Leaving Assets to Minor Beneficiaries

Many times, you, your family members and others wish to leave assets to minor beneficiaries as part of a legacy plan. This type of bequest is often done via a beneficiary designation, a transfer on death designation, a will, or a trust. However, the method in which you leave assets to minors can have a significant impact on how those assets will be managed while the beneficiary is a minor, how the money may be spent on behalf of the minor, or when the beneficiary attains full control over the assets.

Leaving Assets Directly to a Minor

The law stipulates generally that minors cannot enter into contracts or other legally binding situations. For legacy purposes, what this means is that minors cannot hold assets in their own name. Therefore, when someone leaves assets directly to a minor often a court must get involved to oversee the management of the assets. This situation is commonly called a custodianship.

Each state has its own rules for custodianships. Generally, someone acting on behalf of the minor must petition the court to be appointed as custodian. Custodians oftentimes are either someone closely related to the minor or are someone appointed by the judicial system to provide for the best interests of the minor. There can be situations when multiple parties apply to serve as custodian. After reviewing the situation, the court will select the custodian.

Once appointed, the custodian becomes responsible for managing the custodial assets for the minor. During the custodianship judicial oversight continues until the minor reaches the age of majority (typically either age 18 or 21). This oversight usually involves the custodian filing at least annual accountings to the court, requesting distributions of assets for the benefit of the minor, and other administrative tasks.

Because of this judicial involvement custodianships can be onerous and time consuming. Moreover, judicial oversight often includes stipulations as to how assets may be invested for the minor. Courts can be as limiting as requiring the custodian to only invest in specific types of investments, such as federally insured assets, or managing assets for the sole purpose of “preserving principal.”

When the minor beneficiary reaches the age of majority the custodianship is completed. After a final accounting, the court discharges the custodian and immediately vests the beneficiary with the assets.

Creating a Trust to Receive Assets for a Minor

Custodianships generally are not a favorable way to leave assets to a minor due to the judicial oversight and immediate disbursement of assets to the beneficiary upon attaining the age of majority. Another way to pass wealth to minors is to create a trust for the benefit of a minor. You can either create the trust as a contingency in your will (known as a testamentary trust) or you may create provisions in your living trust for your minor beneficiary. For assets that pass via beneficiary designation or transfer on death, you can reference the trust as the beneficiary in lieu of directly naming the minor.

Utilizing a trust for the benefit of the minor may eliminate the need for judicial oversight of the assets as the trustee will bear that responsibility. Moreover, trusts for the benefit of a minor can continue for as long as the grantor wishes. In other words, the trust can be ongoing until the beneficiary meets a certain age or even for the lifetime of the beneficiary rather than distributing outright at the age of majority.

Many trusts, including a minor's trust, also can be structured with "spendthrift" provisions that allow for assets held in the trust generally to be protected from potential creditors of the trust beneficiary (e.g. a divorcing spouse or a judgment creditor). Each state has its own requirements and limitations regarding such trusts.

Certain trusts can also be created so that the assets are available for the beneficiary's use and enjoyment, but the assets are not included in the beneficiary's estate. Properly drafted, after the death of the beneficiary the trust assets can then move to the next generation potentially estate and gift tax free. This technique, often called a dynasty trust or a generation-skipping tax trust, can allow for multiple generations to benefit from a legacy.

For any of these trust drafting issues, consult with your local estate planning attorney and tax professionals to see if such planning may be appropriate for you.

Be mindful of your beneficiary designations.

Passing assets like IRAs, annuities, life insurance, employer-sponsored retirement plans or transfer on death accounts can be an efficient wealth transfer strategy. However, naming a minor as a designated beneficiary may still create the need for a conservatorship.

If you are naming a minor, consider contacting the provider to see if they will accept the designation of a minor beneficiary or the designation of a custodian on behalf of a minor. You can also name a trust for the benefit of the minor. Actively engaging the provider to confirm the best way to name a minor beneficiary can help minimize delays in the transfer of assets.

Taking Action

Leaving assets to a minor beneficiary can add some extra complexity to anyone's planning needs. However, tactfully planning how you would like your legacy to be received can help alleviate some of these concerns. Proactively creating a mechanism selecting how and when a minor beneficiary may receive assets can make the process more efficient.

Moreover, most planning can be modified, so as the minor beneficiary grows up, you can address whether you should change the plan to better fit the latest situation. Most of all, actively planning for these contingencies helps assure you can pass your assets in a manner that achieves your legacy goals. ■

IMPORTANT DISCLOSURES The information provided is based on internal and external sources that are considered reliable; however, the accuracy of this information is not guaranteed. This piece is intended to provide accurate information regarding the subject matter discussed. It is made available with the understanding that Benjamin F. Edwards is not engaged in rendering legal, accounting or tax preparation services. Specific questions on taxes or legal matters as they relate to your individual situation should be directed to your tax or legal professional.