Beneficiary Planning Investor Guide

Design a plan for you and your beneficiaries

Principal® Financial Group

Today is an important day. It is the day you will develop a comprehensive beneficiary plan that will let you relax, knowing your assets will be directed where you want them to be. Today, you will set your beneficiaries on the road to a solid financial future.

This beneficiary planning guide will answer questions about how to designate beneficiaries properly, how to preserve assets for your beneficiaries, and how to manage tax-deferred growth, taxes, and penalty issues.

Let's get started.

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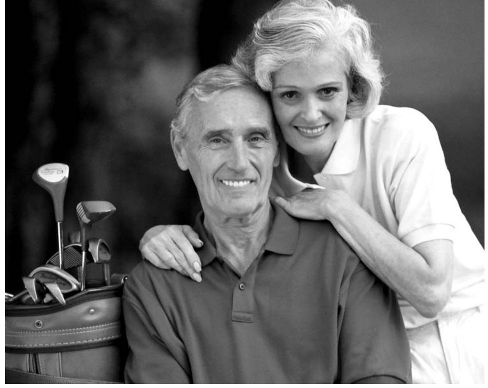

What can a beneficiary plan do for me? For my beneficiaries?

You invested in an IRA to fund your retirement. You may even be getting distributions from your IRA now. But what happens to the remaining assets if you pass away before your account is empty? It will go to someone else, of course. But who?

Good beneficiary planning will help ensure that your intentions for your assets are communicated

If you are like most people, the last time you thought about which beneficiaries you named on your IRA was the day you opened it. But it is important to review your beneficiary designations regularly to make sure your assets go where you want them, and to avoid any unnecessary expenses that could deplete your savings. Developing a beneficiary plan can help make sure your wishes are carried out.

There are also many ways to distribute your assets, with advantages and tax considerations for each. A strong beneficiary plan will not only specify how your assets will be distributed, it will include strategies to help avoid unnecessary taxes and penalties when the funds are disbursed. In addition, your plan will help prepare your beneficiaries to receive and manage their pre-tax dollars and perhaps continue the potential for tax-deferred growth.

This beneficiary planning guide will lead you through the process. You will:

Pull all your assets together and list them in the guide

Review the beneficiaries you have designated and make sure this is still what you want

Have a comprehensive, easy-to-understand resource where all your financial information is consolidated and easy to access

Help your beneficiaries understand how they can receive your assets when you have passed on

Assist your beneficiaries in finding simple steps and key deadlines they need to be aware of once they've inherited your account

Developing a plan will clarify your intentions and maximize your assets

Step 1 — review your assets

First, you will need to locate and record all your retirement assets — such as IRAs, employer-sponsored retirement plans, bank accounts, stock, etc. — on the following pages. Make sure to list them all. It is helpful to record the company with which you have the account and the account number. Also, indicate where you physically store the contract documents and paperwork.

Step 2 — review your current beneficiary designations

What do you want to do with your assets? You must ensure that your hard-earned assets will be properly allocated to those you intend to receive them, and that your instructions will be clear to your beneficiaries.

Month	*Day*	*Year*

Put today's date in the box to the left. This will remind you of when you updated your beneficiary designations. Ideally, you should review your beneficiaries whenever you or your loved ones experience a life change, or at least every few years.

This is the time to think carefully about what your intention is for your assets. Is it:

- Making sure your spouse or significant other is taken care of
- Creating a legacy for your children and grandchildren
- Supporting a meaningful charity
- Setting up a resource to take care of a family member with specific needs

Think about the beneficiaries you have designated on each account. Ask yourself:

1. Have you or your beneficiaries experienced any recent major life events that might change the way you distribute your assets?

☐ Marriage ☐ Adoption ☐ Death ☐ Change in health
☐ Birth ☐ Divorce ☐ Job change

2. Have you named your estate as the beneficiary of your retirement accounts? ☐ Yes ☐ No

3. Have you named both a primary (first to inherit) and contingent (secondary) beneficiary? ☐ Yes ☐ No

4. If you listed a charity or other entity as a beneficiary, do you still want to support this effort? ☐ Yes ☐ No

Are there new beneficiaries, needs, or changes that affect how you want your assets distributed? If so, then it's time to work with your financial professional and bring these designations up to date.

