman had still wanted to remain single, he might have been able to use other techniques to reduce the tax burden for his heirs.

Many retirement accounts are 'ticking time bombs'

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funds directly, the result is a lengthy and expensive court proceeding.

- A person gets divorced, but forgets to change the form, and his or her ex-spouse collects all the assets.
- A grandfather wants the assets to be split evenly between his son and daughter. But the son dies, and the grandfather doesn't update the form. All the assets go to the daughter, and nothing at all goes to the son's children.

Many states have laws that say that if a will hasn't been updated after someone gets married or divorced or has a child, the will can in effect be modified to provide for the changed circumstances. But often, these laws don't apply to IRAs.

The situation is even worse with 401(k)s, because these are governed by a federal law called ERISA that trumps state laws.

Under ERISA, if a person was married, then in most cases the assets in a 401(k) plan must go to the person's spouse, *regardless* of what it says in the beneficiary designation form – unless the spouse signed a notarized waiver. Most people don't realize this, and very few beneficiary forms spell it out.

This rule tripped up Leonard Kidder, a widower in Baton Rouge who named his three children on a beneficiary form to inherit his 401(k) plan worth $250,000. Leonard remarried at age 66, and six weeks later he died. Thanks to ERISA, his new wife pocketed the entire $250,000 and his children were left with nothing.

ERISA is strict – generally, even if your spouse signs a prenuptial agreement saying that he or she won't claim your 401(k) funds, that doesn't matter unless the spouse *also* signs a notarized waiver after the wedding.

Divorce frequently leads to problems because, in the stress of a separation, people forget to update their forms. In Washington state, a Boeing employee named David Egelhoff died in a car crash two months after divorcing his wife. Since he hadn't gotten around to removing her as his beneficiary, she collected his company-provided pension plan and life insurance, and nothing at all went to his children by a previous marriage.

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What happens if you simply don't fill out a beneficiary form? Then the assets will go to a "default" beneficiary. Often, the default beneficiary is spelled out in tiny type somewhere in a massive document from the plan provider that nobody ever reads.

Frequently, the default beneficiary is the account owner's estate. That's usually a bad idea, because it forces the assets to go through probate. Also, the family may end up forfeiting a lot of tax advantages that could otherwise be available.

Another option is to have the assets go to a trust. This can be a wise idea in certain circumstances – but you have to be very careful, because there are many obscure legal technicalities that must be observed to prevent problems with the IRS.

In general, retirement plan assets will be a ticking time bomb for many families in the coming years. It's critical to speak to an estate planner to make sure your retirement accounts are integrated with your will and other documents as part of a complete estate plan.

Should life insurance be included in your estate plan?

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insurance policy generally doesn't have to pay income tax on the proceeds, the amount of the proceeds is typically included in your taxable estate. This can be a problem if the value of the proceeds *plus* your other assets pushes you into the estate tax bracket.

There are ways to avoid this problem, such as by creating a trust to own the life insurance policy. However, these trusts can have some drawbacks and some very technical requirements, so you'll want to talk to an attorney to make sure the idea is right for your situation.

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Should life insurance be included in your estate plan?

Traditionally, the purpose of life insurance is to replace a person's income for their family in the event they die before they stop working. For this reason, many people buy "term" insurance that ends when they reach retirement age.

However, there are also some very good uses for life insurance as part of an estate plan. For example:

- You might want to make sure that your heirs won't have to sell important assets (a business, real estate, etc.) after you die in order to pay estate taxes or because of a lack of liquidity in the period after your death. Life insurance can provide your heirs with ready cash to cover taxes and other expenses.
- Suppose you have several children and you want to leave them equal inheritances, but your estate consists largely of assets that are hard to divide – such as a business, real estate, or an art collection. You could leave the assets to the children most likely to appreciate them, and use insurance to equalize inheritances for the other children.
- If you leave behind a vacation home for use by multiple family members, they could end up squabbling over who has to pay for upkeep, repairs, and so on. Life insurance could be used to find a trust that pays these expenses.
- Life insurance can also fund a trust for college or for children with special needs.

You should know that while the beneficiary of a life

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