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Who Should be the "Contingent Beneficiary" of Your 401(k) if you have Minor Children?

By: Ryan J. Garman, Esq. | February 2022

If you have a 401(k) or a traditional IRA, you likely named your spouse as the primary beneficiary of your benefits. But if you have minor children, who did you name as your contingent beneficiary? Will your minor children receive their benefits once they reach the age of majority, which in Ohio is 18? For many parents, they don't want their children receiving substantial money at such an early age. So, what do you do?

Naming a minor child as a contingent beneficiary of your 401(k) or traditional IRA may seem like a good way of ensuring they receive their share of your retirement plans but doing so can have unintended consequences.

Possible Guardianship / Probate Court Involvement

In Ohio, when a child under age eighteen expects to receive money from a retirement plan in an amount greater than $25,000, a probate court must approve the minor's right to receive the property and appoint a guardian of the estate of the minor. This means that if your minor child is set to receive more than $25,000 from your retirement plan, your minor child cannot receive the funds until a formal guardianship proceeding is commenced, which likely will require attorney fees, court costs, the delay of time, and additional stress. This process is sometimes referred to as a "probate," which so many people strive to avoid.

If the amount that the minor is to receive is $25,000 or less, no guardianship is needed, but the court still must authorize the deposit into a restricted account for the minor. Such funds are payable to the minor child when he or she reaches the age of majority, but not without prior court approval.

Any necessary guardianship established for a minor to receive his or her inheritance from a 401(k) or traditional IRA will continue throughout the child's minority and will require paperwork to be

regularly filed with the court, including having to request the court for approval of certain expenses. An attorney will more than likely need to be involved to represent the guardian of your minor child. Once the child reaches 18, the child will receive his or her full inheritance—with no strings attached.

Ohio's Transfers to Minors Act

In lieu of a lengthy and costly guardianship proceeding, you could name your minor child as a beneficiary of your 401(k) or traditional IRA under the Ohio Transfers to Minors Act. By doing so, you can eliminate the need for a guardian of your child's estate.

There are two major benefits of using the Ohio Transfers to Minors Act: (1) you avoid the probate process (described above); and (2) someone can be in charge of managing your child's money even after he or she reaches age 18.

The Ohio Transfers to Minors Act allows retirement benefits to be made payable to a custodian who is designated by the owner of the 401(k) or traditional IRA for the benefit of the minor until the minor reaches a certain age, which may exceed 18 but cannot exceed 25.

To use the Ohio Transfers to Minors Act, the Beneficiary Designation Form for your 401(k) or traditional IRA should be drafted carefully to comply with the statutory requirements. Every state has a different Transfers to Minors Act and since your Plan may not be administered under the laws of Ohio, careful attention should be given to ensure your wishes are fulfilled.

Cautions to consider under this type of arrangement:

- Your minor child could receive your full 401(k) or traditional IRA outright at age 18 (or as late as age 25).

- Your plan administrator may not allow for the Beneficiary Designation Form to be completed in the way necessary to benefit under this type of arrangement.

Income Tax Consequences

Unlike a spouse, a child cannot rollover an inherited traditional IRA or 401(k). Your minor child must take required minimum distributions from your traditional IRA or 401(k) after your death. The period over which he or she will need to take RMDs under the SECURE Act is 10 years after he or she reaches the age of majority (regardless of whether you have already begun taking RMDs). But your minor child is not required to wait that long to take out all the money. He or she could take the balance out immediately (and lose any tax-deferred growth) once his or her guardianship or custodianship (as explained above) expires.

Trusts for the Benefit of Minor Children

If you would like your children to receive your 401(k) or traditional IRA over a staggered number of years (e.g., 1/3 at age 25, 1/2 at 30, and the balance at 35) or if you have a chronically ill or disabled child, you may consider having your 401(k) or traditional IRA payable on death to the trustee of a trust for the benefit of your minor and/or disabled or chronically ill children. In such a case, a See-Through Trust should be explored.

The goal of a See-Through Trust is for the trustee to receive retirement benefits and pass them to your beneficiaries according to how you want, as set forth in the trust agreement. However, there are two flavors of See-Through Trusts, and each has different income tax and non-tax considerations. The two types of See-Through Trusts include:

- Conduit Trusts
- Accumulation Trusts

Not every revocable trust is a See-Through Trust. There are important legal requirements set forth by the U.S. Treasury Department that must be met for a trust to qualify as a See-Through Trust, and there are post-mortem deadlines as well. Establishing a See-Through Trust should be done only after considerable discussions with an experienced estate planning attorney of the tax and non-tax consequences.

If you would like more information or would like to further consider your estate planning options concerning your 401(k) or traditional IRA, please feel free to reach out to Attorney Ryan J. Garman of Flynn, Py & Kruse Co., L.P.A.

About the Author

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