Step 3 — Compile an inventory of all your current assets

Type of asset:

Account/contract number:

Providing company:

Beneficiary(s): *Primary* *Contingent*

Document storage location:

I want the assets to be used to:

Type of asset:

Account/contract number:

Providing company:

Beneficiary(s): *Primary* *Contingent*

Document storage location:

I want the assets to be used to:

Type of asset:

Account/contract number:

Providing company:

Beneficiary(s): *Primary* *Contingent*

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I want the assets to be used to:

Type of asset:

Account/contract number:

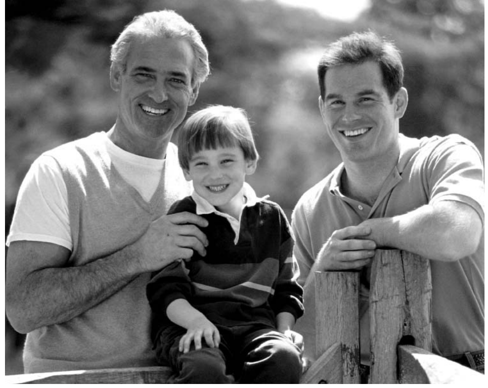
Providing company:

Beneficiary(s): *Primary* *Contingent*

Document storage location:

I want the assets to be used to:

After you designate your beneficiaries, make sure to contact the company that holds your assets and update their records to reflect your current beneficiary designation.



Benefits and considerations for each type of beneficiary

Choosing beneficiaries will clarify your intentions and minimize taxes

There are two classes of beneficiaries:

Primary beneficiary — This is the first beneficiary to inherit the assets.

Contingent beneficiary — If the primary beneficiary is deceased or disclaims the IRA*, the contingent beneficiary will receive the assets.

*Before disclaiming an IRA, consult with a legal professional.

There are four basic types of beneficiaries:	
Spouse	*Non-Spouse* (children, other family member, friend, partner, etc.)
Charity	*Trust*

There are tax implications, rules, and regulations that apply to each type of beneficiary. You need to be aware of these issues when you develop your beneficiary plan. The plan will not only help ensure that your heirs receive their inheritance, but will also help you minimize taxes and avoid penalties.

TIP: Naming both a primary and contingent beneficiary will help ensure that your assets are inherited by the parties you want to inherit them.

Naming a spouse as beneficiary

It is most common for married people to name their spouse as their primary beneficiary. This is the least complicated transfer of assets, and the spouse has the greatest amount of freedom and flexibility in handling the assets.

As your primary beneficiary, the surviving spouse becomes entitled to the IRA. He or she will have two options:

Option 1 — Assume ownership of the IRA

The spouse may do this by re-titling the account in his or her name, or by rolling the assets over into their previously owned or existing IRA. The spouse will be subject to the normal distribution rules for all IRA owners.

Option 2 — Remain a beneficiary

A spouse may choose to remain a beneficiary on an inherited IRA. This is often a good choice when the spouse is under age 59½ and wants to take distributions without an early withdrawal penalty. It is important to note that the spouse would not be required to take distributions until the IRA owner had reached the age of 70½. At any time after reaching age 59½, they may consider assuming ownership of the IRA as described above. Also, the spouse may assume ownership of the IRA at any time, but they would be subject to normal IRA distribution rules.

If the spouse has enough resources from life insurance, pension benefits, etc., they may not need the IRA. Therefore you could name another beneficiary for this asset. Or you could name a contingent beneficiary and leave your spouse the option of waiving the right to disclaiming the IRA assets and passing them on to the contingent beneficiary(s).*

* Before disclaiming an IRA, consult with a legal professional. Please note that gift taxes may also apply.

TIP: Have you named a non-spouse beneficiary on your employer-sponsored retirement plan? If so, they may be able to roll the assets from the plan to an inherited IRA. Until recently, this option was only available to spouses.

