ANDERSON KILL
Wills, Trusts & Estates Advisory

Gifting to Minors: Careful Planning is Needed to Avoid Pitfalls

By Gabrielle C. Lese

Welcome to Anderson Kill's *Wills, Trusts & Estates Advisory*. The professionals in Anderson Kill's Wills, Trusts and Estates practice group provide extensive estate planning advice, administer trusts and estates, assist clients with personal tax and wealth management issues, and resolve related disputes through negotiation or litigation.

We will be providing periodical alerts relating to topics pertinent to our clients and current events.

Gifting to minors can be fraught with unexpected complexity and should be undertaken with careful planning. There are several scenarios in which an individual might make a gift to a minor in his or her estate plan: a specific monetary gift to a grandchild or young family member, a distribution to young beneficiaries who inherit in the case that their parents die while they are minors or young adults, or a designation of a minor as beneficiary under an insurance policy or brokerage account.

When leaving money to a minor, it is important that there is an appropriate adult available and willing to manage the inheritance on behalf of the minor until the minor reaches the age of majority (or older, if you so designate). You may leave your heirs with unintended burdens if you do not provide for transfers to minors with forethought.

Guardian of the Property for Minor Beneficiaries

A child cannot collect assets left to her until she reaches the age of majority. In New York, the age of majority is 18. If a child under 18 receives a gift under a Last Will and Testament, life insurance proceeds, retirement account proceeds or another type of asset, a guardian of the child's property must be appointed in the Surrogate's Court pursuant to SCPA Article 17. It may come as a surprise to learn that although a minor child's parents are his natural guardians, the parents do not have the right to control the child's property without being formally appointed guardian of the property by the Court. Therefore, if an individual leaves a gift to a minor without specifically addressing who will hold the money for the child, it may be necessary for one of the natural parents of the child to petition the Surrogate's Court to get a court order of guardianship of their child's property in order to receive those assets for the benefit of their child, a process that is time-consuming and onerous.

The process to seek guardianship of the property requires a petition in the county where the child is domiciled as well as supporting documents, including a Form 3909, which lists the petitioner's address history and that of all the individuals living in the child's home with the petitioner. This form, which is sent to the state for processing, is used by the court to ensure that the petitioner and the rest of the individuals living in the home with the child have not been a subject of an indicated child abuse or maltreatment report.

Once the guardianship order is granted, it is often restrictive so the court can ensure the guardian is acting responsibly

regarding the minor's assets. The funds are jointly deposited with the Clerk of the Court; therefore, they cannot be invested and can only be withdrawn with a court order. This creates a particular difficulty where the assets gifted to the minor are in a brokerage account. Since the brokerage account assets cannot be invested without a specific modification to the order, the brokerage assets might have to be liquidated, with a capital gains tax due, or the court may require that a bond be posted by the guardian to allow this modification, which is expensive. Additionally, the guardian is required to file annual accountings with the court.

Techniques to Avoid Petitioning for Guardianship of the Property

UTMA Accounts. One technique individuals can use to make gifts to minor children and avoid having a guardian appointed by the court is to make transfers under the Uniform Gifts to Minors Act (UGMA) or its successor, the Uniform Transfers to Minors Act (UTMA). Depending on the state, the custodianship of assets in these accounts continues until the minor attains age 18 or 21. In New York, which adopted the UTMA in 1997, the custodian is required to transfer the custodial property to the minor when the minor reaches the age of 21 (unless the person creating the account, in designating the custodian, elects the age of 18 instead). The donor must make the testamentary gift to a "custodian" for the child, and the resulting account would be titled "[John Doe], as custodian for [Jane Doe], under the New York Uniform Transfers to Minors Act." The custodian can receive the property on behalf of the minor child and can set up the UTMA account easily. Most importantly, the custodian can act without court supervision or oversight and has very few accounting requirements.

