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DESIGNATING BENEFICIARIES THROUGH CONTRACTUAL ARRANGEMENTS

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WHEN PEOPLE DIE, their property can be transferred to their beneficiaries by three methods:

- contractual arrangements
- written wills
- South Dakota intestate succession statutes (*laws for those who did not have a will*).

This fact sheet focuses on contractual arrangements in which the owner designates each beneficiary to receive either all or various percentages of the property.

CONTRACTUAL ARRANGEMENTS

Contractual arrangements are considered as transfers taking effect at death if they specifically provide for the passing of property to a beneficiary. Contractual arrangements include, but are not limited to, the following types of assets:

- life insurance and annuity policies
- qualified and nonqualified deferred compensation plans
- individual retirement accounts (IRAs)
- employee benefit plans and Keogh retirement accounts
- living trust
- payable on death (POD) accounts for checking and savings accounts, certificates of deposit, and savings bonds
- transfer on death (TOD) accounts for stocks and bonds

DEFINITIONS

Throughout this fact sheet, the term *financial entity* refers to a financial institution, insurance company, pension plan, employee benefit plan and so on that provides contractual arrangements. The terms proceeds and assets refer to real and personal property that will pass to designated beneficiaries by the contractual arrangements. The term *beneficiary designator* refers to the person who designates the beneficiaries in writing on the contract.

CONTRACTS AND PROBATE

Probate*, one of the legal procedures that generally takes place to settle a deceased person's estate, is not required for contractual arrangements.

Although probate may be avoided with contractual arrangements, assets that pass to beneficiaries are still subject to federal estate taxes as well as creditors' claims against the decedent's estate.

However, property passing to certain beneficiaries is exempt from state and federal taxes.

South Dakota's multiple party accounts statutes, which allow payable on death (POD) designations on financial institution accounts, state that if there is more than one beneficiary on the account, the sums on deposit belong to them in equal and undivided shares.



CONTRACTS AND WILLS

Contracts take precedence over a person's written will.

Example: If a mother named her son as the beneficiary of a \$100,000 life insurance policy and later wrote a will leaving the same life insurance proceeds to her daughter, that section of the will would be considered ineffective. The contract has priority—her son receives the \$100,000 in life insurance proceeds, not her daughter. If the mother wants her daughter to receive the proceeds she needs to contact her insurance company to request and complete a change of beneficiary designation form.

The personal representative (the person appointed to settle your estate) has no power or duty to administer contractual arrangements, so the financial entity should be notified about the death of the insured, annuitant or owner of an account. It then becomes the responsibility of the financial entity to distribute the proceeds or assets to the specific beneficiaries listed on the beneficiary designation form.

Some financial entities, such as an insurance company, may require claim forms and a death certificate to be submitted before the proceeds will be transferred to the beneficiaries.

JOINT TENANCY CONTRACTS

While joint tenancy with right of survivorship titles* on real and personal property (e.g. checking and savings accounts) are not technically beneficiary designations, they do result in property transfers on death. However, joint tenancy property is not probate property. When a joint tenant dies, his or her economic interest automatically passes to any surviving joint tenant or tenants. The decision to place property in joint tenancy should be made only after serious consideration has been given to the consequences of such an arrangement.

A joint tenant cannot leave his or her interest to someone in a will, nor does his interest pass to his heirs by intestate statutes because the joint tenancy contract has priority.

CREDITORS CLAIMS

Beneficiaries named in contracts should be aware that the deceased's assets are subject to creditors' claims and taxes. For example, if a person dies owing money to a hospital, the hospital is a creditor. If there are enough assets in the probate estate to cover the hospital bills, then a payable on death certificate of deposit (POD), for example, would not be used to cover hospital expenses. However, if there are not enough assets in the estate to pay bills, then the POD certificate of deposit would be subject to the hospital's claim.