Choosing a non-spouse as beneficiary (children, grandchildren, friends, partners, etc.)

This category of beneficiary includes any living person who is not related by marriage to the IRA owner.

Here are some things to take into account when naming a non-spouse beneficiary:

Age — When you name a younger beneficiary, they will be able to stretch distributions out for as long as they are expected to live — 30, 40, or even 50 years — depending on their age. This has several advantages:

- By taking only the required minimum distributions (RMDs), the assets have the potential to continue to grow tax-deferred throughout their lifetime distribution period.
- The beneficiary may receive income over an extended period of time.
- The beneficiary will be taxed only on the distributed amount each year.
- There is no 10 percent IRS early withdrawal penalty.
- The beneficiary will be able to name a remainder beneficiary to receive the assets remaining at their death.

Naming a custodian for minor children — If you are naming a minor child as a beneficiary, also consider naming an adult custodian. If it's available in your state, think about establishing a custodian account like a Uniform Transfer to Minor Account (UTMA) or a trust.

Skipping Taxes — Consider the "generation-skipping" tax when naming grandchildren as beneficiaries. The tax is assessed on assets being passed more than one generation removed from the owner. Ask your tax professional to review your specific situation.

One IRA... multiple beneficiaries

If you have multiple beneficiaries on a single IRA, they could be required to take distributions based on the age of the oldest beneficiary. If there is a significant age difference between the beneficiaries, younger beneficiaries might have larger sums disbursed and less opportunity to defer taxes while letting the assets grow. If each beneficiary wants to take distributions based on their own individual life expectancies, they must notify the IRA custodian to establish separate accounts by December 31 of the year after the IRA owner's death.

NOTE: While taking only the RMD will maximize the power of the stretch IRA strategy, larger distributions can be taken if needed. Stretch IRA strategies may not be appropriate in all circumstances; specifically, if there is an immediate need for the deferred assets.

Charities may provide additional tax benefits and trusts may offer more control

Selecting charities as beneficiaries

If you feel passionate about a cause and want to support an affiliated charity, you might consider naming that charity as your beneficiary. This will allow you to make a donation that could reduce the size of your taxable estate.

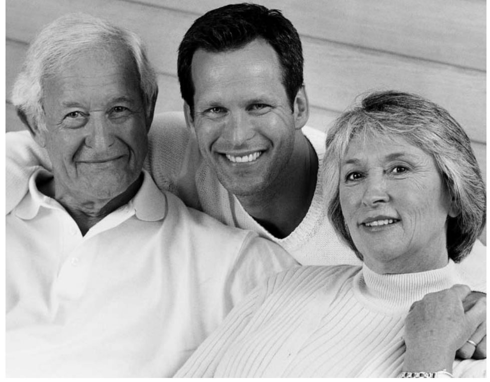
Advantages to the charity in receiving this type of bequest:

- The charity can use IRA assets free of federal income taxes.
- If you've already begun taking a RMD, the charity can take any remaining RMDs for the year of death, free of federal income taxes.

Naming a charity and another beneficiary on the same IRA

When you combine a charity and an individual beneficiary on the same IRA, there is a timing issue that can affect the individual beneficiary. The charity will need to take its entire share by September 30 of the year following the owner's death in order for the individual beneficiary to receive a life expectancy distribution.

Naming a charity and an individual as beneficiaries on the same IRA can get a little tricky when it comes time to transfer the assets. If you want a charity and your heirs to receive a portion of your inheritance, consider leaving your IRA to a charity, and non-IRA assets to your heirs. A charity can use IRA assets tax-free, and heirs who inherit non-IRA assets may receive a step-up in basis, potentially reducing their taxes. With a step-up in basis, the value of the asset is determined to be the higher market value of the asset at the time of inheritance, not the value at which the original party purchased the asset. No tax is paid on the step-up amount.



