Estate Planning Insights

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MAKING GIFTS TO MINORS

Preliminary Matters. It is our sincere hope that you and your loved ones are staying safe and healthy during these precarious times. These are unprecedented times that have caused all of us to adjust our behavior in so many ways. The way work is being done these days has changed quite a bit. Some wonder whether we will ever return to a pre-COVID-19 world. One thing that many people have come to realize during the coronavirus pandemic is how much they miss *being with people*. Video conferencing has helped, but it's not quite the same as being together in person.

2020 Newsletters. We are "behind" in our newsletters this year due to the "stay at home" order previously in place and the many adjustments to practicing law in a COVID-19 world. In this newsletter, we will discuss making gifts to minors, either during life or upon death. This newsletter will *not* address making gifts to minors who have "special needs."

Who Is A Minor? In Texas, a minor is a person who has not yet reached the "age of majority" and who has never been married or had his disabilities removed. In Texas, the age of majority is 18. A different age is used for purposes of the Uniform Transfers to Minors Act (discussed below). Trusts that are created for minors can use any trust termination age the trust creator believes is appropriate.

A minor may have his "disabilities of minority" removed pursuant to a court proceeding. That is sometimes done by minors who are "entertainers" (professional actors, singers, artists, etc.). Once that happens, the minor is no longer considered to be a minor but, instead, a competent adult.

Although a minor can own assets, the minor has no legal ability to deal with the assets in the manner that a legally competent adult could. Thus, for example, if a person who is a participant in an employee benefit plan (the "Plan") dies, having named his minor child as the "direct" (outright) beneficiary of his interest in the Plan, nearly all plan administrators will require the deceased participant's interest in the Plan to be distributed to a legal guardian appointed for the minor by a court having jurisdiction over the minor. Therefore, the Plan benefits inherited by the minor will be subject to a court-supervised guardianship (discussed below). Texas law provides an exception to a guardianship if the amount inherited by the minor is $100,000 or less, but that procedure still involves the court.

There are two kinds of guardians: a guardian of the *person* (referring to the "physical person") and a guardian of the *estate*. In this case, we are discussing a living person–the minor child–so the term *estate* refers to the assets owned by the minor child. Because the minor has no power to manage those assets, the guardian of his estate must do so.

Guardianship of the Minor's Estate. A guardianship of the estate is an expensive and cumbersome court proceeding. Legal fees and court costs are incurred initially to establish the guardianship. Once the guardian is appointed by the court, she normally must obtain court approval prior to making distributions to or for the benefit of the minor and prior to paying expenses of the minor and expenses relating to administration of the guardianship estate. In addition, the guardian must prepare and file an annual accounting of the guardianship assets each year. An attorney for the guardian usually assists the guardian with these matters. Thus, legal fees in guardianship proceedings can be significant. In addition, individual guardians who handle the minor's assets must pay an annual bond premium to obtain a "fidelity bond" to insure their compliance with the guardianship laws. Further, court costs, including filing fees, are regularly incurred in guardianships. Thus, all these expenses relating to the

guardianship proceeding, which are paid out of the guardianship assets (i.e., the assets owned by the minor), reduce the amount available to the minor beneficiary. (Court-created trusts will not be discussed.)

Alternatives to Guardianship. Because guardianships end up "wasting" a significant portion of the assets a parent, grandparent or other person (hereafter individually referred to as the "transferor") wishes to give to the minor, estate planning lawyers advise the transferor to provide that assets distributable to the minor will either be distributed to a trust for the benefit of the minor or to a person named as "custodian" for the minor pursuant to the Uniform Transfers to Minors Act (UTMA).

UTMA. A custodial arrangement pursuant to UTMA is simpler than a trust and is often appropriate for modest amounts the transferor wishes to give to a minor. Establishing and administering a custodial arrangement is certainly less expensive than a guardianship proceeding. Per the UTMA laws in most states, however, the custodial arrangement terminates when the minor reaches the applicable "age of majority" per that state's UTMA laws. In Texas, the age of majority for UTMA accounts is 21. Many transferors view the termination age pursuant to UTMA as "too young" for the beneficiary to obtain complete control of the UTMA assets. Thus, a custodial arrangement pursuant to UTMA may not be the best choice for substantial amounts.