Example: Betty died owing the hospital \$40,000 for expenses incurred during her last illness. Betty had an automobile, a house, and other assets with a fair market value of \$100,000. She also had a \$20,000 certificate of deposit that was payable on death to her daughter. The car and house could be sold by the personal representative to pay the hospital bill of \$40,000, leaving \$60,000 that could be distributed to Betty's beneficiaries. The certificate of deposit for \$20,000 would not be needed in this case. The CD money would go as designated to her daughter.

However, if Betty's estate only consisted of a car valued at \$15,000 and the \$20,000 certificate of deposit that was payable on death to her daughter, then the certificate of deposit would be subject to the hospital's claim of \$40,000. Therefore, Betty's daughter would not receive any money from the CD.

Rules are similar for Medicaid. All funds that are in Betty's name and payable on death to her daughter are considered as recoverable assets from a Medicaid perspective. In other words, the POD designation does not exclude the assets from creditors' claims. Medicaid is considered as a creditor, and recovery can be made from Betty's daughter because she received the CD upon the death of her mother.

FORMS OF COMMON BENEFICIARY DESIGNATIONS

The wording of beneficiary designations on contractual arrangements such as an insurance policy, an annuity policy, a retirement plan and so on, is very important. An improperly completed beneficiary designation could have unintended results. People could receive assets that the beneficiary designator did not want to pass to them. Contact an attorney to assure that your beneficiary designations fit into your overall estate plan.

Typically the beneficiary designation form requests the following information about the beneficiary: the first name, middle initial, and last name; relationship to the beneficiary designator; date of birth; full address; and Social Security number.

One beneficiary. List the full name of the beneficiary followed by the relationship. Thus, a son designating his mother as a beneficiary writes:

Amanda J. Smith, mother.

If a spouse is being named as a beneficiary, the spouse's full name, not his/her social title is listed. The husband should not write Mrs. John Smith, wife. Thus, a husband designating his wife as a beneficiary could write:

Mary Ann Smith, wife.

Two beneficiaries. If two beneficiaries are named, the order in which they are to receive the proceeds and the part each is to receive should be clearly stated. The word "or" should not be used between the names of two beneficiaries as it creates confusion. Should the proceeds be paid only to the first person named or only to the second person named, or equally to both?

Decide if the proceeds are to be divided equally to both beneficiaries or only to the survivor and use the appropriate terms. For proceeds to be divided equally if both beneficiaries are alive, use the term equally.

If one of the beneficiaries predeceases the person designating the beneficiaries or dies in the same accident and the designator wants the surviving beneficiary to receive the assets, then additional wording is added to clarify this goal. Thus, a woman designating her husband and son as beneficiaries could write:

John R. Smith, husband, and Derry A. Smith, son—equally. If either of these named beneficiaries is not living at my death, then the survivor of them shall take all.

Three or more beneficiaries. Decide if the proceeds are to be divided equally to the named survivor beneficiaries and use the appropriate terms. List full names and relationships. Thus, a mother designating her three sons as beneficiaries could write:

Jerry B. Smith, Robert P. Smith, and William A. Smith, sons—equally. If any of these named beneficiaries is not living at my death, then his or her share shall be divided equally by those named beneficiaries who survive me.

One primary beneficiary and one contingent beneficiary. Many persons decide to name a contingent or secondary beneficiary in case the primary or direct beneficiary predeceases them or dies in the same accident. Full names and relationships should be listed. The following designation could be used in such cases:

John R. Smith, husband, if living; otherwise Derry A. Smith, son.

Some financial entities provide a section for the beneficiary designator to list direct beneficiaries and another section for listing contingent beneficiaries.

Children as beneficiaries. The type of beneficiary designation to use for children often depends upon whether they are adults or minors.

Adult children are often designated by their full names. Thus, a father who wants all three of his adult married daughters to share equally



could write:

Donna Kaye Sargent, Debbie Raylene Buczinski, Marsha Anderson Daniels, my children, equally. If any of these named beneficiaries is not living, then her share shall be divided equally by those named beneficiaries who survive me.