Naming trusts as benficiaries

Naming a trust as a beneficiary of your IRA gives you more control over how your savings are passed on to your intended beneficiaries. The main reason to make a trust the beneficiary of your IRA is for personal, non-tax reasons — like restricting access to the money for beneficiaries who could be too young or have special needs, or because you need to protect your assets from creditors.

If your loved one is not able to handle management of the inheritance, forming a trust for this purpose is often a good choice. Trusts help manage withdrawals and can keep the assets invested and growing for the beneficiary. If you form a trust, you would name the trust as beneficiary to your IRA assets. There are a few complexities you need to be aware of: maintenance, tax treatment, and limited flexibility.

Maintenance — You will need to name a trustee to manage the trust in order to invest assets, take care of paperwork, and disburse funds to your loved ones.

Tax treatment — Trust tax rates go up more quickly than personal tax rates. This means the trust will be paying a higher tax rate on earnings than an individual with the same earnings would pay. And each year the trust may need to hire and pay for a professional to file tax returns.

Limited flexibility — If the trust provides for a stretch IRA option in distributing the assets, the age of the oldest beneficiary will determine the amount of the RMD. If there is a significant age difference, that means less flexibility to grow the assets and less opportunity to plan for tax deferral.

Still, if you need to provide ongoing care and support for a family member, a trust may be the best choice. Your financial professional can assist you in setting up an appropriate trust situation to fit your needs.

Special considerations for stretching through a trust

When you name a trust as your beneficiary, make sure the trust document meets the requirements that allow for stretching your IRA distributions. They are:

- The trust must be a valid trust under state law. Contact your legal professional to assist you with this.
- The trust must be irrevocable upon death.
- The beneficiaries of the trust must be identifiable.
- The IRA trustee, custodian, or plan administrator must be provided a copy of the trust document by October 31 of the year following the IRA owner's death.

Proper distribution maximizes the benefits to beneficiaries

How a beneficiary receives assets from an inherited IRA determines how the distributions will be taxed, and whether or not any penalties will apply to the distributions. Remember that distributions may be subject to federal and state income tax, but will not be subject to an IRS early distribution penalty of 10 percent regardless of the beneficiary's age.

There is an exception when a spouse is under 59½ and makes the account his or her own at the time of distribution. Then the IRS early distribution penalty applies. The beneficiary may name his or her own remainder beneficiaries, and the remaining assets continue to have the potential to grow tax-deferred.

Lump sum distribution

If the beneficiary has an immediate financial need — such as covering final expenses, paying the bills of the owner's estate, or personal need — a lump sum payment may make the most sense. But there are some issues to consider:

- The distribution may increase the beneficiary's taxes in the year they are taken.
- The beneficiary will lose the tax-deferral advantage of the IRA.
- Talk to a tax professional before using this option to understand your specific situation.

A word of caution about taking a lump sum distribution: Beneficiaries can decide to immediately cash out the IRA and take a lump sum payment, but there are serious consequences. For example, if a beneficiary cashes out a $500,000 IRA and he or she is in a 35 percent tax bracket, he or she may have to write a check to the government for $175,000 — over a third of the assets. Unless there are extreme circumstances, taking a lump sum distribution is not usually the best distribution choice.

Distribution options available to different types of beneficiaries

This chart is a quick reference to compare how different beneficiaries are affected by their choice of distribution when the IRA assets are transferred.

Distribution Option	Beneficiary Considerations	Spouse	Non-Spouse	Trusts	Charity	Estate
Available regardless of the owner's age at death						
Lump sum distribution with no rollover	As the term implies, the entire balance is distributed at one time or over the course of a single tax year.	X	X	X	X	X
Owner passes BEFORE the required minimum distribution date (generally at age 70½)						
Five-year distribution option	Allows the beneficiary to take distributions at any time, but the entire balance of the accounts must be distributed prior to the end of the fifth year following the owner's death.	X	X	X	X	X
Inherited account with life expectancy	Commonly referred to as "stretch," this may allow beneficiaries to take distributions for a longer time period based upon their own life expectancy.	X[1]	X	X[2]		
Owner passes AFTER the required minimum distribution date (generally at age 70½)						
Inherited account using the life expectancy of the beneficiary	Commonly referred to as "stretch," this may allow beneficiaries to take distributions based upon their own life expectancy.	X[3]	X	X[2]		
Inherited account using the life expectancy of the IRA owner	Beneficiaries may continue distributions based on what would have been the owner's life expectancy. This life expectancy is determined by the age the IRA owner would have been at the end of the year of death.	X	X	X	X	X
Special option for spouse						
Transfer assets into their own IRA	The spouse will be subject to the same distribution rules as if the IRA had been theirs originally.	X				

