# Estate Planning Issues Affecting Parents of Young Children

By: Kathi L. Ayers

The biggest task facing parents of young children with respect to estate planning is to ensure (as best as possible) that their children will be taken care of if both parents die prematurely. Parents must be concerned not only with *who* will take care of the children, but also with *how* the children's many needs will be met. Consequently, in working with parents of young children, estate planning attorneys should encourage their clients to think about both who they would like to raise their children if they were unable to do so, as well as the way in which they would like to structure the distribution of their assets. Basic estate planning gives parents some degree of control over situations in which they would otherwise have no control, as well as peace of mind that they are prepared should the worst happen.

## I. PHYSICAL CUSTODY OF CHILDREN

### A. Designating the Guardian

The subject of guardianship is what first prompts many parents of young children to see an estate planning attorney. The biggest issue that arises in connection with guardianship is deciding who the right individuals are to serve. Many clients struggle with this decision because it is hard to imagine other people raising their children.

There are several factors to consider when choosing a guardian, including age, experience, temperament, values, religious beliefs, relationship with the children, and whether the guardian has his or her own children. Clients must decide whether it is preferable to name family members or friends. They may choose to name one person or a couple to serve, and may wish to specify that a couple be married in order to serve. Because guardians act as substitute parents for the children, some clients may be more comfortable naming a couple so that the children are raised in a two-parent home. Conversely, some clients may feel most comfortable with a specific person as the guardian, regardless of his or her marital status.

Logistical concerns may also be a factor. Although individuals nominated or appointed as guardian do not have to be Virginia residents,[1] clients may want to name a local guardian so that to the extent possible, the children can remain in their current schools and activities. Clients should name a primary guardian, as well as successor guardians in case the primary guardian is unable to serve. Clients should also make sure that potential guardians are willing to accept the role.

In discussing the guardianship issue with parents of young children, it is important for clients to know what would happen to their children if there was no will designating a guardian. In such a case, the court will appoint a guardian of the person of the minor (physical custody). If the minor is under the age of fourteen, the court nominates and appoints the guardian, but if the minor is fourteen or older, he or she may nominate his or her own guardian.[2] Non-relatives of a minor are not permitted to be appointed as guardian by the court until family members have been

[1] Va. Code § 26-59.
[2] Va. Code § 31-4.

able to petition the court for appointment.[3] Upon the death of a guardian, the guardianship ends and the court must appoint a new guardian.[4]

If there is a surviving parent, he or she is automatically entitled to custody of the person of the minor unless he or she is considered by the court to be unfit.[5] This is true even if the parents were divorced and the deceased parent had sole custody of the children.[6] Many custodial parents do not understand this point of law and often wish to prepare wills naming other guardians for their children. Since the presumption that it is in the best interest of a child for the surviving parent to have custody can only be overcome with evidence that the surviving parent is unfit to have custody of the child, a custodial parent may wish to put a statement in his or her will explaining why a surviving parent is unfit to be awarded custody.

These are difficult questions, however, thinking through the issues and selecting guardians is much more beneficial to children than doing nothing. Once a plan is in place, clients will have the peace of mind of knowing that their children will be taken care of.

### B. Providing for the Guardian

Another question that clients should consider when thinking about potential guardians is whether the guardian could afford to care for their children in the manner that they would like their children to be raised without creating a financial hardship. While guardians are entitled to reasonable compensation (which is not clearly defined) as a fiduciary under Virginia law,[7] such compensation may not be adequate. In many cases, potential guardians have children of their own to care for, and adding one or more additional children to the household could create a significant burden. For example, what if a potential guardian lives in a house that is too small to accommodate the children? Or what if a potential guardian owns a car that is too small to transport the children?

Assets that parents leave for their children, whether held in trust or otherwise, are to be used directly for the *children's* benefit, and while using a portion to make an addition onto the guardian's house or to buy a larger vehicle may *indirectly* benefit the children (or may benefit them in the short term), it primarily benefits the guardian because the guardian is the owner of the property and could potentially enjoy the use of the property after the guardianship ends.

