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Why Not to Name Your Estate as an IRA Beneficiary

Making sure you've named the proper beneficiaries for your IRAs is not something most people consider on a regular basis. You presumably designated a beneficiary on the form when you set up the IRA and then probably forgot about it. However, a recent IRS ruling illustrates why taking a little time now to make sure everything is in order could help those you love avoid a big headache in the future.

In the ruling, a deceased IRA owner had designated his estate as his IRA beneficiary. His surviving spouse was the executrix of his estate and also its residuary beneficiary.

Under the normal IRA distribution rules, if amounts are distributed from an IRA to the deceased IRA owner's estate and subsequently paid to the surviving spouse as the estate's beneficiary, the spouse is treated as receiving the distribution from the estate and not directly from the IRA. Thus, the spouse isn't eligible for the special IRA distributions rules applicable to surviving spouses. These rules allow the spouse to either roll over the IRA proceeds into an IRA in her name or to simply redesignate the IRA as her own. These two options, available only to surviving spouses, can be very helpful where the surviving spouse is younger than the IRA owner and wants to stretch out the IRA withdrawals for as long as possible.

The two options can also be helpful when the original IRA owner failed to name secondary beneficiaries and it's likely the IRA will not be fully depleted by the surviving spouse's death. Converting or rolling over the IRA into her own IRA will allow the surviving spouse to name new primary and secondary beneficiaries so that the tax benefits of the IRA can last for a longer period of time.

In the ruling, the taxpayer wanted to take advantage of one of the options available to surviving spouses, but she technically didn't qualify (because she wasn't the sole, direct beneficiary of the IRA with an unlimited right to withdraw amounts from the IRA). Thus, she felt compelled to ask the IRS for permission. Although the IRS ruled favorably on her request, it was only after she went through considerable time and effort to file the ruling request. (The IRS granted the favorable ruling because she was the executrix and sole residuary beneficiary of the estate and had the authority, as executrix, to determine which beneficiary got what assets. Thus, according to the IRS reasoning, she effectively was the sole beneficiary of her husband's IRA and had unlimited withdrawal rights.) A far simpler approach would have been for her husband to directly name her as his IRA beneficiary prior to his death.

Although the facts in the ruling likely differ from your own, there are plenty of taxpayers who have outdated or incorrect beneficiary designations on their IRAs. With all of the

financial institution mergers we had in the last 10 to 15 years, even if your original beneficiary designation is still okay, it may have gotten lost in a file in the surviving financial institution's records. Thus, now would be a great time to go over your beneficiary designations for all of your IRAs to confirm that they are correct from the perspective of whom you want to receive the funds, and that the designations aren't going to cause any undue tax burdens. We'd be happy to assist you in this effort if you'll give us a call.

Very Truly Yours,

Krebs & Co., CPA's, Inc.
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