When a Minor is a Beneficiary

Some factors for parents & grandparents to consider.

Provided by Jill E. Gleba

Naming a minor as a beneficiary brings up a major concern. If parents or grandparents make a child a primary or contingent beneficiary of an insurance policy, IRA or investment account, they should be aware that most policies and investments will not directly transfer to a minor. They need to be received by a court-approved property guardian, a trustee of a children's trust, or a revocable living trust beforehand.[1]

State laws prevent children from receiving large lump sums. They commonly prohibit minors from owning real property worth more than $2,500-5,000 (the limit varies per state) or receiving cash inheritances greater than that. It is incredibly rare for insurers to distribute life insurance proceeds to minors.[1,3]

As for POD checking and savings accounts and CDs, banks will usually allow the child or the child's parent(s) to receive sums less than the aforementioned limits. For larger sums, the parent(s) will likely have to turn to a court and ask to be appointed guardians for the money if no property guardian, children's trust or revocable living trust is in place.[2]

A personal guardian is not always a child's property guardian. Usually, one person serves as both – but if that person lacks financial literacy or accountability, another property guardian may need to be appointed to manage assets for the child until the child turns 18. If that is desired, a court must review the choice of guardian and the inherited assets will be probated.[3]

How may circumstances like these be avoided? Parents or grandparents would be wise to consider three options.

A property guardian can be appointed for a child in a will. If an individual who may become the child's personal guardian is negligent or incompetent at managing wealth, this may be worthwhile. The property guardian will need court approval to sell any of the inherited assets, and rules will govern how the assets are spent.[3]

A property guardian should be someone likely to live at least until the child turns 18. A bank is the property guardian of last resort, as banks charge fees and have no personal stake here.

An UTMA custodianship may be arranged. In 49 states (South Carolina being the exception), an adult may be appointed as a custodian for assets left or gifted to a child under the Uniform Transfers to Minors Act (UTMA). This appointment is made through the language of a will or living trust. (Vermont recognizes only the older Uniform Gifts to Minors Act, or UGMA, under which the custodian is more rigorously supervised.)[3]

The UTMA custodian serves as asset manager and financial recordkeeper, overseeing the assets inherited by or gifted to the child until the child turns 21 (18 in some states). He or she is authorized to manage, spend and invest these assets for the child's benefit and eventual use and file the relevant tax returns. These actions do not need to be supervised by the courts. When the child turns 21 (or 18), the custodianship concludes and the child receives 100% of the assets – which may be a problem.[3]

A child's trust is another possibility. A child's trust, also called a testamentary trust, can be established through language in a will or living trust document; it allows a trustee to use the inherited assets to fund education, health care and everyday expenses for the child. The minor need not receive the funds at 21, as is usually the case with an UTMA custodianship; the assets can be received later in that individual's life. A variation of this, the pot trust, provides for multiple children and lets a trustee vary the amount spent per child. A pot trust exists only until the youngest child reaches legal age; ideally, the children for whom the trust is created are born within several years of each other. If the children reach legal age or the age when they are supposed to receive the assets before the trust can be implemented, then it is revoked and the inherited assets simply pass to them. These trusts can be designed to try to minimize taxes and administrative expenses.[3,4]

An irrevocable variant is the §2503(c) trust, or minor's trust. A minor's trust is funded with irrevocable transfers of assets, which commonly begin while the trust creator is living. The transfers are tax-exempt under the Internal Revenue Code; the wealth may accumulate within the trust without the trust creator being subject to gift or estate tax. A trustee manages the trust assets until a specified date or circumstance, and then they are distributed to the young adult heir.[4]

Naming a minor as a beneficiary means recognizing certain factors. Financially speaking, if you fail to appoint a trustee or a property guardian for a minor through your will or living trust, then you are leaving it open to the courts to decide who that trustee or guardian may be. So it is vital to address these matters. As one or more children approach legal age, terms of your will or revocable trust need to be reviewed and possibly changed as well.

Citations.

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