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## **The Ghost in the Machine: The Critical Role of Beneficiary Designations**

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During my CFP studies, one case study stuck with me. A man had worked for the same corporation his entire career, diligently building a massive 401(k). He eventually passed away, leaving behind a grieving widow. When she went to claim the account, the plan administrator gave her the shock of her life: She wasn't entitled to a dime.

Decades earlier, as a young man, the husband had married, divorced, and eventually remarried his current wife. He had updated his Will, his home title, and his bank accounts, but he never touched his 401(k) beneficiary form. Because his first wife was still listed, she was entitled to the entire balance, leaving his widow with nothing but a legal nightmare.

For many of us, the start of a new year brings a focus on "getting the house in order." While most of our clients have a current Will or Trust, beneficiary designations often remain on autopilot.

It's a common misconception that your Will or Trust governs all your assets. In reality, for IRAs, 401(k)s, and other retirement accounts, the beneficiary form you filed years ago (and perhaps haven't looked at since) acts as a "super-Will." It overrides your formal estate documents. If your Will says one thing and your beneficiary form says another, the retirement plan custodian follows the form.

In this edition of Wealthwise By WEIL, we will dive into the nuances of these designations, the shifting rules for heirs, and why we often caution against naming trusts as beneficiaries for these specific assets.

### **The Hierarchy of Naming: Primary vs. Contingent**

When you open a retirement account, you are typically asked for two levels of beneficiaries. Understanding the difference is the first step in a sound estate plan.

- **Primary Beneficiary:** This is your first line of succession. Usually, this is a spouse. If you are married and want to name someone other than your spouse for an employer-sponsored retirement plan (i.e. 401(k), 403(b), etc.), the law generally requires your spouse to sign a written waiver.
- **Contingent Beneficiary:** Think of this as your "Plan B." If your primary beneficiary predeceases you, the assets go here. If you have no contingent beneficiary and your spouse (or primary beneficiary) passes away before you, the assets often default to your estate, which can trigger a messy, public, and expensive probate process.

We here at WEIL regularly check our clients' beneficiary elections on their WEIL-managed retirement accounts. We recommend reviewing the beneficiary elections on all your retirement accounts at every major life event: marriage, divorce, birth of a child, or the passing of a loved one. Even a change in the tax law (like the SECURE Acts) should prompt a check-in.

There is a distinct difference in how inherited IRAs are treated for spouse versus non-spouse beneficiaries. For the original owner, the primary benefit of a retirement account is the ability to defer taxes for decades. However, once that account is inherited, the rules of the game change entirely. For heirs, the goal shifts from 'deferring as long as possible' to carefully managing the tax bomb of required withdrawals. Here is a summary of distribution options available to beneficiaries.

### **The Spousal Advantage: The Rollover**

Spouses hold the "gold medal" of beneficiary status. When a spouse inherits a retirement account, they generally have three paths:

- **The Spousal Rollover:** The most common choice. You roll the deceased spouse's account into your own. It's treated as if it were yours all along. You don't have to take Required Minimum Distributions (RMDs) until you reach your own RMD age (currently 73 for most, moving to 75 for those born in 1960 or later). As a reminder, an RMD is simply the minimum amount the IRS legally requires you to withdraw from your tax-deferred accounts each year.
- **The Inherited (Beneficiary) IRA:** You keep the account in the deceased spouse's name. This is often beneficial if the surviving spouse is younger than 59½ and needs access to the cash without the 10% early withdrawal penalty.
- **The "Treat as Deceased" Election (Newer Rule):** Under SECURE 2.0, a surviving spouse can elect to be treated as the deceased participant for RMD purposes. This can be a huge win if the deceased spouse was much younger than the survivor, as it allows the survivor to delay distributions.

### **Non-Spousal Beneficiaries: The 10-Year Clock**

For children, grandchildren, or friends, the rules have become significantly more restrictive. Gone are the days of the "Stretch IRA," where a grandchild could pull small amounts out of their inherited retirement account over 50+ years.

Under current IRS regulations in 2026, most non-spouse beneficiaries fall into one of two categories:

1. **Eligible Designated Beneficiaries (EDBs)**  
These individuals are still allowed to "stretch" distributions over their own life expectancy. They include:
  - The chronically ill or disabled.
  - Individuals not more than 10 years younger than the deceased (e.g., a partner or sibling).

