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CUSO FINANCIAL
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Retirement Plans and Estate Planning





Retirement Plans and Estate Planning

When you die, what will happen to your retirement plan benefits? In general, your retirement plan benefits pass to the beneficiaries you designate on the plan beneficiary designation form. Your benefits will generally be subject to estate tax at your death and to income tax when benefits are distributed from the plan to your beneficiaries.

Who receives your retirement plan benefits after your death?

You can designate who will receive your retirement plan benefits at your death by designating a beneficiary on the plan form for naming beneficiaries. (Your spouse may have certain rights in the retirement benefits.) It is generally recommended that you designate beneficiaries, their shares, and any backup beneficiaries on the plan beneficiary form.

If you do not have a named beneficiary (or the designated beneficiary predeceases you and you do not have a backup beneficiary), benefits will be distributed according to the terms of your retirement plans (which may specify certain default beneficiaries, such as a spouse). If retirement plan benefits end up distributed to your estate, the plan benefits will be distributed according to the terms in your will. However, if you do not have a will or if the benefits cannot be distributed under the terms of your will, the benefits will be distributed under your state's intestate succession laws. A typical intestate succession law might give one-half or one-third to your spouse with the balance divided equally among your children.

Estate taxation of your retirement plan benefits at your death

At your death, your retirement plan benefits will generally be included in your gross estate for federal estate tax purposes. However, if your retirement benefits consist of annuity payments for life that end at your death, there is nothing remaining to include in your gross estate. There is an unlimited marital deduction for property you leave to your surviving spouse, and an unlimited charitable deduction for property you leave to charity. You have an applicable exclusion amount that can protect some or all of your taxable estate from estate tax. If your retirement benefits pass to someone who is two or more generations younger than you, such as your grandchild, there may also be generation-skipping transfer (GST) tax. You have a GST exemption that can protect some or all of your GSTs from GST tax.

The applicable exclusion amount and the GST exemption are both equal to \$5,450,000 in 2016. They are adjusted for inflation and may increase in future years.

Income taxation of retirement plan distributions after your death

After your death, your beneficiaries will generally be required to take distributions from your retirement plans over their life expectancies. The rules may be more favorable if your surviving spouse is the beneficiary of your retirement plan.

Generally, property that is included in your gross estate receives an income tax basis that is stepped-up (or stepped-down) to fair market value at your death. However, your retirement plan benefits do not receive such a step-up (or step-down) in basis. In general, for income tax purposes, your beneficiaries will include distributions from the retirement plan in income when received. Your beneficiaries can take an income tax deduction for estate tax attributable to the retirement plan benefits; the deduction is apportioned and taken into account as distributions are received and included in taxable income.

If you have made any nondeductible contributions, your beneficiaries can generally exclude a portion of the distributions from taxable income. However, if you have not made any nondeductible contributions, the entire distribution will generally be included in the beneficiary's taxable income.

On the other hand, distributions made after your death from a Roth 401(k) plan or a Roth IRA will generally be qualified distributions that are not taxable income to your beneficiaries (as long as certain five-year holding periods are met). A nonqualified distribution from a Roth IRA is treated as first coming from your contributions (which are nontaxable), and then from earnings (which are taxable). A nonqualified distribution from a Roth 401(k) plan, however, is treated as consisting of a pro-rata share of Roth contributions (nontaxable) and investment earnings on those contributions (taxable).

State taxation of retirement benefits

Your retirement benefits may also be subject to state estate, inheritance, GST, or income taxes.

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