

**W3 Wealth Management,
LLC**
Shelby Morgan
90 N. Miller Road
Akron, OH 44313
330-836-3805
Shelby@W3wealth.com

Dealing with Divorce

Table of Contents

Planning Concerns of Divorcing Couples	3
Why is it important for you to understand the basics of divorce law?	3
What do you need to know about legal fees?	3
How is property classified for divorce purposes?	3
What should you know about child custody, child support, and alimony?	4
What should you know about property division?	4
What should you know about taxation?	4
What should you know about budgeting and finances?	4
Do you need to know about risk management and Social Security?	4
What information should you gather before consulting with an attorney?	5
Divorce and Estate Planning	7
How does divorce affect estate planning?	7
What should you be concerned about during the separation period?	7
When revising your estate plan, which areas require particular note?	7
Retirement Plans and Qualified Domestic Relations Orders (QDROs)	8
What is it?	8
Choosing a Beneficiary for Your IRA or 401(k)	12
Paying income tax on most retirement distributions	12
Naming or changing beneficiaries	12
Designating primary and secondary beneficiaries	12
Having multiple beneficiaries	12
Avoiding gaps or naming your estate as a beneficiary	13
Naming your spouse as a beneficiary	13
Naming other individuals as beneficiaries	13
Naming a trust as a beneficiary	14
Naming a charity as a beneficiary	14

Planning Concerns of Divorcing Couples

Why is it important for you to understand the basics of divorce law?

While divorce is certainly a time of emotional turmoil, it's a time of financial upheaval as well. The financial change brought about by divorce can be particularly devastating to families with children and to older couples who have assigned the career duties to one spouse and the homemaking duties to the other.

When seeking a divorce, you should become familiar with the major topics: legal fees, marital property versus separate property, alimony, debt, retirement plans, property settlement, taxation, budgeting, and, if you have children, child custody and child support. You should also consider risk management, and, if you're older, Social Security.

By becoming knowledgeable about these areas, you can provide your attorney (if any) with a complete and accurate outline of your wishes regarding the divorce settlement, and you will be able to make an informed decision before signing your divorce agreement.

What do you need to know about legal fees?

When seeking a divorce, you'll want to consider whether a simple, amicable arrangement is likely or whether attorneys should be hired. If you wish to hire an attorney, you should note that divorce attorneys typically charge hourly rates and require you to submit retainers (lump sums) up front. It's not unusual, for example, for an attorney to charge as much as \$150 to \$200 per hour, and require an initial retainer of up to \$2,500 to \$5,000. These fees can be less expensive or more expensive, depending on the complexity of the case, the reputation and experience of the divorce attorney, and the geographic location.

If you're a financially dependent spouse (such as a homemaker), it's possible for a court to award sufficient legal fees and costs to enable you to retain competent counsel. Upon your submission of an appropriate motion to the court, a judge could order your spouse to subsidize your legal fees for the divorce.

You should also consider the deductibility of divorce expenses. In general, most legal fees and court costs for obtaining a divorce are considered personal expenses and aren't deductible for income tax purposes. However, you may deduct as a miscellaneous deduction on IRS Schedule A, subject to the 2 percent floor, any money paid for advice related to the tax consequences of your divorce or securing income. Specifically, deductible items include fees for advice on securing and collecting alimony and the tax consequences of property and payments received. On your legal bill, your attorney should make a reasonable allocation of the legal expenses between tax-related (deductible) and non-tax-related (nondeductible) advice.

How is property classified for divorce purposes?

Assets are divided in accordance with state law, so it makes a difference whether you live in a community property state (presently Alaska (which has an optional system), Arizona, California, Idaho, Louisiana, New Mexico, Nevada, Texas, Washington, and Wisconsin) or Puerto Rico, or an equitable division state. Within these two categories of states, property may be classified as either separate property or marital property, but again, these definitions will vary depending on your state. Therefore, it's important for you to know how your state classifies property. For example, one state may mandate that separate property consist of gifts, inheritances, and property owned prior to the marriage, and that such items will not be divided between the spouses in the event of a divorce. Another state may proclaim that all property owned by the couple is marital property, subject to division at divorce--it doesn't matter who inherited what.