- Minor children of the account owner (though they switch to the 10-year rule once they reach age 21).

## 2. Non-Eligible Designated Beneficiaries (NEDBs)

This includes most adult children. They are subject to the 10-Year Rule.

- The Deadline: The entire account must be emptied by December 31st of the 10th year following the year of death.
- The "In-Between" RMDs: If the original owner had already started taking RMDs (past age 73), the heir must also take annual RMDs in years 1 through 9, then empty the rest in year 10. If the owner died *before* their RMD age, the heir must empty it by year 10, with no annual requirement in between.

## The Tax Bite

For all retirement accounts (except for Roths), heirs don't simply inherit the money; they inherit the tax bill. Every dollar they withdraw is taxed at their ordinary income tax rate.

If an adult child inherits a large retirement account and is forced to empty it over 10 years during their peak earning years, they could easily be pushed into the highest tax brackets (37% or more). This is why partial Roth conversions during your lifetime can be such a powerful gift to your heirs.

To mitigate this, a common initial thought is to simply spread out the tax liability by withdrawing equal amounts (like 1/10th of the starting balance) each year. However, this approach is often too simplistic. First, it ignores the fact that the remaining funds are still invested and growing; if you don't calculate and estimate that potential growth, flat withdrawals could still leave you with a massive, unexpected tax bomb in Year 10.

Second, this strategy assumes your personal income will remain entirely flat for a decade. In reality, life happens. You might experience lower-income years due to a career transition, a sabbatical, or early retirement, which offer a valuable window to withdraw larger amounts from the account at a much lower tax rate. Because there is no single "right" formula for everyone, we work closely with our clients in these situations to calculate estimated growth, navigate changing tax brackets, and make the best distribution decisions for their specific financial picture.

## Caution: Naming a Trust as Beneficiary

It is a common practice to name a Living Trust as the beneficiary of a retirement account to maintain "control from the grave." While this sounds good in theory, in our experience, the administrative and tax costs can outweigh the benefits.

It is important to remember that Required Minimum Distributions are calculated based upon the beneficiary's age. A trust does not have a date of birth. So, naming a trust as beneficiary of a retirement account could cause the early distribution of funds from the account and the tax liability as well. The trust can be drafted as a "see-through" trust which focuses on the age of the beneficiary. However,

there are specific language requirements for the trust document. Also, the trustee must provide the custodian with trust documentation by October 31 of the year after death, or the tax-deferral benefit can be lost entirely.

Further, if the trust receives the distribution and *retains* the money (an "accumulation trust"), it reaches the top Federal tax bracket (37%) at just \$16,000 of income (in 2026). For an individual, it takes over \$640,000 of income to hit that same bracket. The amount of taxes paid on distribution to a trust could be significantly higher than the amount of taxes paid if the distribution was made to the beneficiaries directly.

Lastly, if you name a trust with multiple beneficiaries (say, your children and their children), the RMDs are often calculated based on the oldest person named in the trust. This effectively "shortchanges" the younger beneficiaries, forcing the money out of the tax-advantaged account much faster than if they had been named individually.

Unless you have a specific reason (such as minor children, a beneficiary with a gambling/addiction problem or a special-needs heir requiring a Supplemental Needs Trust), naming individuals directly is usually cleaner, cheaper, and more tax-efficient.

### **A Smarter Way to Give: The Charitable Contingent**

If you are charitably inclined, the retirement account may be the best estate planning asset to give to a non-profit. Distributions from retirement accounts are generally taxable. However, if the distribution is made directly to a nonprofit, it is, in effect, a tax-free withdrawal, because nonprofits do not pay taxes. If you have charitable intent, and also have funds in a retirement plan, we recommend you use your retirement asset as the source of satisfying your philanthropic bequests.

For example, you still name your spouse as primary beneficiary. However, you could then name your children as 90% contingent and a charity as 10% contingent. This allows the charity to receive the "tax-heavy" money tax-free, while you leave the "tax-light" assets (like your home or a brokerage account with stepped-up basis) to your children. Making charitable gifts from your after-tax estate is much less efficient because the charity doesn't care about the tax-free status of cash, but your heirs certainly do.

In summary, designating beneficiaries is not a "set it and forget it" task. It is a dynamic part of your estate plan and financial health. If it's been more than two years since you've looked at your beneficiary elections, you should take a look. As always, the Advisors at WEIL are here to help if you have any questions.

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