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The Perils of Relying Solely on Beneficiary Designations to Transfer Assets

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In modern estate planning, many assets can be transferred at death via properly completed beneficiary designations, and increasingly substantial amounts of wealth are being transferred by such means. Given the value and special tax status of assets such as retirement plans, IRAs, and life insurance, it is imperative to consult with your estate planning attorney when completing beneficiary designation forms to ensure that the designation is consistent with your estate plan and properly addresses tax considerations. For other assets that can be transferred by transfer-on-death or payable-on-death registrations, such as investment accounts, depository accounts, real estate, and certain personal property, beneficiary designations should also be made with great care and the advice of counsel.

What can go wrong, you say? Plenty, as it turns out. First, consider that every beneficiary form is different. The entity offering the form is different, the registration process with the entity is different, the interpretation of the form and the designation of beneficiaries are different, and the list goes on. Does the designation of beneficiaries comply with the internal requirements of the entity? What if one entity administers the asset and another entity acts as custodian? Whose beneficiary form governs? The form itself may have limitations on the naming, number and age of beneficiaries, and whether designations may be made by specific dollar amounts or percentages. What if your plan doesn't comport with the form permitted by the entity? Can you use your own form? If so, will the registering entity accept it?

Next, consider the applicable state law. Some states, like Ohio, have adopted the Uniform Transfer-on-Death Security Registration Act, which governs certificated securities, uncertificated securities, and security accounts. However, the application of the law is supplemented by principles of law and equity that vary by jurisdiction. If the form is

completed in Ohio for an Ohio account, does Ohio law control how the beneficiary designation is interpreted and functions? What if the bank is organized under the laws of another state? What if you have a depository account through a virtual (internet) bank? If so, does Ohio law on payable-on-death accounts apply, or does the law of the state where the virtual bank is organized control? These are all issues that your estate planning attorney can manage while assisting you in titling your assets for transfer at death.

If you intend to transfer income tax deferred assets, such as qualified retirement plans and IRAs, to your spouse directly or to a trust for the benefit of your spouse, there are important tax regulations to navigate in order to maximize income tax deferral and minimize tax. If you intend to transfer certain qualified assets to someone other than your spouse, a waiver or consent may need to be signed by your spouse in order for the transfer to be effectuated. Moreover, it will be important to understand the tax consequences of selecting a non-spouse as a beneficiary. If you would prefer to designate a trust as the beneficiary, it may be important to customize your trust to maximize the tax benefits of such assets and coordinate the beneficiary designation form with the trust. This is especially important if you have beneficiaries of varying ages and want to insure benefit payments over the life expectancy of a particular beneficiary.

What happens if a designated beneficiary is deceased or if the form otherwise fails to pass the asset? Where does the asset go? Does it default to being a probate asset that passes to your probate estate for disposition according to your will? What if you don't have a will? Does the asset pass pursuant to Ohio law, or does the asset pass according to the default terms of the retirement plan, life insurance or annuity contract? It depends. You can guarantee that if a beneficiary designation fails to transfer an asset for any reason, there will be considerable time and cost involved to determine where the asset passes and how, if at all, the mistake may be remedied. It's worth your time to make sure the beneficiary designation is correctly prepared and registered with the entity controlling the asset.

To the uninformed or ill-advised, a beneficiary designation form may appear to be a "no-brainer" substitute for a professionally drafted estate plan. In actuality, though, a beneficiary designation should be used only as a tool in a thoughtful and thorough estate plan that is professionally designed. Don't fall prey to bad advice. Please contact your Vorys attorney today if you have questions about this article or any questions related to your specific estate plan.