For more information about these topics, see Property Settlement.

What should you know about child custody, child support, and alimony?

When parents separate and divorce, one of the most emotionally charged issues involves the decision regarding who will live with the children. Determining the extent of child support, and possibly the necessity for enforcement of child support payments, is also cause for stress.

Child custody is based on a number of factors. Most judges place primary importance on the best interests of the children. Custody may be classified as physical or legal, and can be awarded to one or both parents. For more information, see Child Custody.

Most states have child support guidelines for determining the amount of child support to be paid. Child support orders can be modified when there's a substantial change in circumstances, and most states provide a number of methods for collecting unpaid support. For more information, see Child Support.

Alimony is also an important topic, particularly to spouses with custody of minor children and to older homemakers. Alimony is based on one party's need and the other's ability to pay. Deciding whether a spouse should receive alimony (and, if so, how much) is based on certain criteria, which can vary from state to state. For more information, see Alimony.

What should you know about property division?

Property division is a complex area, encompassing such subtopics as the marital residence, debt, and retirement plans and QDROs.

It also involves a number of other areas as well, including: classification and valuation of property, hidden assets, family businesses, and structuring property settlements. For information on these topics, see Property Settlement.

What should you know about taxation?

If you're legally separated or divorced, it's important to become familiar with the applicable tax rules regarding filing status, dependent children, alimony, and property disposition. Indeed, understanding the tax implications of your initial preferences regarding child custody and property settlement may alter or influence your final decisions. For more information about these topics, see Tax Issues Related to Divorce.

What should you know about budgeting and finances?

During the divorce process, both spouses must determine and disclose their monthly income and expense needs. Claims for support (based on need and an evaluation of the other party's ability to pay) are based on this financial affidavit.

It's not uncommon in a marriage for one spouse to assume primary responsibility for the family budget. For some couples, bills are paid when due, but neither party tries to stick to a budget. When two households are created incident to a divorce, cash becomes tighter and it becomes necessary to develop a budget. A number of tools can be used for this purpose. For more information, see Budgets and Cash Flows.

Do you need to know about risk management and Social Security?

Risk management should certainly be considered when a divorce seems likely. The selection of beneficiaries for your life insurance policy will probably be revised, and, in some cases, your health insurance coverage may terminate. Often, for example, one spouse participates in a group health insurance plan at work that provides coverage for both spouses. When a divorce occurs, coverage for the nonemployee spouse may end. You need to know what your health insurance options are and how life, disability, and property insurance should factor into your divorce agreement. For more information about these topics, see Divorce and Risk Management.

Social Security may be an issue if you're an older individual seeking a divorce after a long-term marriage. Be aware that, if you've been married to your spouse for at least 10 years, you may (in certain cases) be able to qualify as a dependent for Social Security purposes. Thus, you might be entitled to benefits, even if you never worked. For more information, see [Divorce and Social Security](#).

What information should you gather before consulting with an attorney?

Before sitting down with an attorney to commence a divorce, go through the following list to make sure you provide all relevant information:

- Your name, address, telephone number
- Spouse's name, address, telephone number
- Each spouse's date of birth
- Names and birth dates of children
- Date and place of marriage and length of time in present state
- Existence of prenuptial agreement
- Information about parties' prior marriages, children, etc.
- Date of separation and grounds for divorce
- Current occupation and name and address of employer (both parties)
- Social Security number of both parties
- Income of each party
- Education, degrees, and training of each party
- Extent of employee benefits for each party
- Details of retirement plans for each party
- Joint assets of the parties, including: House
- Other real estate
- Stocks, bonds, and securities
- Bank accounts
- Individual retirement accounts (IRAs), and
- Boats and other assets
- Liabilities and debts of each party
- Life and other insurance of each party
- Separate or personal assets of each party, including trust funds and inheritances
- Financial records, including: Bank statements

- Tax returns
- Loan applications, and
- Investment statements
- Family business records, including: Type of business
- Shareholders
- Percentage of ownership
- Bank statements of business
- Tax returns of business
- Applications for loans
- Income and balance sheets
- Financial reports, and
- Buy-sell agreements
- Collections, artwork, and antiques

