



Life Insurance Beneficiary Mistakes to Avoid

Life insurance has long been recognized as a useful way to provide for your heirs and loved ones when you die. Naming your policy's beneficiaries should be a relatively simple task. However, there are several situations that can easily lead to unintended and adverse consequences you may want to avoid.

Not Naming a Beneficiary

The most obvious mistake you can make is failing to name a beneficiary of your life insurance policy. But simply naming your spouse or child as beneficiary may not suffice. It is conceivable that you and your spouse could die together, or that your named beneficiary may die before you do. If the beneficiaries you designated are not living at your death, the insurance company may pay the death proceeds to your estate, which can lead to other potential problems.

Death Benefit Paid to Your Estate

If your life insurance benefit is paid to your estate, several undesired issues may arise. First, the insurance proceeds likely become subject to probate, which may delay the payment to your heirs. Second, life insurance that is part of your probate estate is subject to claims of your probate creditors. Not only might your heirs have to wait to

receive their share of the insurance, but your creditors may satisfy their claims out of those proceeds first.

Naming primary, secondary, and final beneficiaries may avoid having the proceeds ultimately paid to your estate. If the primary beneficiary dies before you do, then the secondary or alternate beneficiaries receive the proceeds. And if the secondary beneficiaries are unavailable to receive the death benefit, you can name a final beneficiary, such as a charity, to receive the insurance proceeds.



Naming a Minor Child as Beneficiary

Unintended consequences may arise if your named beneficiary is a minor. Insurance companies will rarely pay life insurance proceeds directly to a minor. Typically, the court appoints a guardian — a potentially costly and time-consuming process

— to handle the proceeds until the minor beneficiary reaches the age of majority according to state law.

If you want the life insurance proceeds to be paid for the benefit of a minor, consider creating a trust that names the minor as beneficiary. Then the trust manages and pays the proceeds from the insurance according to the terms and conditions you set out in the trust document.



Can You Fund Your Retirement?

In January 2021, more than seven out of 10 workers were very or somewhat confident that they would have enough money to live comfortably throughout their retirement years. This was the highest confidence level since 2000 and a significant rebound from levels in March 2020 after the pandemic began. Overall, retirement confidence has trended upward since the Great Recession.

Life Insurance Beneficiary Mistakes to Avoid, continued

Consult with an estate attorney to decide on the course that works best for your situation.

Per Capita or Per Stirpes Designations

It's not uncommon to name multiple beneficiaries to share in the life insurance proceeds. But what happens if one of the beneficiaries dies before you do? Do you want the share of the deceased beneficiary to be added to the shares of the surviving beneficiaries, or do you want the share to pass to the deceased beneficiary's children? That's the difference between per stirpes and per capita.

You don't have to use the legal terms in directing what is to happen if a beneficiary dies before you do, but it's important to indicate on the insurance beneficiary designation form how you want the share to pass if a beneficiary predeceases you. Per stirpes (by branch) means the share of a deceased beneficiary passes to the next generation in line. Per capita (by head) provides that the share of the deceased beneficiary is added to the shares of the surviving beneficiaries so that each receives an equal share.

Disqualifying a Beneficiary from Government Assistance

A beneficiary you name to receive your life insurance may be receiving or is eligible to receive government assistance due to a disability or other special circumstance. Eligibility for government benefits is often tied to the financial circumstances of the recipient. The payment of insurance proceeds may be a financial windfall that disqualifies your beneficiary from eligibility for government benefits, or the proceeds may have to be paid to the government entity as reimbursement for benefits paid. Again, an estate attorney can help you address this issue.

Review All Your Beneficiary Designations

In addition to life insurance, you may have other accounts that name a beneficiary. Be sure to periodically review the beneficiary designations on each of these accounts to ensure that they are in line with your intended wishes.

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased.

Considerations When Making Gifts to Children

If you make significant gifts to your children or someone else's children (perhaps a grandchild, a nephew, or a niece), or if someone else makes gifts to your children, there are a number of things to consider.

Nontaxable Gift Transfers

There are a variety of ways to make transfers to children that are not treated as taxable gifts. Filing a gift tax return is generally required only if you make gifts (other than qualified transfers) totaling more than \$15,000 per individual during the year.

- **Providing support.** When you provide support to a child, it should not be treated as a taxable gift if you have an obligation to provide support under state law.

Parents of minor children, college-age children, boomerang children, and special-needs children may find this provision very useful.