In Texas, during the time when the minor child is under age 21, the adult person named as custodian manages the custodial account for the benefit of the child. That means the custodian makes the investment decisions and the distribution decisions relating to the account.

Death of UTMA Custodian. One problem with the Texas UTMA law is that, if the person named as custodian for the minor dies and no successor custodian was named in the UTMA agreement or appointed by the custodian, a successor custodian of that UTMA account must be appointed within 60 days of the deceased custodian's death, otherwise a court proceeding is required. Frequently, by the time it is discovered that the decedent was the custodian of a UTMA account and that no successor custodian was named or appointed, it is too late to use the "easy method" for appointing a successor custodian. Therefore, all UTMA accounts should be set up with both a primary custodian and a successor custodian.

Another "problem" with the UTMA arrangement is that the assets held in the UTMA account when the custodian dies are included in the custodian's estate for federal estate tax purposes. That is not true in the case of assets held in a properly drafted trust for the benefit of the minor child. That is also not true in the case of a 529 plan. (This newsletter will not discuss 529 plans, although that is another way to make a gift for the benefit of a minor for purposes of "education.")

Trusts for Minors. Estate planning attorneys usually advise a transferor who wishes to give significant assets to a minor to provide for those assets to be held in a trust created for the benefit of the minor. If the transfer is one that will be made on the death of the transferor, the transferor usually creates the trust for the minor in the transferor's Will or revocable trust. If the transferor wishes to place assets in a trust for the benefit of the minor while the transferor is still alive, the transferor can create a trust for the benefit of the minor pursuant to a presently effective, irrevocable trust agreement.

There are many different types of trusts. In regard to gifts made for the benefit of minors, three kinds of trusts seem to be used most often: (i) a 2503(c) trust, (ii) a "contingent trust," and (iii) a lifetime trust often referred to as a "descendant's trust." In each case, an individual or a qualified corporation is appointed to serve as Trustee of the trust–at least during the period when the beneficiary is "too young" to serve as Trustee. A Trustee is a "fiduciary" and, therefore, subject to "fiduciary duties" and "fiduciary standards." That aspect of a trust provides significant protection for the beneficiary. The Trustee must administer the trust for the benefit of the beneficiary and not for the Trustee's own personal benefit. The Trustee makes the investment decisions and the distribution decisions.

2503(c) Trusts. We used to see a lot more of these trusts than we do today. They are set up by the transferor to become effective while the transferor is alive. Pursuant to Section 2503(c) of the Internal Revenue Code, the transferor creates a trust for a minor beneficiary and contributes assets to the trust. The Trustee manages the trust, making both investment decisions and distribution decisions. When the beneficiary reaches age 21, the beneficiary has the right to withdraw *all* of the assets in the trust for a period of time. If the beneficiary does not withdraw the assets, the assets stay in trust for the beneficiary until the beneficiary reaches an older age, such as 30 or 35.

When the beneficiary reaches the stated age, the trust terminates and all of the assets are distributed to the beneficiary, outright and free of trust.

Contingent Trusts. These trusts are used a lot in Wills and revocable trust instruments and, therefore, they are trusts that usually become effective on the transferor's death. The contingent trust applies if the beneficiary is under a stated age when the transferor dies. The contingent trust lasts until the beneficiary reaches the stated trust termination age. Transferors vary in what they believe is a "safe" age for the trust to terminate. In most cases, that age is well beyond age 18 or 21. Commonly selected ages for the termination of a contingent trust are when the beneficiary reaches age 25, 30 or 35. Sometimes, the transferor provides for "staged" or "partial" terminating distributions from a contingent trust. For example, the trust may provide that the beneficiary should receive one-third of the trust assets upon reaching age 25, one-half of the remaining trust assets (i.e., a second third of the original trust assets) upon reaching age 30, and all of the remaining trust assets (i.e., the final third of the original trust assets) upon reaching age 35.

