KANAWHA
CAPITAL MANAGEMENT
Third Quarter 2018

This Quarter's Highlights

- The Beneficiary Designation Form
- IRA Minimum Distribution Rules for Beneficiaries
- Naming a Trust as an IRA Beneficiary

Kanawha Currents

Beneficial Planning

Preparing for the succession of assets is a critical step in any sound financial plan. Individuals and couples should be diligent in putting together a strategy that outlines precisely to whom they wish to give their assets and under what conditions, if any, they wish to transfer those assets. A well-constructed estate plan, preferably completed by a trust and estate attorney, typically defines such asset transfer objectives and the means to achieve them. In addition to important legal documents that may be used to execute an estate plan, it is often left up to the client and their other advisors to implement various components of the plan. For certain types of assets, including employer-sponsored retirement plans, individual retirement accounts, and life insurance policies, assets are transferred via a contractual agreement between the deceased owner and the company responsible for the account or policy. Assets held in these types of accounts are usually transferred independent of a will or trust, unless the estate or trust is a named beneficiary. This discussion will focus on the front-end beneficiary planning for retirement account owners as well as the back-end decision making for the named beneficiaries.

The Beneficiary Designation Form

When opening retirement accounts, it is incumbent upon the account owner to complete the beneficiary designation form as part of any new account application. This form, and the specific beneficiary information the owner provides, will define the terms of the contract that governs how the assets are to be distributed at death. An account owner may identify both Primary beneficiaries and Contingent beneficiaries. A Primary beneficiary will receive his or her share of the assets if he or she is alive at the time of the post-death transfer of assets. Generally, if all primary beneficiaries predecease the account owner, then a Contingent beneficiary would have a right to his or her predetermined share of the assets. The account custodian or administrator will often require the name, relationship, date of birth, and identification number of the named beneficiaries. Non-persons, such as estates, trusts, and charities, may also be listed as beneficiaries, but they may not be granted the same distribution privileges given to living persons.

Account custodians and trustees often provide optional beneficiary instructions to define how assets are to be distributed if a beneficiary predeceases the owner or testator. One such option is designating a beneficiary as Per Stirpes, a Latin term meaning "by root" or "by branch". Let's assume an IRA owner named his two children, Child A and Child B, as equal primary beneficiaries. Let's also assume they each have two children of their own. Now let's assume that Child A died two years before his father,

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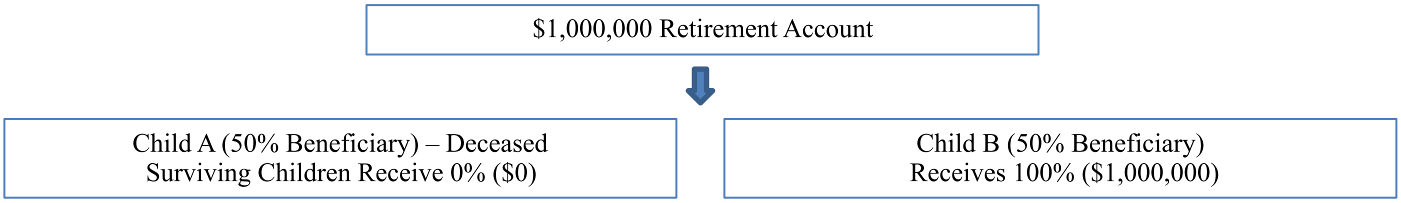
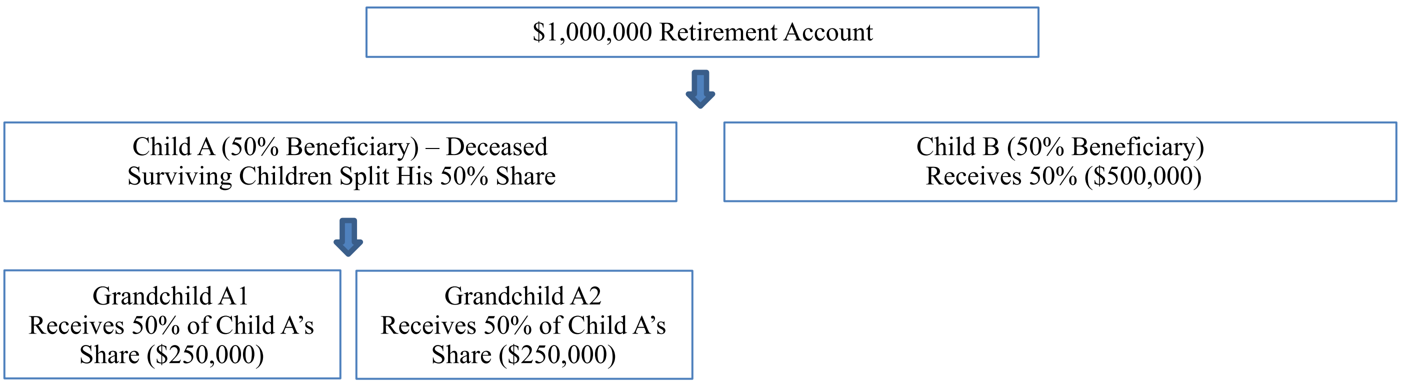
who subsequently died with a retirement account valued at $1,000,000. If the original IRA owner failed to name his two primary beneficiaries as Per Stirpes (or Per Capita), Child B would have a right to receive the entire $1,000,000 value and Child A's children would be left with nothing (see Figure 1).