If *minor children* are designated as beneficiaries, assets cannot be turned over directly to them. Under South Dakota law minors lack legal capacity to exercise policy rights, enter into contracts, or sign for the receipt of proceeds. There are four possible alternatives:

1. Proceeds could be transferred to a conservator, guardian, or other qualified party. Any of these parties would have the responsibility of managing money and property left to minor children until they reach the age of 18.
2. Another possibility is that the financial entity could manage the proceeds until the beneficiary reaches age of majority which, in South Dakota, is 18 years. Some financial entities indicate on their beneficiary designation forms an age of 21, however.
3. Still another alternative is that a trust* could be named as the beneficiary. The trust document states how the money is to be spent, who the trustee is, who the successor trustee is, and when the trust should terminate so assets pass to the children. This option could allow the trustor and/or trustee to determine at what age the “child” is capable of managing the funds.
4. Another option is that assets could be transferred under the South Dakota Uniform Transfers to Minors Act to a custodial account pursuant to an authorization in the will or trust that is held in the name of a designated adult custodian for the benefit of a child. Although the assets placed in the account belong to the child, control over them is not transferred to the child until he or she reaches the age of 18.

If a parent names specific children, later-born children may be left out unless the beneficiary

designation is changed. If a parent anticipates that children will be born or adopted after the beneficiary designation is signed, the following types of generic designations could be used:

- *the children of _____.*
- *the children born during marriage with _____.*
- *the children born of or legally adopted during marriage with _____.*

Typically the words “children,” “issue,” “grandchildren” and “children of a deceased child” include adopted children, adopted issue, adopted grandchildren and adopted children of a deceased child unless otherwise specified in the contract.

Children of a deceased beneficiary. A person may want a beneficiary’s children to receive that beneficiary’s share if the beneficiary predeceases him/her. For example, Harold may want his grandsons to receive proceeds if his sons predecease him. Harold can accomplish that goal with the following language:

To my children, Steven and Alan, equally. However, if either one predeceases me, that beneficiary’s children living at my death shall take equally the share that their deceased parent would have taken if he or she survived me.

Another way that this goal can be accomplished is by using the terms *per stirpes* or *by representation*. *Per stirpes* is a term that was used more commonly years ago to express the concept of representation, that is, the principle of generational division of shares among surviving descendants of different generations. Today, each term has a precise meaning under South Dakota law, although the results of using one or the other are the same in many cases.

When the term *per stirpes* is used as a part of the beneficiary designation, this means that if the named beneficiary predeceases the designator, the assets will pass to that beneficiary’s children in equal shares. In other words, the beneficiary’s children split the share their parent would have

received. Thus, a father who wants his grandchildren to receive the share their parent would have received if that parent dies in the same accident or predeceases him could write:

Donna Kaye Sargent, Debbie Raylene Buczynski, Marsha Anderson Daniels, my children, equally or per stirpes if any of my children predecease me.

The preceding designation would result in the following divisions. If Donna predeceases her father, her two children split the 1/3 that would have passed to her. Thus, Donna's two children, receive 1/6 each. The other 2/3 is equally split between Marsha and Debbie (1/3 to each).

If Debbie dies before her father, her three children split the 1/3 that would have passed to her. Thus, Debbie's three children each receive 1/9.

If a designated beneficiary dies without leaving children, that beneficiary's share of the proceeds will be distributed among the remaining designated beneficiaries in equal shares. If Marsha, who does not have children, predeceases her father, her share (1/3) is equally split between Donna and Debbie. Thus, Donna would receive 1/2 and Debbie would receive the other 1/2.

If the term *by representation* had been used in the previous example, the distributions described would have been the same as *per stirpes*. Therefore, pursuant to South Dakota law, if Marsha, Donna, and Debbie all die before their father, under *per stirpes* or under *right of representation* or *by representation* under South Dakota law, Donna's two kids split the half Donna would have received (1/4 each), and Debbie's three children split the other half or receive 1/6 each.

Estate as the beneficiary. Generally, the estate is a beneficiary of last resort, as most people prefer to name family, friends or charities, and they desire to avoid probate, which is required if the estate is the beneficiary. However, a person may wish to name the estate if all other beneficiaries do not survive. Typically, the governing instrument will provide that the

owner's estate is the default designation.