Obviously, you won't have all of the above information and documentation at your fingertips. Provide whatever you can. The rest can be ascertained during the divorce discovery process. You'll need to think about a few other questions as well once you've provided your attorney with the basic checklist of information. Consider the following:

- Which assets do you really want, and which are you willing to assign to your spouse?
- How do you feel about the family home? Do you feel strongly about living there, or should it be sold or allotted to your spouse?
- With respect to the children (if any), what are your wishes regarding custody, visitation, and child support?
- Do you earn enough money to adequately support yourself, or should alimony be considered?
- Will you have sufficient liquidity to pay the debt on whatever assets you keep?
- What are the income tax consequences of your decisions regarding property disposition?
- Regarding a family business, does your state value assets at the time of separation, settlement, divorce, or some other time?

Discuss these and any other questions with your attorney.

Divorce and Estate Planning

How does divorce affect estate planning?

Wills for both spouses are often drawn up sometime during the marriage--particularly if there are children involved. When divorce is contemplated, the selection of beneficiaries and executors will likely be revised to reflect the absence of your former spouse. Additionally, you will need to re-examine the gift and estate tax aspects of your estate plan. For these reasons, many divorcing couples revise their estate planning documents during the period of separation or soon after the divorce has been finalized.

What should you be concerned about during the separation period?

If divorce proceedings have begun, it's important to draft a formal separation agreement as soon as possible, establishing the spouses' rights regarding property, debts, temporary alimony, child support, and child custody. When drafting the provisions, you (or your attorney) will want to consider the possibility of your spouse dying prior to entry of the final divorce decree. You may wish to make the agreement binding on heirs and assigns so that the obligations will continue if one party dies.

If you expect to receive alimony and child support from your spouse, you may want to require (in the separation agreement) that your spouse buy a life insurance policy (or keep the existing one in force), naming you as the beneficiary. The policy should be in an amount sufficient to cover the sum of support obligations and property distribution payments contemplated. You could even be named as the owner of the policy insuring your spouse's life. For more information about this, see Alimony.

Similarly, your agreement might require your spouse to maintain minimum will provisions in favor of you (and/or your children). Often, the parties to a separation agreement include a provision that both waive the right to elect a share of the estate of the other in the event that one party dies before the divorce decree is entered. For more information about elected shares, see Surviving Spouse's Elective Share or Probate.

When revising your estate plan, which areas require particular note?

First of all, you should make the necessary changes in your will or other estate planning documents to ensure that your former spouse isn't named as your personal representative, successor trustee, beneficiary, or holder of the power of attorney. A new will will likely be drafted during the separation period. Note that in some states, wills drawn up during a marriage are considered void after a divorce unless specifically ratified after the divorce. This means that intestacy rules would apply, instead of the will being controlling.

Next, consider gift tax implications if funding your children's education is required by your property settlement. Although your direct tuition payments (even for adult children) are exempt from gift tax when required by a property settlement agreement, be aware that your payments for related educational expenses (e.g., books and room and board) may be subject to gift tax.

Example(s): Liz and Frank have a daughter, Carol. Carol has reached the age of majority under state law. When the couple divorced, Frank agreed (as part of the settlement) to pay for Carol's college tuition, books, room, and board. During the year, Frank pays \$20,000 tuition directly to Carol's university, and he gives Carol \$15,000 in cash for living expenses. The tuition isn't a taxable gift, but the \$15,000 in cash will be treated as a taxable gift.

Finally, consider the absence of the unlimited marital deduction. An unlimited marital deduction is allowed for qualifying transfers (gifts) to one's spouse during lifetime or at death. Because this estate and gift tax deduction is one of the most important estate planning tools for married couples, your loss of this tool at divorce can affect your tax situation adversely when you die. For more information, see Unlimited Marital Deduction.

Retirement Plans and Qualified Domestic Relations Orders (QDROs)

What is it?

To what extent are retirement assets subject to probate and family court jurisdiction?

A retirement plan is a form of property. Like a house, cars, and bank accounts, it can be divided between spouses at the time of a divorce. If a husband, for example, participates in a pension plan at work while his wife stays home to care for the children, a judge has numerous options with respect to the retirement plan. Among other choices, he or she can award the entire pension to the husband, award all of it to the wife, or divide it between the parties. Judges often use qualified domestic relations orders (QDROs) to effect these pension assignments. In a marriage of long duration, a pension plan may be one of the most valuable marital assets.

