PacificCPE

COURSE
40654A

Leaving Money to Children Effectively

Transferring wealth to children requires more than just naming them in a will. This course examines the various methods for leaving money to minor and adult children, including the use of trusts, custodial accounts, and other planning vehicles. It highlights the practical and legal considerations that shape these decisions, helping CPAs and tax professionals guide clients toward structures that protect inheritances and reflect the client's intentions—both now and as circumstances change over time.

CREDIT HOURS 2 | FIELD OF STUDY BUSINESS | EXAM QUESTIONS 8

Start Course ↓ | Final Exam Copy ↓

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 8 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recall the characteristics of custodial accounts and trusts for children.

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Chapter 1: LEAVING MONEY TO CHILDREN

Chapter Objective

After completing this chapter, you should be able to:

- Recall the characteristics of custodial accounts and trusts for children.

If you have young children, you should choose a custody guardian (known as a guardian of the person) who will raise them (see Chapter 2 of course 40653B). If your young children will inherit any money from you, you must also choose someone (known as a property guardian) who will be responsible for safeguarding, investing, and spending that money. Of course, you'll also need a property guardian if you want to leave money to children who aren't your own, such as a niece or grandchild.

Parents have a tough job choosing custodial guardians, whose job it will be to actually raise their children if they can't. Fortunately, picking someone to manage the money and property that a child might inherit shouldn't be nearly as challenging. The job of this person is to make good investment decisions and spend that money for a child's benefit. And the need to appoint a property guardian isn't a task exclusive to parents. Anyone who wants to leave money to children needs to be thoughtful about how that's done.

Until children are legal adults, they can't directly receive more than a nominal amount of property, and they can't sign legal contracts to do things like sell a house. For example, under California law, if a gift is more than $5,000, the child needs adult supervision for it. In Florida, this amount is $15,000. And even after age 18, when a child is legally capable of owning a gift and signing a legal contract, you might want that money to be managed for several more years by someone older and more experienced. You don't need to find the next Warren Buffett. You just need to choose someone who is diligent, responsible, honest, and thoughtful about money management.

This chapter will help you get an overview of your options if you want to leave money to children (yours or anyone else's). Here's the sneak preview:

- Don't leave children under 18 a gift of more than $2,000—$5,000 without checking your state's legal limit for property ownership by minors and making provisions for adult supervision.
- If you want your gift to be used for certain purposes (or not used for others), make sure that you leave that gift in a way that allows you to place limits on its use.

- Finally, if you leave money to children older than 18, think about whether you want those children to have full access immediately (you can delay access to a later age).

MONEY AND KIDS: THE BASICS

Leaving money to children requires some strategic planning. How and when a child has access to money, who should manage it until that time, and what that money can and should be used for are all things that you should address in your estate plan.

Know What You've Got

It's possible that you don't have much to leave to children. If that's the case, the basic rules for leaving money to minors still matter for what you do have to give. Life insurance is often a way that a person can provide immediate cash to children. But many people are surprised at just how much their kids or other young beneficiaries would inherit at their death. When they add up the value of their life insurance, home equity, and retirement, my clients would realize that, even though they feel cash-strapped now, they have more to leave behind than they thought.

Knowing how much you might be leaving behind matters a lot when you take the children's ages into account. You might be happy to have a 25-year-old inherit $50,000 outright, but it would be a completely different situation if the amount were $500,000 or $1 million. The more money children stand to inherit when you die, the older you're likely to want them to be before it falls into their hands.

You can use the Net Worth Calculation Worksheet to fill in the big-ticket numbers so that you can get an estimate (see the sample in Chapter 2 of course 40651B and included on this course's companion page). All you need is an approximation, so round things off to the nearest $10,000 or so.

Pick a Good Manager

To figure out whom to name as the person to manage money for children (a money manager), start by jotting down the people who first come to mind. You can make your final decision when you've picked a method for managing the money children might inherit.

For parents with minor children, the personal guardian and the money manager are often going to be the same person. That's a great choice for many families. After all, most parents do both jobs—get the kids ready for school and manage the family's money to make sure that there's enough to take care of their needs.

