# Three Ways to Ensure your Minor Children can Inherit without Costly Guardianship Proceedings

John C. Martin, Esq.[1]

While it's not a pleasant subject, sometimes parents pass away while their children are still under the age of 18. What happens then? By law, children under the age of 18 who receive anything more than modest amounts of money from their deceased parents' estate cannot manage the property on their own. Instead, the law provides for court-appointed guardianship proceedings in order to manage and supervise the child's estate. On the one hand, court supervision is better than allowing the money to just disappear in the hands of unscrupulous friends or relatives. On the other hand, the practical disadvantages of guardianship proceedings are numerous:

(1) The guardianship terminates when the minor reaches age 18, leaving assets in the hands of a child who is most likely to be financially immature. The majority of parents would rather postpone giving full control over their property until a later date.
(2) The requirements of court supervision and formal accountings add expense and inconvenience. In addition, because the appointed guardian will likely need the advice and representation of an attorney at court, these costs will be borne by the child's estate and reduce the total amount of the gift.
(3) Court oversight, and laws requiring court approval for sales of certain types of assets, diminish the likelihood that the child's property will be managed effectively.

By the way, guardianship of the estate should be distinguished from guardianship of the person, which means the appointment of a guardian by the court to protect a child in the event of a parent's disappearance or death. Parents should also engage in some planning to ensure that their choice for guardian of the person will be named if this ever becomes an issue; however that is not the subject of this article.

**Solutions for avoiding guardianship of the estate**. There are three major techniques for avoiding the problems associated with transferring assets to minors: (I) Custodianships, (II) Testamentary trusts, and (III) Minors trusts.

(I) Custodianships

[1] John C. Martin is a business formation and estate planning attorney in Menlo Park, California. His law office provides small businesses, families, and individuals with wills and trusts and business lawyer services throughout the San Francisco Bay Area. For more details, visit his Silicon Valley law office website at: http://www.johncmartinlaw.com.

A custodianship is a legal arrangement in which parents can nominate an adult to manage property for the benefit of a child until the child reaches a specified age, up to 25 years old. A custodianship is actually a type of trust, the terms of which are provided by law under the California Uniform Transfers to Minors Act (CUTMA). Parents can draft their will or living trust in such a way as to establish a custodianship over property transferred to minors. This can include any type of property, including stocks, bonds, cash, and real estate. Final distribution of the property to the minor by the custodian can be delayed up to the child's 25th birthday. Custodians are held to strict fiduciary standards under the CUTMA, and are required to prudently invest and mange property.

Custodianships can be very useful when transferring modest amounts of assets to a minor. The ability to delay distribution until age 25 offers significant advantages over a guardianship. Furthermore, a custodianship does not require the court oversight, expense, and inconvenience of a guardianship.

The primary disadvantage of a custodianship is the inflexibility involved: the only thing parents can control is the termination date and the identity of the custodian. Yet even that power is limited as the termination date cannot exceed age 25. Every other aspect of a custodianship is rigid and unchangeable, including the guidelines on investing, managing, and distributing the property. Unlike a testamentary trust or minors' trust, explained below, custodianships cannot be tailored to match the way parents would themselves handle assets on behalf of their children. Moreover, multiple fiduciaries cannot be chosen, neither can parents pool assets for multiple children in a single account. Finally, should a child pass away prior to the termination date, parents cannot specify an alternative beneficiary, such as a brother, sister, niece, or nephew.

(II) Testamentary Trusts

A testamentary trust is a legal entity that is created upon the death of an adult, which provides for a trustee to manage the assets of a child until a pre-determined age. Set up either by one's will or living trust, a testamentary trust has several advantages over both guardianship and custodianship.

(1) A testamentary trust can postpone payment of an inheritance well beyond age 18, in some cases lasting for the lifetime of a child. The trust can provide for changed circumstances, such as educational, business, or travel requirements, and can even support a child in the event the child is adopted. In the case of guardianship, by contrast, funds are cut off (or at least limited) at adoption. Custodianships can last beyond adoption, but will terminate at age 25 at the very latest.

(2) Unlike a guardianship, a testamentary trust generally need not be subject to court supervision. This reduces the cost, complexity, and difficulty associated with managing the child's estate. The same is true for a custodianship.

(3) Unlike both guardianships and custodianships, parents can decide exactly what standard should govern how the trust assets are managed and invested. Furthermore, parents are given flexibility in how the trust will provide for their children. This ability to customize the trust enables the trustee to make financial decisions similar to the way a parent would if the parents were still living.

(4) Unlike both guardianships and custodianships, a testamentary trust can specify alternative beneficiaries if the child is no longer living by the termination date.

(5) Unlike both guardianships and custodianships, a testamentary trust can be established as a "pot trust," meaning that assets can be pooled for the use of multiple children beneficiaries. A pot trust is particularly advantageous when the parents' estate is not large enough to justify a division into separate trusts for each child. Moreover, a pot trust can provide for greater expenses incurred by one child (such as a sickness or education) without wiping out that child's inheritance. On the other hand, testamentary trusts can also be divided into separate trusts for each child if the parents so choose or the circumstances warrant.

(6) Finally, a testamentary trust can be optimized to decrease taxes and expenses. A guardianship has no such flexibility. In a custodianship, the fiduciary is only limited by the broad standards of the CUTMA.

(III) Minors' Trusts

Minors' trusts are in a breed of their own, as they are established during the child's life and involve long-term financial planning. A properly structured minors' trust, or "§2503(c) trust," allows parents and other individuals make multiple tax-free transfers to a trust over a period of years, and then delay the final distribution of the assets until a date (or circumstance) of their choosing. During the trust's lifetime, a trustee is chosen who manages and distributes the assets according to a pre-determined standard.

A minors' trust is particularly advantageous from a gift tax perspective. Under the tax laws, an individual can only transfer $13,000 per year (in 2010) to a child without filing a gift tax return. An outright transfer of assets over $13,000 to a child or into a custodial account, for instance, must be reported to the IRS. By transferring up to $13,000 (or $26,000 per married couple) into a minors' trust each year, the trust can accumulate significant value over time. With a few exceptions, income and principal can be paid to the child according to the parents' stated intentions. Furthermore, any accumulation in the trust will not subject the parents to gift or estate tax as long as the trust has been properly drafted and managed. In most other respects, minors' trusts have the same advantages as a testamentary trust.

At the same time, minors' trusts involve making irrevocable transfers of assets during one's lifetime. Once transferred, these assets cannot be taken back. Also, unless no other assets pass to children upon a parent's death, minors' trusts should be coordinated with other estate planning documents. Furthermore, some of the drafting and tax rules associated with minors trusts are quite complex, requiring the assistance of an attorney at the very least during the drafting and set up of the trust.

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