How are retirement plans classified?

Many different kinds of retirement plans exist, with individual retirement accounts (IRAs) being one of the more common forms. In terms of employer-sponsored retirement plans, plans are classified as either qualified or nonqualified. Qualified plans are those that satisfy federal requirements and are afforded special tax treatment. Most qualified plans can be further categorized as either defined contribution plans or defined benefit plans.

- **Defined contribution plans:** Each participant in a defined contribution plan has an individual account. When you retire, you're entitled to receive what's in your account (no more and no less). Funding depends on the type of plan, and numerous possibilities exist for contributing. With some plans, the employees alone contribute. With other plans, the plan is either funded entirely by the employer, or funded by both employer and employees. Common examples of defined contribution plans include 401(k) plans and profit-sharing plans. For more information, see Defined Contribution Plan.
- **Defined benefit plans:** A traditional defined benefit plan does not use individual accounts. Instead, benefits for the participants in the plan are fixed under a particular formula. Specified benefits are paid to participants, based on such factors as age, length of service, and amount of compensation. Using these factors, most plans promise to pay the employee a certain amount per month upon retirement. Contributions to the plan are calculated by actuaries as the amounts needed to fund the promised benefits. For more information, see Defined Benefit Plan.

Before you think about dividing pension plans, it's important to grasp the difference between defined contribution plans and defined benefit plans. For more information, see [Saving for Your Retirement](#).

What is a qualified domestic relations order (QDRO) and what requirements must it satisfy?

A QDRO is a court judgment, decree, or order establishing the marital property rights of a spouse, former spouse, child, or dependent of a pension plan participant. Specifically, a QDRO:

1. Provides for child support, alimony payments, or marital property rights for a spouse, former spouse, child, or other dependent of a qualified plan participant and is made pursuant to a state domestic relations law, and
2. Creates or recognizes the existence of the right of the individual named in item 1 (i.e., the alternate payee) to receive all or a portion of a participant's benefits under a qualified retirement plan

A QDRO must satisfy certain requirements. It must clearly specify:

- The name and last known mailing address of the participant and each alternate payee covered by the order
- The amount or percentage of the participant's benefits that the plan must pay to each alternate payee (or the manner in which an amount or percentage is to be determined)
- The number of payments or periods to which the order relates, and
- Each qualified retirement plan to which the order applies

However, a QDRO may not require the plan to do any of the following:

- Mandate increased benefits
- Pay benefits to an alternate payee that must already be paid to a different alternate payee under another QDRO
- Provide a type or form of benefit (or any option) not otherwise provided under the plan

For example, the QDRO can't require the plan to provide cost-of-living increases if the plan doesn't already have cost-of-living provisions. Furthermore, a husband's plan can't allocate 60 percent of his benefits to his ex-wife if 50 percent of the benefits had previously been allocated to a prior spouse.

In what ways may retirement plans be divided pursuant to a QDRO?

The QDRO specifies what the plan administrator does with the spouse's share of the plan. But, if under the plan a participant has no right to an immediate cash payment, then a QDRO can't require the plan administrator to make an immediate cash payment to the spouse. Instead, a QDRO is generally used to segregate plan assets into a subtrust for the benefit of the alternate payee-spouse, with cash distributions made at the earliest time they would be permitted under plan provisions.

Defined contribution plans are easy to value (since the money is sitting in an individual account), and the plan administrator usually provides a quarterly report of the value. Defined benefit plans can pose a problem and often require the services of an actuary to ascertain the present value. This can be particularly true when your eventual pension payout is tied to your compensation during your three highest paid years.

Example(s): John is 50 years old and has a defined benefit plan that has no cash value right now. When John retires, he currently expects to receive \$1,200 per month. His ex-wife, Jill, will get a portion of the payout. If there is a 50/50 split of the present value according to a QDRO, John and Jill will each get \$600 per month at retirement time. However, if John actually receives \$1,800 per month when he retires, Jill will still only get \$600 per month.

