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ESTATE PLANNING WITH MINOR CHILDREN

Individuals and couples with young or teenaged children face unique hurdles in estate planning. In truth, many of these considerations apply equally to individuals with children who perhaps have reached the age of majority (eighteen years in Missouri), but are still not fully independent. At issue are matters ranging from guardianship to financial support to important potential tax-related considerations. When these matters are adequately addressed, together with the many other more general estate planning considerations, a life and estate plan can be created that assures that a family's needs are met, their children are supported and cared for and unnecessary taxation is avoided.

This brief article addresses the major considerations in planning for families with younger children. It should be noted that, each family situation (and particularly those involving young children), is truly unique, from both a financial and personal perspective. Accordingly, life and estate planning for each family is unique and an estate plan must be crafted to fit the situation, needs and desires of a particular family. The matters addressed herein provide a general understanding of the issues and concepts in consideration but are not an adequate substitute for individualized legal advice.

THE ISSUES: UNIQUE CONSIDERATIONS FOR MINOR CHILDREN

1. Legal Guardianship.

As every parent of a minor child has surely asked themselves, "Who will take care of the kids if something was to happen to me (or us)?" If this issue is not addressed directly, a court will determine the most appropriate individual to assume guardianship of children. As might be expected, this can result in difficult disputes among surviving family members and an emotionally traumatic experience for children, and ultimately it may result in guardianship granted to an individual or couple whom the parents would not have selected or approved.

2. Legal Minority: Inability to Own and Control Property.

Individuals under the age of eighteen cannot own property and cannot undertake many of the tasks associated with property ownership. Regardless of the very obvious concerns of actual maturity and experience, this legal limitation of minority creates very apparent hurdles for families with younger children.

In the event that property is transferred to children as part of an estate plan, without further clarification or planning, a court-appointed conservator would be designated to hold the property. While this indeed offers some actual protection to the child's eventual legal right to the property, it creates some very difficult and problematic issues with respect to control and desired use of the relevant property.

3. Immaturity.

In addition to the legal incapacity of a minor child to own and control property, there are very practical concerns with a young person's lack of experience and their likely financial, emotional and social immaturity.

Where proper planning has not occurred, a probate conservatorship would be created, as discussed above. However, once the youngster reaches the ripe age of eighteen years, they will actually get the property—perhaps an even worse outcome than the conservatorship. This generates numerous concerns due to the child's general immaturity, their likely susceptibility to undue influences and their station on life. Many children of this age are yet to even graduate from high school, much less prepared to prudently use any amount of significant money or property.

4. Maintenance and Needs Associated with Child Rearing.

As every parent understands, the cost and effort to raise children is tremendous. To state the obvious, children are not self-reliant or self-supportive. Accordingly, in the event of a parent's death (or incapacity) there must be in place a means of providing for the needs of their children. These needs often include daily maintenance, health care, educational and recreational expenses, and college tuition).

5. Unique Tax Considerations.

Many parents, grandparents or other family members wish to provide gifts to minor children, while retaining some control over the use of those funds. Perhaps dog-earing a monetary gift for educational or professional purposes, a family member desires to give a gift to a child, but is reluctant to do so without some formal designation or restriction on its use. Such giving raises some significant tax concerns. In order to qualify for an annual exclusion from gift tax, the gift must be of a "present interest," and a standard transfer in trust would not qualify for such tax treatment. If not planned for properly, the donor could end up with an unexpected tax bill, presently or as part of their ultimate estate tax liability.

THE SOLUTIONS:
MECHANISMS FOR PLANNING FOR MINOR CHILDREN

1. Will.

A properly-drafted will should squarely address the issue of child guardianship. A provision nominating a guardian(s) for minor children should always be included in a will for an individual who has (or expects to soon have) children under the age of eighteen years. Typically, an individual or couple is "nominated" for guardianship, and a secondary, or back-up individual or couple is included in the event that the first nomination does not work out due to premature death, incapacity or unwillingness of the nominated individual(s).

In the event that there is no will, or if the will is silent with respect to guardianship, a court will determine the most appropriate individual to assume guardianship of the children. As might be expected, this can result in difficult family disputes and an emotionally traumatic experience for children, and ultimately it may result in guardianship granted to an individual or couple whom the parents would not have selected or approved.