One possible estate planning solution to this problem is a trust for the benefit of the guardian. A guardians' trust could be funded with a set amount of money (or percentage of the Trust Fund) set aside for the benefit of the guardian. The beneficiaries of the guardians' trust would be the individuals selected by the court as the guardians of the clients' children *during such time that they are acting as guardians*. Naming the beneficiary in this manner would allow the beneficiary of the guardians' trust to change if the guardian changes. Distributions from the guardians' trust would be made by the trustee for the guardian's support and maintenance, with the intent being to provide sufficient funds to enable the guardian to raise the clients' children according to the clients' wishes or standard of living without incurring personal financial burden. The guardians' trust would terminate when the guardianship ends and upon termination, any leftover funds are distributed to (or held in trust for the benefit of) the children. The use of a

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[3] *Id*.
[4] Va. Code § 31-9.
[5] Va. Code § 31-2.
[6] *Judd v. Van Horn*, 195 Va. 988, 81 S.E.2d 432 (1954).
[7] Va. Code § 26-30

guardians' trust gives parents the peace of mind that their children will not be a financial burden upon the guardians.

## II. DISTRIBUTION OF ASSETS

The other major concern parents often have when thinking about estate planning is deciding the best way to distribute assets to their children. The goal in distribution planning is to maximize control over the management and distribution of assets. Parents of minor children need to decide the best method for distributing the assets to the minor child as well as the best person to control those assets.

### A. Distribution of Assets

#### 1. Outright Distributions

When minor children are the outright beneficiaries of assets, either because they are named as beneficiaries of life insurance policies, retirement accounts, or other assets, or because they inherit property in a will that does not keep the money in trust or does not provide for distribution to a custodian under the Uniform Transfers to Minors Act, then it will be necessary for the court to appoint a guardian of the estate (property) of the minor.[8] In most cases, a payor of benefits or assets will only distribute the benefits or assets to a court-appointed guardian (even if a parent is the guardian of the person of the minor).[9]

Guardians of the estate of a minor appointed by the court must give bond in the amount equal to the value of the minor's estate, and provide surety on that bond, unless surety is waived by statute because the amount is less than $15,000[10], or in the case of guardians named in a will, surety is waived in the will.[11] The guardian of a minor's estate must file an inventory with the commissioner of accounts which details the minor's property within four months of becoming the guardian, and must file an accounting with the commissioner of accounts within six months, and then on an annual basis.[12] The fees associated with filing accountings with the Commissioner of Accounts under the State of Virginia voluntary fee guidelines range from $116 to a maximum of $5,016 per year and are based on the value of the minor's estate.[13] It is easy to see how the expenses related to preparing and filing the accounting could erode the value of the assets being held for the minor over time.

Another complicating factor with court appointed guardianships is that guardians of the estate of a minor are limited in their ability to make distributions from the minor's estate for the support of the minor when the child has a living parent (even if the living parent is the guardian).[14] This is because a parent has a legal obligation to support his or her minor child.[15] Under Virginia law, the guardian of the estate can make a distribution to a minor with a living parent only if (a) the parent is unable to fulfill that duty of support, (b) the parent is not required to provide the support or (c) the distribution is beyond the scope of the parental duty.[16] Even if a request for a distribution meets these guidelines, the guardian must first seek Court

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[8] Va. Code § 31-4.
[9] 8.202(C)(1)-Estate Planning in Virginia, Third Edition, Volume II (2009 Supplement).
[10] Va. Code§ 26-4.
[11] Va. Code § 31-6.
[12] Va. Code § 26-12(B); Va. Code §26-17.4(A) and (B).
[13] http://www.fairfaxcommissionerofaccounts.org/open/docs/resource.comfees.guardfees.pdf
[14] Va. Code § 38-8.1.
[15] *Id*.
[16] *Id.*

authorization before any distribution can be made.[17] The only exception to this rule is that distributions of up to $3,000 per year will be allowed without court approval provided that the distributions meet the same criteria for Court authorization.[18] Thus, naming a minor child as the outright beneficiary of an asset can severely limit the guardian's ability to use such funds for the child when the child has a living parent and such a result could completely frustrate the donor's intent for naming the minor child as the beneficiary.