In general, the following QDRO options are available:

- Segregation of plan assets: Segregate the alternate payee's portion of the plan until the employee reaches retirement age. At that time, the alternate payee can access the funds. With this approach, the alternate payee is treated as a participant in the plan. The employee's defined contribution plan balance (or defined benefit plan accrued benefit) is valued as of a certain date, and that benefit is divided between the participant and the alternate payee in accordance with the QDRO. Once divided, the alternate payee is treated similarly to a terminated participant with a vested deferred benefit. There are certain advantages to this approach. For example, if you're the alternate payee, you're probably assured of receiving some retirement income in the future. Also, you won't have to deal with the problems of how to invest your money right now and how to value the plan today. On the downside, staying in the plan maintains your economic ties to your ex-spouse, so you might lose some money if your ex-spouse takes early retirement. Also, you will not be able to control the investment decisions for your share of the retirement assets. Finally, your share of the plan will generally not be accessible to you until your ex-spouse reaches retirement age.

- **Current distribution of plan assets:** If the plan allows, the plan administrator can distribute (to the alternate payee) the full amount of money due. The alternate payee can then either keep the money and pay tax on it now, or roll it into an IRA or other plan within 60 days, thus delaying taxation. The best approach depends on the particular circumstances. For example, if you need cash now to fund expenses, you may want to keep all of the distribution. You're also able to control investment decisions. However, several potential drawbacks exist. First, there are tax problems if you don't roll the money into an IRA or qualified retirement plan within 60 days (the IRS can waive this 60-day rule under certain circumstances, such as proven hardship). Also, requesting a current distribution requires you to make your own investment decisions. Finally, you'll lose the long-term tax deferral advantage (as well as the retirement savings themselves) if you spend the money currently. For more information, see IRA and Retirement Plan Distributions.

Aside from QDROs, what options may spouses consider with respect to retirement plan assets?

One option is to trade retirement assets for something else. For example, a divorcing couple can simply decide that one spouse gets the entire retirement plan and the other gets the house, plus alimony. Alternatively, the other spouse receives a big cash buyout right now, instead of a claim on the pension assets. For more information about trading assets, see Property Settlement.

There are advantages to avoiding QDROs. You save time and money by not having to draft a QDRO. QDROs can be very expensive, especially when actuaries must be hired. Trading assets can simplify the property settlement considerably, which saves attorney's fees. Also, you may be able to trade for an asset you really want, like the house. In terms of disadvantages, you may jeopardize your future financial security if you relinquish pension rights today. Also, you and your spouse may not have enough other assets to make a fair division if your spouse keeps the entire retirement plan. In addition, if the retirement plan is a defined benefit plan, it will have to be valued in order to determine what amount of other assets would make an equitable offset.

Tip: QDROs don't apply to most nonqualified retirement plans, such as certain annuity plans and deferred compensation plans. So, if your spouse's plan is nonqualified, the specific QDRO rules don't have to be followed.

Tip: QDRO rules don't apply to IRAs. Nevertheless, it's possible for a QDRO to require a distribution of pension benefits to an employee, and then a transfer of the distribution to an IRA for the benefit of the former spouse.

When retirement plans are divided pursuant to a court order, what are the income tax ramifications?

- **Tax impact of QDRO on plan participant:** If a QDRO orders a distribution of funds from a participant's plan to a spouse or former spouse, those funds will not represent taxable income to the plan participant. The 10 percent early withdrawal penalty will not apply. However, if the alternate payee is a child or dependent (rather than a spouse), the distribution will be taxed to the plan participant. In such a case, the 10 percent early withdrawal penalty will not apply.
- **Tax impact on plan participant if there is no QDRO:** If there is no QDRO and retirement plan assets are distributed to a spouse (or anyone else), the distribution will be taxed to the plan participant. Furthermore, the 10 percent early withdrawal penalty may apply. Also, beware of withholding requirements. For more information, see IRA and Retirement Plan Distributions.
- **Tax impact of QDRO on former spouse (or alternate payee):** A spouse or former spouse who receives a distribution under a QDRO steps into the shoes of the plan participant. Thus, such distributions become taxable to the spouse rather than to the plan participant. The money will be included in the alternate payee's gross income in the year of distribution. However, any cost basis that the participant had in the plan must be apportioned. It will be allocated on a pro rata basis between the present value of the alternate payee's interest and the total present value of all the benefits payable with respect to the plan participant. If the alternate payee is the spouse or former spouse, the taxable part of any distribution received by such person will qualify as an eligible rollover distribution. Thus, it can be rolled over to an IRA or other plan. If the alternate payee is a child or other dependent, the money may not be rolled over to the IRA.