But if the person that you want to name as your children's custodial guardian isn't good with money — you fear they would squander your children's money on frivolous items or be overwhelmed by the task of responsibly investing and spending their money—you can pick someone else. If you are a divorced parent, while you might be okay with having your ex-spouse or partner be the custodial

guardian, you might want someone else to be in charge of your child's money, so you'd name someone else in that situation, too.

Whomever you choose, you should pick someone who will invest the child's money even more carefully than they would invest their own. You should trust this person to exercise judgment about how that money should be spent and be fair to all beneficiaries. And if you have minor children for whom you've chosen a custodial guardian, you'll need to make sure that the two guardians will be able to work together and communicate well.

If you are leaving money to other people's children, it's important to structure the gift thoughtfully. As explained earlier, a large direct gift to a minor child requires a court-appointed guardian of the estate. For example, an outright gift of $25,000 to a 10-year-old niece will require that her parents go to court and get a property guardian appointed, which limits how the money can be invested and requires court oversight. There's a better way, which avoids that level of hassle and oversight.

Grandparents sometimes want to leave their IRAs to their grandchildren. The grandchildren would then have inherited IRAs, and could withdraw these assets over ten years. (Read Chapter 1 of course 40656B to learn more about retirement plans and estate planning.) Leaving retirement assets to grandchildren can be a great idea, but not if the grandchildren are minors and are named directly, because that requires that a property guardian be appointed before these accounts can be created. To avoid that outcome, you shouldn't leave money to minor children directly. Instead, you should name a custodian for the gift— often a parent, but not always. Read on.

Example

Marion, a divorced woman in her seventies, had an IRA worth $200,000. She named her two grandchildren, aged 9 and 11, as the beneficiaries of the IRA. After Marion died, Kelly, her daughter, contacted the plan administrator to transfer the IRA into inherited IRAs for each of her children. The plan administrator told Kelly that they couldn't distribute the money without a court order appointing a property guardian for each child. Kelly had to go to the probate court in her county and begin the process of having herself appointed as property guardian for her children. After Kelly submitted the required forms, she had a court hearing and an interview with a court investigator. Kelly was not happy about the amount of background information she was required to submit to the court, including whether she'd had a restraining order filed against her, and whether she'd been arrested for a felony or misdemeanor. If Marion had named her daughter Kelly as a custodian for each grandchild under her state's Uniform Transfer to Minors Act on her beneficiary forms for the IRA, Kelly would not have had to be appointed as property guardian at all.

Pick the Right Structure

In addition to picking the right people to manage children's money, you'll need to pick the right way for them to manage that money. You have two good options, each of which is discussed in detail below:

- **Custodial account**. With a custodial account, you select someone to serve as custodian to manage assets for children in a custodial account. This type of account allows someone you've named to manage a child's money and property until that child turns 25 (the legal age limit).
- **Trust**. With a trust, you select someone as a trustee to manage money and other property for whatever purposes you specify, until a child turns whatever age you choose. You can create trusts for each minor beneficiary or one "pot trust" for all of them, if appropriate. You can set up a trust in your will or your living trust.

These methods have many similarities. Each provides a way to manage children's property until they're adults. But custodial accounts and trusts differ significantly in several key respects, including:

- How long management lasts, and
- How much flexibility they offer.

To know whether a custodial account or a trust is better for your situation, you need to understand how each one works. It's a little like shopping for the latest phone or tablet. You might not need all the bells and whistles that the most expensive model offers. Sometimes, a simpler, lower-cost option has everything you need. The important thing is to understand which features are essential and which ones you can live without, based on the size of your estate and other factors.

Children with Special Needs

If you want to help a child who might never be able to manage and invest funds without help, you face a special challenge, and the estate planning techniques discussed in the rest of this chapter will not accomplish your goals. If that child relies on government benefits for essential services and support, inheriting money could jeopardize eligibility for those services, at least until the funds are spent. For most families, the key fear is losing Medicaid coverage, because their special needs child might never have a job that provides health insurance.

Medicaid and some other programs are available only to those who can't pay for such care themselves. This means that directly leaving a disabled child money can cause the loss of benefits —the opposite consequence intended by a well-meaning adult.

To leave a special needs child money to live a meaningful and comfortable life, without losing the support of government programs, you will probably want to create (or make a gift to) a "special needs trust," also called a "supplemental needs trust." This type of trust can be structured so that a trustee manages a child's property for that child's entire lifetime. Because legally the child does not own or control the trust assets, those assets won't cause that child to be disqualified from receiving essential government benefits.