Figure 1: Designated Beneficiaries Listed without Per Stirpes or Per Capita



If instead, each of the two primary beneficiaries were named Per Stirpes, then deceased Child A's 50% share would be split equally between his surviving children (see Figure 2).

Figure 2: Designated Beneficiaries Listed as *Per Stirpes*



Retirement account custodians may also give owners the option of designating beneficiaries as Per Capita, which generally means property is divided "by the head" or equally among survivors. Using Per Stirpes or Per Capita may be an effective means for an account owner to protect the surviving issue of a beneficiary should he or she predecease the owner. Investors should understand how their account custodians define Per Stirpes and Per Capita as their legal interpretation and application may vary.

IRA Minimum Distribution Rules for Beneficiaries

Traditional IRA owners have to begin required minimum distributions (RMDs) once they reach 70 ½. These IRA minimum distribution rules are often different for beneficiaries than they are for the original owners. IRA account holders and beneficiaries alike should have a basic understanding of how these rules vary by beneficiary type.

A spouse who is named as sole beneficiary is afforded the benefit of taking ownership of an IRA and continuing to use the less onerous Uniform Lifetime table to determine RMDs. The Uniform table is used by IRA owners unless their spouse is more than 10 years younger. Spousal beneficiaries who take ownership of an IRA may have substantially lower annual distribution requirements than those who choose to remain as beneficiary. This is because the Uniform table used by owners has longer distribution periods at a given age compared to beneficiaries who use the Single Life table.

The difference in RMD amounts determined by the two tables is illustrated in Figure 3. In this hypothetical example, a surviving spouse, age 85, would be required to distribute almost twice the amount ($131,579 vs. $67,568) annually if he or she decided to remain as a beneficiary and be subject to the Single Life table instead of taking ownership of the IRA and using the Uniform table. The RMD dollar amounts assume an IRA value of $1,000,000.

Figure 3: RMDs at Different Ages for $1,000,000 IRA Value

	Uniform Lifetime Table		**Single Life Expectancy Table**	
At Age	Divisor	RMD $ Amount	Divisor	RMD $ Amount
75	22.9	$43,668	13.4	$74,627
80	18.7	$53,476	10.2	$98,039
85	14.8	$67,568	7.6	$131,579
90	11.4	$87,719	5.5	$181,818
95	8.6	$116,279	4.1	$243,902
*Assumes IRA value of $1,000,000 remains constant.				

Note the surviving spouse must also be the sole designated beneficiary to take ownership of the IRA. When a surviving spouse treats the IRA as his or her own, this is commonly called a Spousal IRA Rollover.