Example(s): Assume Donald was married to Helen and had a vested balance in his 401(k) plan of \$300,000. Donald had made after-tax contributions to the plan in the amount of \$30,000. Donald and Helen negotiated a divorce and a QDRO was approved. Pursuant to the QDRO, Helen would get 50 percent of the plan assets immediately (\$150,000). Donald's \$30,000 after-tax basis in the plan will be allocated to him and Helen based on the ratio of their respective interests in the plan. Thus, \$15,000 of the \$150,000 distribution to Helen will be nontaxable. The remaining \$135,000 will be taxable to Helen, unless she rolls this money over to an IRA or other plan within 60 days after receipt (subject to certain exceptions, as indicated above). Since the distribution was made pursuant to a QDRO, there will be no 10 percent early withdrawal penalty.

- Tax impact on former spouse if there is no QDRO: If there is no QDRO, the former spouse doesn't include the distribution in gross income. The distribution is taxable to the plan participant. Also, the plan participant may be subject to the 10 percent early withdrawal penalty. Such a distribution doesn't qualify to be rolled over to an IRA or other plan.

Tip: If you receive a distribution or payment under a QDRO from an eligible government Section 457 plan in which your spouse or former spouse is a participant, you generally must pay the applicable income tax. This treatment is a result of the Economic Growth and Tax Relief Reconciliation Act of 2001. Prior to 2002, the plan participant generally would have been responsible for paying the tax. However, under the act, the plan participant still must pay the tax if the distribution or payment is made to a child or other dependent.

Choosing a Beneficiary for Your IRA or 401(k)

Selecting beneficiaries for retirement benefits is different from choosing beneficiaries for other assets such as life insurance. With retirement benefits, you need to know the impact of income tax and estate tax laws in order to select the right beneficiaries. Although taxes shouldn't be the sole determining factor in naming your beneficiaries, ignoring the impact of taxes could lead you to make an incorrect choice.

In addition, if you're married, beneficiary designations may affect the size of minimum required distributions to you from your IRAs and retirement plans while you're alive.

Paying income tax on most retirement distributions

Most inherited assets such as bank accounts, stocks, and real estate pass to your beneficiaries without income tax being due. However, that's not usually the case with 401(k) plans and IRAs.

Beneficiaries pay ordinary income tax on distributions from 401(k) plans and traditional IRAs. With Roth IRAs and Roth 401(k)s, however, your beneficiaries can receive the benefits free from income tax if all of the tax requirements are met. That means you need to consider the impact of income taxes when designating beneficiaries for your 401(k) and IRA assets.

For example, if one of your children inherits \$100,000 cash from you and another child receives your 401(k) account worth \$100,000, they aren't receiving the same amount. The reason is that all distributions from the 401(k) plan will be subject to income tax at ordinary income tax rates, while the cash isn't subject to income tax when it passes to your child upon your death.

Similarly, if one of your children inherits your taxable traditional IRA and another child receives your income-tax-free Roth IRA, the bottom line is different for each of them.

Naming or changing beneficiaries

When you open up an IRA or begin participating in a 401(k), you are given a form to complete in order to name your beneficiaries. Changes are made in the same way--you complete a new beneficiary designation form. A will or trust does not override your beneficiary designation form. However, spouses may have special rights under federal or state law.

It's a good idea to review your beneficiary designation form at least every two to three years. Also, be sure to update your form to reflect changes in financial circumstances. Beneficiary designations are important estate planning documents. Seek legal advice as needed.

Designating primary and secondary beneficiaries

When it comes to beneficiary designation forms, you want to avoid gaps. If you don't have a named beneficiary who survives you, your estate may end up as the beneficiary, which is not always the best result.

