Hidden Pitfalls Of Naming A Minor As An IRA Beneficiary

FEATURED ATTORNEYS

Moriah Adamo

Partner

Maureen Rothschild DiTata

Partner

Lawrence N. Berwitz

Partner

Naming someone as the beneficiary of your IRA or other retirement account can be a wonderful way to provide for a loved one after you have passed away. Often, the people we name as beneficiaries of our IRA accounts are our children and/ or grandchildren. Prior to the enactment of the Secure Act (January 2020), this was a powerful planning tool for the named beneficiary as, following the account holder's

death, the account could continue to grow, tax free, over the beneficiary's entire lifetime. Pre-Secure Act, leaving retirement accounts to young beneficiaries was an important planning strategy, provided that appropriate safeguards were in place, because of their longer life expectancies and, therefore, smaller annual required minimum distributions.

Under the Secure Act, minors are required to take distributions annually based upon their life expectancy but, after they reach the age of 21, they must exhaust the account within ten years. This requires that they take at least the amount of the required minimum distribution in years one through nine and the balance in the tenth year, but they may take more in any given year and may even deplete the entire account.

There are several things you should consider when designating a minor as the beneficiary of your IRA account. A minor cannot inherit an IRA in their own name, outright. An adult, a parent or guardian or the trustee of a trust established for that minor's benefit, must be designated as the recipient since the minor lacks the legal capacity to own the account or make the necessary withdrawals. If the minor beneficiary fails to take the required minimum distribution each year, substantial penalties can be assessed. When the account holder dies, the minor beneficiary's parent or guardian must seek Court appointment to control and manage the account and to make the annual distributions on the minor's behalf. This is a process which can be both costly and time consuming.

Even more problematic is that the minor beneficiary attains complete control over the account upon reaching the age of 21. 21-year-olds are often not mature enough to handle this responsibility or understand the benefits of the tax def erred investment. The 21-year-old beneficiary may be more easily influenced by others to engage in spending that is not beneficial or may be more susceptible to scamming. It is usually preferable to delay control over the account for some time.

The best way to avoid those potential issues is to create a trust expressly for the purpose of serving as the repository for IRA accounts that you intend to leave to minor beneficiaries. This makes it possible to designate an appropriate person or entity to manage the minor beneficiaries' interests until they fully mature. Depending on the size of the IRA and the particular beneficiary, that may be at age 25, 30, 35 or even 40. Larry Berwitz, Maureen DiTata, and/or Moriah Adamo would be happy to help you explore your options relative to this important part of your estate plan. Call for an appointment today (516) 328-2300.