

# How to choose a life insurance beneficiary

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Many consumers buy life insurance, list their spouses as the beneficiaries and never think about the matter again. But experts say that failing to put much thought into your beneficiary selection can be a big mistake.

The first step in choosing a life insurance beneficiary is to think about the people who depend on you financially. "Think about who would be affected if you didn't come home from work tomorrow," says Jeff Root, owner of Root Financial and Insurance Services, an independent life insurance agency.

According to Nationwide Insurance, you've got several options for listing a beneficiary: one or more people, a trust, your estate or a charity. A trust is a legal agreement that allows you to place property in the trust and to name trust manager. A probate estate is made up of all the property a person owns in his or her own name, including a home, bank accounts, antiques, art and jewelry. After death, a probate court – a state court that handles wills and estates – usually oversees the distribution of the property; this can take up to a year or longer.

Option 1: Pick someone as your beneficiary.

- Designate a primary beneficiary – If you're married and you bought life insurance to replace your lost income, you probably should name your spouse as the primary beneficiary, says Tony Steuer, director of financial preparedness at nonprofit education and advocacy group United Policyholders.

If you die, your spouse then would be able to file a life insurance claim and get a lump sum directly, says Stephen Hartnett, associate director of education for the American Association of Estate Planning Attorneys. The spouse would not pay federal income tax on the payout because life insurance proceeds usually are not subject to income tax. Because of a federal provision called the "unlimited marital deduction," which allows spouses to transfer an unlimited amount of money or property to each other tax-free, the amount that goes to the surviving spouse would not be subject to estate taxes.

- Choose a secondary beneficiary – Many policyholders don’t know they can and should list a secondary (or contingent) beneficiary – someone who will get the life insurance money if the primary beneficiary no longer is alive, Steuer says. If a husband and wife were to die at the same time – in an airplane crash, for example – having another adult beneficiary listed could prevent the payout from getting tied up for months in probate court, which handles wills and estates.

“Going through the courts takes a long time, it’s a hassle and it reduces the size of the estate,” says Chris Huntley, president of Huntley Wealth Insurance.

He notes that probate court costs and attorney’s fees can end up taking 1 percent to 1.5 percent of the total assets. Choosing a secondary beneficiary lets the policyholder, rather than the probate court, decide who gets the money. A probate court will use a will, if one exists, to decide how to hand out property. However, money and other property not covered by a will typically are awarded to one or more relatives based on state laws.

- Consider naming several beneficiaries – You also have the option of listing two or more people as primary or secondary beneficiaries. You can select what percentage you’d like each person to receive. Experts say this can be a good way to keep things simple, make sure each person actually gets his or her fair share and prevent squabbling. “It’s just a cleaner way to do it,” Steuer says, rather than awarding the money to one person and counting on him or her to distribute a share to others.

Naming a beneficiary is not a set-it-and-forget-it situation, Huntley says. He recommends setting up a once-a-year reminder to yourself, such as an alarm on your online calendar, to review your beneficiaries so you can include additional children or grandchildren and remove ex-spouses or beneficiaries who have died, he says.

Option 2: Set up a trust to act as your beneficiary.

Choosing a person as a beneficiary might be easier initially, but experts say taking the time to set up a trust can offer many advantages. Many estate-planning attorneys offer free consultations to help a consumer determine whether a trust might be the right option, Hartnett says. Having an attorney set up a trust can cost from about \$500 to \$2,000 or more, according to Huntley. Each situation is different, but here are some reasons experts say it might make sense to set up a trust:

1. A trust can help you take care of your kids or pets. If you have minor children, you can set up a trust to make sure they'll have everything they need as they grow up. For example, you could set it up to make regular payments to a guardian to cover food, clothes and school supplies, with provisions for the person you name as trustee to pay extra money if, for example, the child needs braces or surgery, Steuer says.

You also should name a backup trust manager, in case the manager you chose dies or is unable to handle the duties, experts say. If you want to use your life insurance to provide for pets, how you do so will depend on the laws of your state. However, Hartnett says, the most common way is to set up a trust or choose a pet guardian and name that person as a beneficiary.

2. A trust gives you more control over the money. A successful businesswoman married to a financially irresponsible man might use a trust to make sure her husband uses the life insurance money to pay off the mortgage and bills rather than blowing it all on a Maserati, according to Hartnett. You could set up the trust to pay out any amount you want and designate that money for specific expenses – for example, \$10,000 a year for living expenses, Steuer says.

3. A trust can keep the money safe. A trust offers many protections for a large sum of money, Hartnett says. For example, say a husband who has \$1 million in life insurance dies of a heart attack. If that money goes into a trust for his wife, it will be protected from creditors and lawsuits for personal liability, Huntley says. That's because the trust, not the wife, is considered the owner of the money that's in it. So, if the wife racks up a huge debt, the creditors won't be able to go after the money in the trust.

4. A trust can have tax benefits. While life insurance money going directly to a spouse typically is exempt from income taxes and estate taxes at the time of death, an estate planning attorney can help consumers figure out the tax benefits of a trust now and in the future, experts say. "A trust can be a legitimate tax minimization technique," Hartnett says.

For example, if you set up an irrevocable life insurance trust, which cannot be changed and is designed to hold a life insurance policy, then you can avoid having the life insurance policy be counted as part of your estate when you die. And you also can avoid having it counted as part of your spouse's estate when he or she eventually dies.) That means it would not be included in the total amount of your estate, so your estate might be less likely to reach the dollar threshold for federal taxes.

It's important to find an attorney who specializes in estate planning to help you determine whether a

trust is right for you and which type of trust is best, and to set up the trust, Steuer says, He says you can find a good attorney through your state bar association or through a financial planner.