Your primary beneficiary is your first choice to receive retirement benefits. You can name more than one person or entity as your primary beneficiary. If your primary beneficiary doesn't survive you or decides to decline the benefits (the tax term for this is a disclaimer), then your secondary (or "contingent") beneficiaries receive the benefits.

Having multiple beneficiaries

You can name more than one beneficiary to share in the proceeds. You just need to specify the percentage each beneficiary will receive (the shares do not have to be equal). You should also state who will receive the proceeds

should a beneficiary not survive you.

In some cases, you'll want to designate a different beneficiary for each account or have one account divided into subaccounts (with a beneficiary for each subaccount). You'd do this to allow each beneficiary to use his or her own life expectancy in calculating required distributions after your death. This, in turn, can permit greater tax deferral (delay) and flexibility for your beneficiaries in paying income tax on distributions.

Avoiding gaps or naming your estate as a beneficiary

There are two ways your retirement benefits could end up in your probate estate. Probate is the court process by which assets are transferred from someone who has died to the heirs or beneficiaries entitled to those assets.

First, you might name your estate as the beneficiary. Second, if no named beneficiary survives you, your probate estate may end up as the beneficiary by default. If your probate estate is your beneficiary, several problems can arise.

If your estate receives your retirement benefits, the opportunity to maximize tax deferral by spreading out distributions may be lost. In addition, probate can mean paying attorney's and executor's fees and delaying the distribution of benefits.

Naming your spouse as a beneficiary

When it comes to taxes, your spouse is usually the best choice for a primary beneficiary.

A spousal beneficiary has the greatest flexibility for delaying distributions that are subject to income tax. In addition to rolling over your 401(k) or IRA to his or her IRA, a surviving spouse can decide to treat your IRA as his or her own IRA. This can provide more tax and planning options.

If your spouse is more than 10 years younger than you, then naming your spouse can also reduce the size of any required taxable distributions to you from retirement assets while you're alive. This can allow more assets to stay in the retirement account longer and delay the payment of income tax on distributions.

Although naming a surviving spouse can produce the best income tax result, that isn't necessarily the case with death taxes. One possible downside to naming your spouse as the primary beneficiary is that it will increase the size of your spouse's estate for death tax purposes. That's because at your death, your spouse can inherit an unlimited amount of assets and defer federal death tax until both of you are deceased (note: special tax rules and requirements apply for a surviving spouse who is not a U.S. citizen). However, this may result in death tax or increased death tax when your spouse dies.

If your spouse's taxable estate for federal tax purposes at his or her death exceeds the applicable exclusion amount (formerly known as the unified credit), then federal death tax may be due at his or her death. The applicable exclusion amount is \$2 million in 2007 and 2008.

Naming other individuals as beneficiaries

You may have some limits on choosing beneficiaries other than your spouse. No matter where you live, federal law dictates that your surviving spouse be the primary beneficiary of your 401(k) plan benefit unless your spouse signs a timely, effective written waiver. And if you live in one of the community property states, your spouse may have rights related to your IRA regardless of whether he or she is named as the primary beneficiary.

Keep in mind that a nonspouse beneficiary cannot roll over your 401(k) or IRA to his or her own IRA. However, beginning in 2007, a nonspouse beneficiary may be able to roll over all or part of your 401(k) benefits to an inherited IRA.

Naming a trust as a beneficiary

You must follow special tax rules when naming a trust as a beneficiary, and there may be income tax complications. Seek legal advice before designating a trust as a beneficiary.

Naming a charity as a beneficiary

In general, naming a charity as the primary beneficiary will not affect required distributions to you during your lifetime. However, after your death, having a charity named with other beneficiaries on the same asset could affect the tax-deferral possibilities of the noncharitable beneficiaries, depending on how soon after your death the charity receives its share of the benefits.

**W3 Wealth Management,
LLC**
Shelby Morgan
90 N. Miller Road
Akron, OH 44313
330-836-3805
Shelby@W3wealth.com

Neither Forefield Inc. nor Forefield Advisor provides legal, taxation, or investment advice. All content provided by Forefield is protected by copyright. Forefield claims no liability for any modifications to its content and/or information provided by other sources.