- **Annual exclusion gifts.** You can generally make tax-free gifts of up to \$15,000 per child each year. If you combine gifts with your spouse, the amount is effectively increased to \$30,000.
- **Qualified transfers for medical expenses.** You can make unlimited tax-free gifts for medical care, provided the gift is made directly to the medical care provider.
- **Qualified transfers for educational expenses.** You can make unlimited gifts for tuition free of gift tax,

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provided the gift is made directly to the educational provider.

For purposes of the generation-skipping transfer (GST) tax, the same exceptions for nontaxable gift transfers generally apply. The GST tax is a separate tax that generally applies when you transfer property to someone who is two or more generations younger than you, such as a grandchild.

Income Tax Issues

A gift is not taxable income to the person receiving the gift. However, when you make a gift to a child, there may be several income tax issues regarding income produced by the property or from sale of the property.

- **Income for support.** Income from property owned by your children will be taxed to you if used to fulfill your obligation to provide support.
- **Kiddie tax.** Children subject to the kiddie tax are generally taxed at their parents' tax rates on any unearned income over \$2,200 (in 2021). The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.
- **Basis.** When a donor makes a gift, the person receiving the gift generally takes an income tax basis

equal to the donor's basis in the gift. The income tax basis is generally used to determine the amount of taxable gain if the child then sells the property. If instead the property were transferred to the child at your death, the child would receive a basis stepped up (or down) to the fair market value of the property.

Gifts to Minors

Outright gifts should generally be avoided for any significant gifts to minors. For this purpose, you might consider a custodial gift or a trust for a minor.

- **Custodial gifts.** Gifts can be made to a custodial account for the minor under your state's version of the Uniform Gifts/Transfers to Minors Acts. The custodian (an adult or a trust company) holds the property for the benefit of the minor until an age (often 21) specified by state statute.
- **Trust for minor.** A Section 2503(c) trust is specifically designed to obtain the annual gift tax exclusion for gifts to a minor. Principal and income can (but need not) be distributed to the minor before age 21. The minor does generally gain access to undistributed income and principal at age 21. (The use of trusts involves a complex web of tax rules and regulations, and usually involves upfront costs and ongoing administrative fees. You should consider the counsel of an experienced estate professional before implementing a trust strategy.)



Transfer by Gift Versus Transfer at Death

Difference in taxable gain when appreciated property is sold at fair market value (FMV) after the transfer.

Calculation Steps	Transfer by Gift	Transfer at Death
Sales price (FMV)	\$100,000	\$100,000
– Income tax basis	– \$20,000 (carryover of donor's basis)	– \$100,000 (stepped-up to (FMV)
Taxable gain	= \$80,000	= \$0

A Map for Your Family

A will is an essential legal document that describes how your estate should be distributed upon your death. It is the basis for the probate process and can serve as a guide for your heirs.

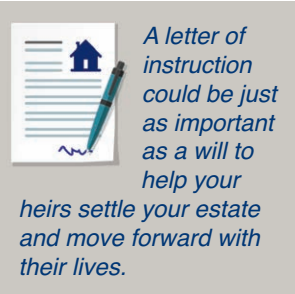
A letter of instruction — which has no legal status — provides information that can help your loved ones settle your estate and move forward with their lives. You might consider it a map for your family.

Unlike a will, which must follow legal guidelines for your state and may require an attorney, a letter of instruction can be written yourself in any way you choose. Here are some topics you may want to address.

Financial accounts and account numbers, including online user names and passwords. If you prefer not to write down user names or passwords, the executor of your estate should be able to access accounts with the account numbers and your Social Security number.

List of documents and their locations, including (but not limited to) your will, insurance policies, tax returns, bank and investment account documents, real estate deeds and mortgage documents, vehicle titles, Social Security and Medicare cards, marriage and/or divorce papers, and birth certificate.

Contact information for professionals who handle your financial and legal affairs, such as your attorney, financial advisor, insurance agent, and accountant. Also include



others who may be helpful, such as a business partner or trusted friend.

Bills and creditors, including when payments are due and other pertinent information, such as loan terms and balances as of the date of the letter.

Your final wishes for burial or cremation, a funeral or memorial service, organ donation, and charitable contributions in your memory.

You might also include more personal thoughts or life lessons that you want to pass on, or you could write a separate letter. Keep your letter of instruction in a safe, yet accessible place and tell your loved ones where it can be found. It might be wise to give a copy of the letter to the executor of your estate and other trusted friends or advisers.

Be sure to review the letter regularly and update it as appropriate. Your heirs will thank you for taking the time to prepare.

Contact a CBI Bank Trust Department Staff Member

As trusts can be complex and influenced by a number of factors, we like to start with a personal appointment where we get to know you and your needs. Contact any of the CBI Bank Trust Department staff members to arrange an appointment today.



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