The main benefit of an UTMA account, as mentioned above, is that it allows a custodian to hold the funds for a minor with low setup costs and minimal ongoing requirements. However, there are downsides to giving assets in an UTMA account. The main disadvantage is the rigidity of the distribution of the assets. The custodian is required to distribute the assets in the account to the beneficiary at a very young age. In many cases, the young beneficiary is not mature enough and does not have sufficient financial acumen at 18 or 21 to handle a significant amount of money. Another disadvantage is the uncertainty of the beneficiary's situation at the time of distribution. For example, the child may be diagnosed with a disability, or the child may have troubles with the law and/or develop a drug or alcohol addiction. If

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these types of circumstances arise, the funds gifted to the minor will still become available to the minor at age 21 and may hinder either state or federal aid that would otherwise be available to a disabled individual. Even if the child does not have a serious developmental disability and/or addiction, the mere fact that she could be financially irresponsible and squander the money and assets in the UTMA account is a possibility.

The time of distribution from the UTMA account to the young person can present a good opportunity for planning— we can help clients in this situation by crafting a plan for those assets, such as creating a trust where appropriate for the benefit of the young person to prevent an outright distribution of all of the assets.

Trusts. Under most circumstances, a more prudent way to deal with distributions to young beneficiaries that will obviate the worry of a very young person receiving a windfall of money is to create a trust. The trust can include provisions as to the use of the trust principal and/or income for the benefit of the child that are structured in accordance with the wishes of the grantor/creator of the trust. Most importantly, the assets can continue in trust until the beneficiary attains a specified age. The person who holds these assets for the young beneficiary is the trustee, so the grantor would give the gift "to [John Doe], as Trustee." Most often the trust terms provide that income is distributed to the beneficiary annually upon the attainment of a certain age and that principal is distributed either in stages (half at thirty years old and the remainder at thirty-five, for example) or in one lump sum at a certain age. Additionally, the trust usually provides that principal of the trust can be distributed for the beneficiary's "health, education maintenance and support" (a very broad spectrum) at any time during the term of the trust. This last point is a comfort to the grantor in that the beneficiary, while being protected from receiving a major sum of money, will not be denied distributions for necessities during the term of the trust (such as tuition, medical bills or a car).

An additional advantage of creating a trust is creditor protection benefits for the beneficiary during the trust term, since the beneficiary does not have access to or control over the trust assets. One more advantage is that trust assets will be protected in the case of a beneficiary who experiences marital troubles or goes through a divorce.

The trustee of a minority trust has a large amount of discretion and interaction with the beneficiary. In addition, the trustee must have the financial acumen to handle the ongoing requirements of the trust (as described below). Therefore, it is imperative to choose the right person for this role. Usually, the trust creator (also called the grantor)

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will nominate a trustee, and provide for a successor (or even two successors) in case the first cannot serve. Alternatively, a grantor can nominate a bank or trust company to act as trustee (or co-trustee) of the trust.

As referenced above, a trust has more ongoing requirements than an UTMA account. The trust must file annual tax returns, and the trustee has a fiduciary responsibility to the beneficiaries in managing the trust assets.

While a trust is usually the optimal structure for a gift to minors, sometimes it's not practical. Say an individual wants to bequeath a percentage of his IRA to a minor nephew, but there is no trust set up for the child. The uncle would be best advised to make the beneficiary designation in the name of a custodian of an UTMA account for the child, as it's not possible to set up a trust in the IRA beneficiary designation. Naming a custodian would result in the least burdensome transfer to a responsible adult to hold the assets for the benefit of the child.

If, on the other hand, a couple with substantial assets is contemplating gifts to their minor children in their wills, it would be prudent for them to create testamentary trusts for their children (or, theoretically, grandchildren), enabling the more flexible and nuanced controls described above.

Gifting to minors is an important topic in one's estate plan and requires attentive forethought to ensure the intended result and the ease of administration for your heirs. You should consult with a knowledgeable advisor before preparing your plan.

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