[1] The spouse beneficiary can defer distributions until the owner would have reached age 70½. The required minimum distribution will be based on the beneficiary's age at that time and will be adjusted each year.

[2] Must be a qualified trust. Distributions are based on the life expectancy of the oldest beneficiary of the trust.

[3] For a spouse beneficiary, the factor is re-calculated each year based on their age.

Five-year distribution

This option is available only if the IRA owner was under 70½ and had not taken the first RMD. If the option is available, spreading distributions out over a five-year period could have better tax consequences for the beneficiary. Furthermore, the assets have the potential to continue to grow on a tax-deferred basis during this time.

Inherited account with life expectancy

The IRS requires beneficiaries to take minimum distributions from their inherited IRA each year. **Failure to take the required distribution can result in a 50 percent IRS penalty on the amount that should have been withdrawn.** Beneficiaries must make sure their RMDs are calculated correctly.

When a beneficiary inherits the IRA, distributions can be based on his or her life expectancy. If he or she only takes the RMD, this can have the advantage of keeping the bulk of the assets growing in a tax-deferred account longer.

RMDs are calculated using the Single Life Expectancy Table to determine the beneficiary's life expectancy based on their current age. Here's an example:

Prior year's 12/31 account value

Divided by

Single life expectancy factor

= RMD

Example of how to calculate inherited RMD

John, age 55, has an inherited IRA valued at $100,000 as of December 31 of last year. He calculates his RMD by dividing $100,000 by 29.6 (the life expectancy factor from the IRS Single Life Expectancy Table). John's RMD is $3,378.

$100,000

Divided by

29.6

= $3,378

This amount must be taken out by December 31 of the year after the IRA owner dies. Yearly RMDs for subsequent years are calculated by subtracting 1 from the life expectancy factor used for the first year's RMD. Additional amounts can be withdrawn at any time, but the RMD must be calculated and taken each year.

Your financial professional can help with this. If there are several beneficiaries on the IRA, the age of the oldest will be used to calculate the RMD.

Special option for a spouse

As mentioned earlier, the surviving spouse of an IRA owner has more options and flexibility in setting up distributions. As your primary beneficiary, the surviving spouse becomes entitled to the IRA. He or she will have two options:

Assume ownership of the IRA — The spouse may do this by re-titling the account in his or her name, or by rolling the assets over into his or her previously owned or existing IRA. The spouse will be subject to the normal distribution rules for all IRA owners.

Remain a beneficiary — A spouse may choose to remain a beneficiary on an inherited IRA. This is often a good choice when the spouse is under age 59½ and wants to take distributions without an early withdrawal penalty. It is important to note that the spouse would not be required to take distributions until the IRA owner had reached the age of 70½. At any time after reaching age 59½, they may consider assuming ownership of the IRA as described above. The spouse may assume ownership of the IRA at any time, but they would be subject to normal IRA distribution rules.

If the spouse is the sole beneficiary and chooses to remain as a beneficiary (other than making it their own), then the spouse must begin taking RMDs by whichever is *later:*

December 31 of the year the IRA owner would have turned 70½

or

December 31 of the year after the IRA owner's death

The spouse would take distributions as a beneficiary and can recalculate life expectancy each year rather than reducing the first year's life expectancy by one every year. This allows the distributions to be stretched out a little longer. With this option, all distributions taken before the spouse is 59½ will not be subject to the 10 percent IRS penalty.