If the proceeds are to be a part of the estate to be distributed either by a written will or under South Dakota intestate (without a will) statutes, then the following phrase could be used:

My Estate.

The name of a specific individual named in your will as personal representative should not be listed, because this person may not be appointed by the district court to be personal representative for the estate.

Partnership. If a partnership is designated as a beneficiary, include the full name of the partnership, mailing address and indicate that it is a partnership.

Miller, Bryan, and Wilson, 135 B Westridge, Mitchell, SD, 57103, a Partnership.

Corporation. If a corporation is designated as a beneficiary, include the full name of the corporation, mailing address, and indicate the state of incorporation

ABC Enterprises, 498 N. 7th Street, Rapid City, SD, 57701, a South Dakota corporation.

Charitable beneficiaries. To name a charity as a beneficiary, contact the organization and ask for the official legal title and the address of the organization. Determine whether it has been designated as a 501 (c) (3) charitable organization. Include all pertinent information, including the federal taxpayer identification number of the charity, if available. This will help the financial entity identify the correct charity at the time of the claim. Thus, a person desiring to leave a bequest to the South Dakota 4-H Foundation could write:

*The South Dakota 4-H Foundation
South Dakota State University
Brookings, South Dakota 57007
Federal Taxpayer Identification Number 00-1234567
23-7051460*



Trusts. A trust is a legal arrangement by which a person transfers property from personal ownership into the legal ownership of the trust. There are two general types of trust: living trusts and testamentary trusts. A *revocable living trust** is just what the name implies—one that is created during a person's life, but that can be changed or terminated at any time up until his or her death.

To name the trustee of a living trust as beneficiary, use the full name of the trustee. If a bank or trust company is the trustee named, use the full correct name, as well as the city and state address. Thus, a beneficiary designation for the John F. Smith Family Trust could read:

John F. Smith, trustee, of the John F. Smith Family Trust, his successor or successors in trust, under a trust agreement executed by John F. Smith on September 20, 1999, as amended.

A *testamentary trust* is one created by a person's written will or under the provisions of a living trust. It does not become effective until the person dies and the will is probated. If a testamentary trust is to be named as beneficiary, the name of the trustee or date of the will are not necessary. The following language could be used as a beneficiary designation in a testamentary trust:

Gayle Y. Smith, trustee of the testamentary trust created by my will, her successor or successors in trust. If the financial entity receives satisfactory evidence that no trustee can qualify, or if the financial entity has not been furnished with satisfactory evidence that a trustee has qualified, then to my estate.

Unequal Shares. A person may request that proceeds be paid in unequal shares to several beneficiaries. Because the value of assets at the time of death may differ from the amount when the beneficiary designation is made, the proceeds could be divided into parts or percentages rather than dollar amounts.

Example: Bruce Smith has a universal life insurance policy with a value of \$100,000. He

wants \$75,000 to pass to his wife and the remaining \$25,000 to pass to his daughter. Bruce should decide how he wants the proceeds to be split, if the value of the policy would grow, for example, to \$120,000 by the time of his death. Bruce could use percentages in his beneficiary designation:

75% to Carol Smith, my wife, and 25% to Jennifer Smith, my daughter. If either beneficiary predeceases me, that beneficiary's share shall be paid to the surviving beneficiary. If both beneficiaries predecease me, the proceeds shall be paid to the South Dakota 4-H Foundation.

Common Disaster Clause. A person who is concerned about the possibility that both he/she and the beneficiary may die simultaneously or as a result of a common accident, may want to use a common disaster clause. In reality a common accident is not really required. If an individual and beneficiary both die within a specified time period, regardless of the cause of their deaths, the clause becomes applicable.

South Dakota law requires a survival requirement of 120 hours. In other words, if your beneficiary clause says nothing about survival time, and a beneficiary dies within 120 hours of the decedent, he/she will be presumed to have predeceased the decedent.