During the existence of the contingent trust (i.e., prior to termination of the trust), the Trustee will make distributions from the trust to or *for the benefit of* the beneficiary for prescribed purposes, such as distributions for the health, education, support and maintenance of the beneficiary. *Health* and *education* are understandable terms. *Support and maintenance* refers to the basic necessities of life, such as food, clothing and shelter. In many cases, while the beneficiary is "too young," the Trustee will not distribute significant amounts directly to the beneficiary, but will make the distribution from the trust *for the benefit of* the beneficiary. Making a distribution *for the benefit of* the beneficiary means the Trustee will pay "third parties" who provide goods and services for the benefit of the beneficiary. An example would be the Trustee paying directly the beneficiary's tuition, room and board, fees and other charges for the beneficiary's attendance at a college or university.

Descendant's Trusts. A "descendant's trust" can be created by the transferor to be effective immediately or only upon the transferor's death. A descendant's trust lasts for the entire lifetime of the beneficiary. During the time when the beneficiary is "too young" to manage the trust himself, the descendant's trust is basically identical to the contingent trust: The Trustee manages the trust assets and makes distributions to or for the benefit of the beneficiary based on the particular terms of the trust. The main difference between a contingent trust and a descendant's trust is that the contingent trust will terminate when the beneficiary reaches the specified trust termination age (or, ages), while the descendant's trust will continue beyond that age for the lifetime of the beneficiary. In many cases, the child who is the primary beneficiary of a descendant's trust will become the Trustee of his own trust upon reaching a specified age.

Trust Benefits. The benefits of placing assets in a trust apply in the case of all three trusts just described, but the benefits continue for *the beneficiary's entire life* in the case of a descendant's trust (which is not true in the case of a contingent trust or a 2503(c) trust because those trusts terminate when the beneficiary reaches the specified age). Some of the benefits a trust can provide include: (i) divorce protection for the assets held in the trust (i.e., the assets inside the trust should be protected from loss in the event the beneficiary and his spouse get divorced because those assets are not "marital property" of the marriage–they are trust assets); (ii) creditor protection for the assets held in the trust (i.e., the assets held in the beneficiary's trust should be protected from being taken to satisfy a judgment against the beneficiary, such as could arise in the case of a professional malpractice lawsuit or a lawsuit for personal injuries resulting from a car accident); (iii) increased income tax options (i.e., the trust may allow its income to be distributed to any of multiple current beneficiaries, some of whom may be in low tax brackets); and (iv) estate tax avoidance (i.e., trusts that are fully exempt from the GST tax can continue for the benefit of the current beneficiary and future generations without incurring federal estate taxes). Thus, there are reasons why a transferor might create a lifetime trust for a beneficiary who is currently a minor, rather than a contingent trust or 2503(c) trust, especially in the case of assets having a more substantial value.

A contingent trust usually has just one beneficiary. Many descendant's trusts have multiple current beneficiaries (as explained above). In some cases, the transferor will create a contingent trust for the benefit of multiple current beneficiaries (this might be the case if the amount the transferor wishes to give is not large enough to justify creating a separate contingent trust for each beneficiary).

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If a trust has multiple current beneficiaries, the priority for making distributions to the beneficiaries should be made clear in the trust instrument.

Trust Disadvantages. Of course, a trust is "more complicated" than a custodial account and usually has to file its own income tax return.

Summary. Persons under age 18 should not be direct recipients of gifts, whether made during life or upon death. Instead, the gift should either be made to a UTMA custodian for a beneficiary under age 21 or to a trust for the benefit of the beneficiary.

End of Year Estate Planning. Depending on the November 2020 election results, some people may wish to make gifts of their remaining exemption amount before the end of 2020. We will be happy to assist as many clients as we can in November and December, but note that our office will be closed for Thanksgiving, the day after Thanksgiving, Christmas Eve and Christmas Day. **We may not be able to send another newsletter this year, so we wish you, in advance, Happy Holidays!**

AWARD: The Killing of Community Property. Karen Gerstner's article, *The Killing of Community Property*, which was published in Texas Tech Law School's *Estate Planning and Community Property Law Journal*, was selected as the best law review article of 2020 by the Texas Bar Foundation. Unfortunately, the event that was scheduled to honor Karen and other 2020 award recipients had to be cancelled due to the coronavirus pandemic. Karen is very grateful for this award. She is also glad that she "stood up for" community property, which is so often disparaged and, worse, "preempted" by lawmakers and jurists in common law states and by federal "agents" (such as those who work for the IRS).

Contact us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone, fax or traditional mail at the address and phone number shown above, or by email sent to:

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