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Hidden Pitfalls of Naming a Minor as an IRA Beneficiary

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. This is a powerful planning tool for the named beneficiary as the account can grow tax free and the beneficiary can take distributions over his/her entire lifetime. This might lead one to assume that the younger the beneficiary the better. Take heed! 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 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, major penalties can be assessed. When you die, the parent/guardian/trustee for the minor beneficiary 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. Another potential issue is that, when the minor beneficiary reaches the age of 18, he/she attains complete control over the account. An 18-year-old may not yet be fiscally responsible or understand the benefits of the tax deferred investment. 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 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 beneficiary's interest until they mature. We would be more than happy to help you explore your options relative to this important part of your estate plan.