Parents and others can also open ABLE accounts, which are protected savings accounts for individuals with disabilities that began prior to age 26. The money in an ABLE account won't imperil their eligibility for programs like SSI and Medi-Cal, as long as the trustee uses the money according to the rules. These accounts can be used for qualified disability expenses such as education, housing, transportation, basic living expenses like food, and employment training and support. To learn more about ABLE accounts, go to the ABLE National Resource Center: www.ablenrc.org.

CUSTODIAL ACCOUNTS

A custodial account is usually a bank or brokerage account in the name of a minor child. You can open an account like this at any time. If it is part of your estate plan, it would be opened after your death by the person you named as your executor in your will. The person in charge of the account is called its custodian.

State law determines how the custodian must manage the account, and when the account must end. Every state except South Carolina and Vermont has adopted the **Uniform Transfers to Minors Act**, so that people can easily leave property to children under adult supervision.

In most states, the custodianship ends when a child reaches the age of 21, though some states allow you to choose to terminate the account when a child reaches any age between 18 and 25. Funds in a

custodial account may be used for the minor's benefit, but you can't restrict such an account to certain, specific purposes.

If you don't mind the idea of children getting complete control over their inheritance at a relatively young age—18 to 25—then you might want to use a custodianship account. It's definitely the simpler method and can work well for the right gift. However, if you are leaving more money than you'd comfortably turn over to a 25-year-old, or you want to restrict the use of the money for specific things (like education or the purchase of a house), a custodial account won't work.

Setting Up a Custodial Account

Setting up a custodial account is easy. All you need to do is to state in your will or trust that any money a child inherits from you should go into a custodial account and name a custodian to manage that account. If the child will inherit other kinds of assets—real estate, for example—the custodian can manage them, too.

You must establish a separate custodianship for each child—you can't pool your assets for the benefit of them all. The custodian may use each child's account to benefit that child only. If one child had extraordinary medical expenses, for example, the custodian couldn't dip into a sibling's custodial account to pay those bills. This isolation of assets can be a significant drawback to using custodianships.

A custodial account is really a simple trust created for a child's benefit, with standard terms, which you can use and everyone else understands. For example, banks and other financial institutions know exactly when the property in a custodial account must be distributed to a child and what the money can and can't be used for. And opening a custodial account at most banks and other financial institutions is free.

Using Custodial Accounts for Your Children's Assets

Pros Cons

Easy to set up You can't restrict the use of the money for a specific purpose, such as education. Low or no cost An account can't be set up to benefit multiple One size fits all children. Familiar to all financial institutions and easy An account must end at age 21 or 25 for an for a custodian to manage account funded after the death of the donor. After a custodial account ends, the money must be turned over to the child with no strings attached.

The Custodian's Job

Once the executor or trustee places money or property in a custodial account, the assets belong to the minor child but are controlled by the custodian. The custodian is required to manage the money prudently—investments in risky start-ups or penny stocks (stocks that trade for less than $5 per share, all the way down to fractions of a penny) would not be legal. The custodian may spend the

money only for the use and benefit of the child. For example, money in a custodial account could be used to pay for housing, food, education, a computer that a child would use for school, summer camp, extracurricular activities, a car, or a trip to Bali.

	Uniform Transfers to Minors Act
State	**Age at Which Custodianship Ends and Any Limits on Gifts**
Alabama	1. If custodian appointed in will or trust, custodianship ends at age 21.
Ala. Code §§ 35-	2. If custodian appointed by personal representative or trustee, transfers to
5A-1 and following	custodian cannot exceed $10,000 in value; custodianship ends at age 19.
Alaska	1. If custodian appointed in will or trust, custodianship ends at age 18–25.
Alaska Stat. §§	2. If custodian appointed by personal representative, transfers exceeding
13.46.010 and following	$25,000 must be authorized by court, and custodianship ends at age 18 unless custodian extends the time and minor does not promptly object in writing.
Arizona	1. If custodian appointed in will or trust, custodianship ends at age 21.
Ariz. Rev. Stat.	2. If custodian appointed by personal representative, transfers exceeding
§§ 14-7651 and	$10,000 must be authorized by court, and custodianship ends at age 18.

following