Life Insurance Beneficiary

Things most people don't think about when naming a beneficiary for life insurance.

The First Area is Naming a Minor Child

Life Insurance Companies cannot pay the life insurance proceeds directly to a minor and in most cases they will not hold the proceeds until the beneficiary attains age of majority (if they would hold the proceeds is that really what you would want). Insurance companies will rely on the court appointing a guardian, which is costly and considered a public record. You can avoid this by either creating a trust or making legal arrangements for someone to manage the money in essence naming a guardian. However, naming someone as the beneficiary gives the proceeds to that person for their benefit; you cannot establish requirements or restrictions. You can think, assume or hope that the person you have named as beneficiary will use the proceeds for the benefit of your minor child but you cannot require it or guarantee it.

It is better to set up a trust to benefit the child and name the trust as the beneficiary of the policy. This type of trust is established in your will. It does not have any assets in it until you die and is known as a testamentary trust.

The second area is well intentioned but can be problematic. If you name a child with a disability as beneficiary it could result in the special needs individual no longer qualifying for government assistance. Anyone who receives a gift or inheritance of more than $2,000 is disqualified for Supplemental Security Income and Medicaid, under federal law.

Forgetting that you live in a Community Property State

Generally you can name anyone including a nonprofit organization or trust as a beneficiary. However in Community Property States, your spouse would have to sign a waiver of their rights to the proceeds if you designate anyone else as beneficiary.

The Community Property States are:

- Arizona
- California
- Idaho
- Louisiana
- Nevada
- New Mexico
- Texas
- Washington
- Wisconsin
- Alaska and Tennessee are opt-in States, where spouses can elect to participate in the community-property laws. But they must remember that the community-property laws work both ways.

In essence if after opting-in they should win a lottery it will be shared.

Making Life Insurance Proceeds Taxable

Life insurance proceeds are generally tax-free with one exception: if different people play the roles of policy owner, the insured and the beneficiary. If separate people are in each role the death benefit could count as a taxable gift to the beneficiary.

If a husband owns a policy on his wife and name's their children as beneficiaries, this effectively creates a gift of the proceeds. The husband, the giver of the gift would be the one who would be subject to the gift tax, if the amount of the policy exceeds the federal gift tax limit which is $15,000 per recipient for 2018.

Wills Never Supercede a Designation of Beneficiary (No Matter How Out-of-Date)

Regardless of what is in your will, the Designation of Beneficiary form will be complied with. Remember that in addition to Designation of Beneficiary forms for life insurance including the FEGLI (SF-2823) within your federal benefit package you should also keep the TSP-3 for your Thrift Account, SF-1152 unpaid compensation if you should die as an employee and the SF-3102 for your contributions to the FERS fund if you should die before they are recovered and there is no one eligible for a monthly survivor's benefit. Make sure to keep all Designation of Beneficiary forms updated. No matter how old and out dated your designation is it will be complied with unless you have cancelled or superceded it with a signed, witnessed, dated, properly processed designation.

Pay Attention to Details

List beneficiaries by name, include their social security numbers, and address so that the insurance company doesn't have to search for "my children" which can result in lengthy delays. Don't forget to include instructions if one or more named beneficiaries predeceases you, per stirpes meaning by branch of the family or per capita meaning by head. For example, if you have two children to whom you would want your assets to go, or to the grandchildren if either child pre-deceases you. If one child has three children and the other has one child. If your child who has three children predeceases you and your assets were distributed 'per stirpes' half of your assets would go to your three grandchildren and the other half would go to your child. Under per capita the money would be divided equally among the three grandchildren and your surviving child in essence each would receive 25%.

Follow-up with contingent, or if living, otherwise to beneficiaries. If there is no living beneficiary, the life insurance proceeds typically goes into the estate and becomes subject to probate. There are two problems with that: (1) heirs might wait a long time before getting the proceeds and (2) life insurance proceeds are normally protected from creditors, once it becomes part of the estate it is open to creditors' claims.