Figure 4: Spouse Takes Ownership (Spousal IRA Rollover)

- John Doe IRA
- Jane Doe Is the Sole Beneficiary

John Dies →

- Jane becomes IRA owner
- Title is now Jane Doe IRA
- RMDs now at her life expectancy
- Still uses IRS Uniform Table
- Recalculates using new divisor annually

In most cases, a surviving spouse who is the sole beneficiary will choose the Spousal IRA Rollover due to the less severe minimum distribution requirements. There are some situations, however, where a surviving spouse may be better off remaining as beneficiary under the terms of an Inherited IRA. If the surviving spouse is under the age of 59 ½ and needs access to the funds, he or she would be able to take withdrawals from the IRA free from early distribution penalties. Also, if the surviving spouse is older than the decedent spouse and does not need the money (and the decedent had not reached age 70 ½), the spouse could defer RMDs for a longer period of time by remaining as beneficiary until the decedent would have turned 70 ½.

Figure 5: Spouse Remains as Beneficiary (Spousal Inherited IRA)

- John Doe IRA
- Jane Doe Is the Sole Beneficiary

John Dies →

- Jane inherits account as beneficiary
- Title becomes Jane Doe Inherited IRA of John Doe IRA
- RMDs must begin December 31 of year decedent would have turned 70 ½ or December 31 of year after decedent's death, whichever is later
- Uses IRS Single Life Table
- Recalculates using new divisor annually

Non-spouse beneficiaries who aim to stretch the distributions over their lifetimes must refer to the Single Life table, which uses shorter life expectancies (and thus higher withdrawal rates). Also, non-spouse beneficiaries only refer to the table for one year. Each subsequent year, they simply subtract 1 from the preceding year's life expectancy to get the current year's divisor. Non-spouse beneficiaries take indirect title via an "Inherited IRA" for their benefit.

Figure 6: Non-Spouse Beneficiary Inherited IRA

- John Doe IRA
- Individual A Is a Designated Beneficiary

John Dies

- Non-spouse Individual A inherits account as beneficiary
- Title becomes Individual A Inherited IRA of John Doe IRA
- RMDs must begin December 31 of year after decedent's death
- Uses IRS Single Life Table and calculate RMDs on beneficiary's life expectancy (*unless decedent was younger)
- Only refers to table in first year of RMD, subtracts 1 in subsequent years

For non-person beneficiaries such as estates, the minimum distribution requirement depends on whether the IRA owner had attained age 70 ½. If they had not reached 70 ½, then the entity must liquidate the IRA by the end of the fifth year following the death of the owner. If the IRA owner died after age 70 ½, then the non-living beneficiary may be able to take annual distributions according to the decedent's life expectancy using the Single Life table.

Naming a Trust as an IRA Beneficiary

Since trusts are not living persons, they do not technically qualify as designated beneficiaries for IRA distribution rules. This does not mean that trusts cannot be beneficiaries of an IRA. In fact, there may be situations where it is practical to name trusts as IRA beneficiaries. For example, an IRA owner who is in a second marriage may wish to benefit a spouse during his or her life but ultimately pass the IRA to the blood children. Generally, a trust must meet the following conditions for its beneficiaries to be treated as IRA designated beneficiaries and allow the IRA to make post-death annual required distributions:

- The trust is a valid trust under state law.
- The trust is irrevocable at death.
- The trust has identifiable beneficiaries.
- The trustee provides the IRA custodian with appropriate documentation.

Source: IRS Publication 590-B

Developing a prudent estate plan is critical to ensure the efficient transfer of assets before and after death. But even the most well designed intentions can be futile without proper implementation and follow up. For assets transferred via contractual agreements, such as retirement accounts and insurance policies, it is important that beneficiary designations be properly assigned. It is equally important to review and update these designations as circumstances change (e.g. divorce, child marriage, grandchildren, death). For retirement accounts, those individuals who have been named as beneficiaries should understand the potential advantages and disadvantages of various minimum distribution rules. Staying informed of these rules may help individuals benefit from such accounts over long periods of time. Please note this discussion focused on retirement account beneficiary planning within the broader context of estate planning. Individuals should be just as diligent in making sure their non-retirement accounts (e.g. living trusts, transfer on death accounts) are properly titled and consistent with their estate planning objectives. Please consult with your trust and estate attorney and/or tax advisor for specific advice about your personal situation.

The information contained herein is intended to be for illustrative purposes only and should not be interpreted as advice. The examples are basic in nature and do not factor in all important legal and tax considerations. Please consult your legal and tax professionals for specific tax advice about your personal situation.