Designating your assets for a specific purpose

Do you want to make sure your spouse is financially taken care of? Are you making your son your beneficiary so that he has the funds to start his own business? Do you want your daughter to get her master's degree? Now is the time to make these feelings known.

Bringing it all together

Determining who will be your beneficiary is just one step in developing an effective beneficiary plan. Your plan also may need to provide opportunities to educate and counsel beneficiaries to make the transition easier for them when the time comes.

Make sure they are aware of your wishes by recording them in this guide. Although your wishes are communicated, once the beneficiaries receive the money, they are not obligated to comply with those wishes.

A family meeting — a time to discuss your plan with your loved ones

Think about holding a family meeting to discuss these and other end-of-life issues. A family meeting will provide the opportunity to state your goals and intentions for your hard earned assets. The meeting will make your beneficiaries better prepared when the time comes, and it may be a smart financial move. Your financial professional will help you set up and conduct a successful family meeting.

Review regularly

Remember to check and update your asset list and beneficiaries regularly. Review your beneficiary designations to take into account life changes like marriage, divorce, births, or a family member's health issues. Any of these can cause you to rethink your beneficiary designations.

Use this guide. Work with your financial professional and craft a beneficiary plan you can be comfortable with. Both you and your beneficiaries will be glad you made the effort.

Beneficiaries can maximize their inheritance by planning ahead

When the time comes to receive your inheritance, there will be a lot to think about. This guide — and particularly this section — will help you handle the details of the transfer, outline important steps you need to take, and help make sure you avoid missteps that could be costly. Remember that your financial professional is available to help you through the process.

First steps

- ☐ Work with your financial professional. They will help you with any filing deadlines, distribution options, penalty avoidance, or tax issues, and help you allocate the assets to meet your goals.
- ☐ Make sure you request enough death certificates. Most financial institutions will require a death certificate before releasing assets.
- ☐ Contact the Social Security Administration and advise them of the death. They will let you know if there is a need to return a Social Security payment.
- ☐ Notify all appropriate companies and ask for necessary claim forms.
- ☐ Make sure you name primary and contingent beneficiaries on your inherited account.
- ☐ Review the beneficiary listings on your own assets. The deceased may have been listed on your accounts.

Choosing a distribution option

Carefully consider these questions before you determine how you will take distributions from inherited IRAs:

- Is money needed now to cover final expenses and the owner's debts?
- As a beneficiary, does your need for income outweigh the growth opportunities offered by an IRA?
- If you have an immediate need, how much is needed?
- What are the tax implications for you if you take a lump sum distribution now?
- Would there be a benefit to you if you could defer taxation on some of the inheritance until a later time?
- Did the owner discuss how they would like their assets distributed? Do you need help to carry out those wishes?

Remember that IRAs are not governed by the owner's will and are not subject to probate. If the IRA owner names the estate as the beneficiary, then it will go through probate. That may save time and money. Now examine your options. It's a good starting place when you talk with your financial professional.

Be aware of these important dates

After you've identified all IRA assets, contact the companies (custodians) as soon as possible after the owner's death to discuss how distributions will be made. There are some time considerations that will affect the options available to you:

- **To elect a life expectancy distribution for individual beneficiaries if a charity is also named as a beneficiary on the same IRA** — The charity will need to take its entire share by September 30 of the year following the owner's death in order for the individual beneficiary to receive a life expectancy distribution.
- **If a trust is the beneficiary** — The trustee must file a copy of the trust documents with the IRA custodian by October 31 of the year following the IRA owner's death to meet IRS requirements.
- **Life expectancy distributions** — Distributions must be separated and distributed by December 31 of the year following the IRA owner's death.

At this time you'll understand the wonderful gift your loved one left for you. As you move forward, remember to take the same care as you designate and prepare your own beneficiaries. As soon as you're able, visit with your financial professional to make sure this wonderful legacy can continue to meet your goals and those of your beneficiaries for years to come.

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WE'LL GIVE YOU AN EDGE®

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MM3791-01 | 04/2010 | t100401009e