

# Should You Leave Your IRA to a Child?

*What you should know about naming a minor as an IRA beneficiary.*

Provided by Bill Mann, AIF®

**Can a child inherit an IRA?** The answer is yes, though they cannot legally own the IRA and its invested assets. Until the child turns 18 (or 21, in some states), the inherited IRA is a custodial account, managed by an adult on behalf of the minor beneficiary.<sup>1,2</sup>

**IRA owners who name minors as beneficiaries have good intentions.** Their idea is to “stretch” a large Roth or traditional IRA. Distributions from the inherited IRA can be scheduled over the (long) expected lifetime of the young beneficiary, with the possibility that compounding will partly or fully offset them.<sup>2</sup>

**Those good intentions may be disregarded, however.** When minor IRA beneficiaries become legal adults, they have the right to do whatever they want with those IRA assets. If they want to drain the whole IRA to buy a Porsche or fund an ill-conceived start-up, they can.<sup>2</sup>

**How can you have a say in what happens to the IRA assets?** You could create a trust to serve as the IRA beneficiary, as an intermediate step before your heir takes possession of those assets as a young adult.

In other words, you name a trust as the beneficiary of your IRA, and your child or grandchild as a beneficiary of the trust. When you have that trust in place, you have more control over what happens with the inherited IRA assets.<sup>2</sup>

**The trust can dictate the how, what, and when of the income distribution.** Perhaps you specify that your heir gets \$10,000 annually from the trust beginning at age 30. Or, maybe you include language that mandates that your heir take distributions over their life expectancy. You can even stipulate what the money should be spent on and how it should be spent.<sup>2</sup>

**A trust is not for everyone.** The IRA needs to be large to warrant creating one, as the process of trust creation can cost several thousand dollars. No current-year tax break comes your way from implementing a trust, either.<sup>2</sup>

**In lieu of setting up a trust, you could simply name an IRA custodian.** In this case, the term “custodian” refers not to a giant investment company, but a person you know and have faith in who you authorize to make investing and distribution decisions for the IRA. One such person could be named as the custodian; another, as a successor custodian.<sup>2</sup>

What if you designate a minor as the beneficiary of your IRA, but fail to put a custodian in place? If there is no named custodian, or if your named custodian is unable to serve in that role,

then a trip to court is in order. A parent of the child, or another party who wants guardianship over the IRA assets, will have to go to court and ask to be appointed as the IRA custodian.<sup>2</sup>

**You should also recognize that the Tax Cuts & Jobs Act reshaped the “kiddie tax.”** This is the federal tax on a minor’s net unearned income. Required minimum distributions (RMDs) from inherited IRAs are subject to this tax. A minor’s net unearned income is now taxed at the same rate as trust income rather than at the parents’ marginal tax rate.<sup>3,4</sup>

This is a big change. Income tax brackets for a trust or a child under age 19 are now set much lower than the brackets for single or joint filers or heads of household. A 10% rate applies for the first \$2,550 of taxable income, but a 24% rate plus \$255 of tax applies at \$2,551; a 35% rate plus \$1,839 of tax, at \$9,151; a 37% rate plus \$3,011.50 of tax, at \$12,501 and up.<sup>3,5</sup>

While this is a negative for middle-class families seeking to leave an IRA to a child, it may be a positive for wealthy families: the new kiddie tax rules may reduce the child’s tax liability when compared with the old rules.<sup>4</sup>

One last note: if you want to leave your IRA to a minor, check to see if the brokerage holding your IRA allows a child or a grandchild as an IRA beneficiary. Some brokerages do, while others do not.<sup>1</sup>

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#### **Citations.**

1 - investopedia.com/articles/retirement/09/minor-as-ira-beneficiary.asp [6/19/18]

2 - kiplinger.com/article/retirement/T021-C000-S004-pass-an-ira-to-young-grandkids-with-care.html [5/17]

3 - forbes.com/sites/ashleaebeling/2018/05/08/the-kiddie-tax-grows-up/ [5/8/18]

4 - tinyurl.com/y7bonwzx [5/31/18]

5 - forbes.com/sites/kellyphillips/2018/03/07/new-irs-announces-2018-tax-rates-standard-deductions-exemption-amounts-and-more/ [3/7/18]