When the parent's will does include nomination of a guardian or guardians, the ultimate determination is still made by a court, but the provisions of the will would typically govern its decision. Exceptions would include unwillingness by the nominated guardians, or, as should be expected, other considerations made by the court based on the best interests of the child.

2. Transfer to Custodian Account.

Funds can be transferred to a custodian for the benefit of a minor child. Such a transfer can occur during the donor's lifetime or can be made by the personal representative of the donor's estate. The Missouri Transfers to Minors Law (MTML) governs these types of transfers. The property held in a custodial account must be used by the custodian for the benefit of the minor child and the funds must be prudently invested. A detailed record and accounting of the funds must be kept by the custodian. The major benefits of this type of transfer are (i) providing funds to a minor child and (ii) the potential minimization of taxes for the donor from the gift. It should be important to note that a donor should not also serve as custodian if tax minimization is a motivation for the transfer. The custodianship will terminate when the child reaches twenty-one years of age.

3. Testamentary Trust.

A testamentary trust is a trust which only comes into existence in the event that certain situational criteria are met—usually the death of both parents while the children are under a designated age, perhaps twenty-five or thirty years old. The specifics of the existence and duration of a testamentary trust are determined by the parents and detailed in the relevant provisions of the parent's will.

The creation of a testamentary trust speaks to the concerns of legal minority, a child's immaturity, and the need to provide for the maintenance and needs of the child. A testamentary trust is typically embodied in a will, in the form of a separate section of that document. It is not usually a separate agreement or document in and of itself.

A testamentary trust designates that a named trustee (often a family member or close friend) is to hold indicated property for the benefit of the children. The assets in the trust are used strictly in accordance with the terms of the stated provisions, often for maintenance, health and education. The administration of the testamentary trust is substantially more flexible, less expensive and simpler to administer than a probate conservatorship, while squarely addressing the issues of minor property ownership, avoiding a premature windfall to the child and providing for the maintenance and support of the child, all in accordance with the detailed desires of the parents.

An additional benefit of a testamentary trust is the parent's ability to create financial incentives for certain behavior or life choices. To this end, the allocation or outright transfer of money or property can be predicated upon educational milestones, family events or similar circumstances.

4. Irrevocable Trust for a Minor: Avoiding Taxation on Gifts to a Minor.

When an individual gives a gift to a minor child, they often want to create an explicit limitation or restriction on the use of those funds or property. By transferring the property/money in trust, these desires for control or direction are readily accomplished. However, if not structured properly, such a gift will not qualify for the donor's annual exclusion from gift tax.

In order to properly structure a gift in trust, to maximize the tax benefits to the donor, the gift must meet certain IRS guidelines embodied in I.R.C. 2503(b). Essentially, the child to whom the gift is given must have a chance (usually a 60-day window of time) to claim the gift outright. This can occur immediately at the time of the gift or when the child reaches the age of twenty-one. Additionally, the trust and property transfer must be irrevocable.

5. Life Insurance Policy.

No substantive discussion of estate planning with minor children can be complete without a brief inclusion of the benefits and opportunities of adequate life insurance. Many individuals and couples with younger children lack the assets to sufficiently fund a meaningful testamentary trust. An adequate life insurance policy can readily provide the needed assets to provide for the ongoing needs of younger children. For younger families, a testamentary trust is very often funded primarily with the proceeds of a life insurance policy. Some consideration should also be given to the creation of an irrevocable life insurance trust, especially in the event of significant assets, which might otherwise be subject to estate taxation.

6. Trustee Selection.

The discussion of a testamentary trust and an irrevocable trust for a minor necessitates some consideration of the trustee designation. When any property is transferred "in trust" for beneficiaries, the property is formally held by a "trustee." While the trustee is legally obligated to use the trust property solely for the benefit of the beneficiaries and in strict accordance with the trust agreement, care should still be taken in selecting an appropriate trustee. A trustee may be given wide latitude with respect to discretion in the use of the property. Also, the reliability and responsiveness of the trustee are of understandable importance to the beneficiaries.

** Jim Schleiffarth practices in the areas of life and estate planning for individuals and families. Mr. Schleiffarth's practice emphasizes superior client service, straightforward legal counsel and reasonable fees. Schleiffarth Law Firm represents estate planning clients of all income and wealth levels.*