1. *Regular common disaster clause.* This clause keeps the proceeds (e.g., life insurance policy) from being subject to federal estate taxation in two estates, first the insured's and then the beneficiary's when both are killed in a common accident:

If any beneficiary dies simultaneously with the insured, or within (any number of days, typically 180) days thereafter, but before due proof of the insured's death is received at the financial entities' home office, the proceeds shall be paid as though that beneficiary had predeceased the insured.

2. *Reverse common disaster clause.* This clause is often used on life insurance beneficiary designations. It reverses the presumption, created by

statute that the insured survived the beneficiary if their deaths were in fact simultaneous. Its purpose is to preserve federal estate tax savings by keeping the proceeds in the beneficiary's rather than in the insured's estate, when the life insurance policy owner is not the person insured.

For example, a wife could be owner of an insurance policy on her husband's life. She can also be the beneficiary. The husband is the insured.

The reverse common disaster clause is typically used when the insured and the beneficiary are married and only if the insured's estate is in a federal estate tax bracket (above \$1,500,000 in 2004 and 2005; \$1,000,000 in 2002 and 2003). To save on federal estate taxes the insured can not be owner of the policy:

If the beneficiary and the insured die and there is no sufficient evidence that they died other than simultaneously, or if they die within 120 hours of one another, then it shall be presumed that the beneficiary survived the insured and the proceeds shall be payable as if the beneficiary has survived the insured, but died before receiving payment.

Married Couples. The Federal Employee Retirement Income Security Act (ERISA) has special rules for beneficiary designations on pension plans for married couples.

A surviving spouse is automatically presumed to be the beneficiary if the worker dies before receiving benefits. If the worker wishes to select a beneficiary other than a spouse, the spouse must consent in writing, witnessed by a notary or plan representative.

Divorced Couples. The legislature passed a law providing that a marriage dissolution (divorce) revokes any revocable disposition to a former spouse in a *governing instrument* executed before the divorce. Examples of *governing instruments* include but are not limited to: insurance and annuity policies, and IRAs. (See definition of contractual arrangements on page 1).

Therefore, couples should examine beneficiary designations on contractual arrangements during and after the divorce to assure that the individuals they want to receive the assets are listed.

A person can expressly provide for the former spouse to receive the assets if noted in a contract or beneficiary designation signed and dated after the marriage dissolution decree.

Example: Donna and Ron were divorced in April 2001. Ron still has Donna listed as the beneficiary on his life insurance policy. If Ron were to die, the proceeds would pass as though Donna had disclaimed the proceeds. In other words, the treatment would be the same as if Donna had predeceased Ron and the proceeds would then pass to his heirs—their children. If Ron's preference is that his former wife, Donna, receive the life insurance proceeds, then he must complete a new beneficiary designation form that is dated after the marriage dissolution decree.

SUMMARY

A person should review beneficiary designations when he or she marries, divorces, upon death of a spouse or beneficiary, or when a beneficiary's address changes. When a person dies, a beneficiary living at that time has a right to the assets covered by the contractual arrangement. For example, a grandson named as a POD on his grandmother's certificate of deposit can not cash it in while she is still living. He receives the funds only upon his grandmother's death.

A person who wants to change a beneficiary must make a written request to the financial entity. Most financial entities have a special beneficiary designation change form that should be signed, dated, and returned for the change to be effective. Most forms indicate that the change revokes any beneficiary designations made previously under that contract.

Many people choose the wording for their beneficiary designations for life insurance and



pension plans, in particular, after consulting with their insurance agent, certified public accountant and attorney. Tax planning for qualified pension and profit sharing plans is complicated and advice from qualified professionals is recommended.

* *Topics that are starred are further explained in other guide fact sheets.*

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This publication is not designed as a substitute for legal advice. Rather, it is designed to help families become better acquainted with the South Dakota estate tax. Future changes in state and federal laws cannot be predicted and statements in this fact sheet are based solely on the laws in force on the date of publication.

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This publication is suggested for the reading of all South Dakotans. It has been reviewed and approved by the South Dakota Bar Association and South Dakota State University faculty in the Human Development, Consumer and Family Sciences Department, College of Family and Consumer Sciences, March 2005.

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