2. Uniform Transfers to Minors Act

Under the Virginia Uniform Transfers to Minors Act (UTMA), property is transferred to a custodian who holds and administers the property for the benefit of a minor.[19] The nomination of a custodian can be made in a will, trust, deed, an instrument exercising a power of appointment, or in a beneficiary designation.[20] A custodian is nominated by naming the custodian followed by the phrase "as custodian for (minor) under the Virginia Uniform Transfers to Minors Act."[21] If desired, the custodianship can be extended until age twenty-one (21) by adding "(21)" after the phrase "Virginia Uniform Transfers to Minors Act"[22] Transfers can only be made for a single beneficiary and there can only be a single custodian.[23]

The benefits of an UTMA custodianship are numerous: 1) any type of property can be transferred[24]; 2) the custodian does not have to post bond[25], does not have to file accountings unless mandated by the court,[26] and does not have to file fiduciary income tax returns; and 3) the termination of a Virginia UTMA custodianship can be extended to twenty-one (21) years rather than eighteen (18) as long as the proper designation is made.[27]

One disadvantage to an UTMA custodianship is that property must be distributed completely at twenty-one (21) years. Although there are exceptions, many parents would not feel comfortable with a twenty-one (21) year old having complete control of assets. Another disadvantage to an UTMA custodianship is the potential income tax consequences in a situation in which a surviving parent is the custodian. If the income from the custodial property is used to discharge a support obligation (which is permitted in Virginia[28]), then the parent is subject to taxation on that income.[29] For this reason, it is advisable to nominate as custodian someone who does not have a legal obligation to support the minor.

3. Trust under Will

Parents could also distribute assets to children by creating trusts under will, but there are several drawbacks to doing so. First, trusts under will require probate, which can delay the distribution of the assets because the assets must first go through the probate process (fiduciary qualification, notification to creditors, and filing of inventories and accountings) before the trust can be funded. Second, the probate process will reduce the amount of assets available to take care of the child because of probate taxes, fees and expenses. Third, trusts under will only go

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[17] *Id.*
[18] Va. Code § 38-8.2.
[19] Va. Code § 31-38.
[20] Va. Code § 31-39
[21] *Id.*
[22] Va. Code § 31-45(D).
[23] Va. Code § 31-46
[24] Va. Code § 31-45
[25] Va. Code § 31-51
[26] Va. Code § 31-55
[27] Va. Code § 31-45(D).
[28] Va. Code § 31-50.
[29] Rev. Rul. 56-484, 1956-2 C.B. 23.

into effect upon client's death (and not incapacity), so that assets are not necessarily available to provide for children in case of a parent's incapacity, and finally, trustees of trusts under will must file annual accountings with the Commissioner of Accounts (in addition to probate fees) unless the will waives the accounting requirement.[30] The fees associated with filing accountings for trusts under will are similar to those for estates and are based on the value of the property held in trust.[31]

4. Revocable Trust

A revocable trust (whether individual or joint) offers much more flexibility in the distribution of assets than outright distributions, UTMA custodianships and trusts under will. First, assets in a revocable trust do not have to go through the probate process, so assets are more readily available to the child. Second, assets do not have to be distributed to children at eighteen (18) (or twenty-one (21)) when they likely do not have the maturity to handle the money—rather, parents can specify that assets are to be distributed to children at older ages (such as thirty (30) or forty (40)) with periodic distributions of principal. The key is that parents are able to customize the distribution scheme to suit their preferences.

Through the revocable trust structure, parents establish rules for how and when their children receive assets, thereby maintaining as much control as possible. For example, in an age forty (40) trust, the trustee would provide discretionary income and principal to the child for his or her needs, and would distribute portions of the principal at ages thirty (30) and thirty-five (35), and the balance at age forty (40).

Revocable trusts can also provide a flexible way for divorced clients to handle incomplete property settlement agreements. Many property settlement agreements require an ex-spouse to maintain a certain level of life insurance for minor children. The property settlement agreement usually has a vague requirement that the beneficiary of the life insurance policy proceeds be the former spouse as "trustee" for the children. Yet, in many cases no trust agreement actually exists, and so the terms of the trust regarding how the former spouse can use such funds, when the trust terminates and what happens to the remaining funds when the trust terminates, do not exist.

One estate planning solution to this problem is to direct the trustee of the divorced client's revocable living trust to place the required life insurance death benefit into a sub-trust called the "property settlement trust," with the ex-spouse as Trustee. The property settlement trust would fill in the missing terms from the property settlement agreement in a manner consistent with the intent of the property settlement agreement. For instance, the trustee would be able to use the trust assets for the support and maintenance of the children. The trust termination date would be when the minor children reach the age specified in the property settlement agreement, or when the ex-spouse (Trustee) dies. Upon the termination, the trust would direct that the any leftover funds be distributed in a manner consistent with the client's overall estate plan.

**B. Control of Assets**

With regard to the management and control of assets, it is important for parents to think about whether they feel comfortable with the person who has the custody of the child also having control of the child's assets. There is no right or wrong answer, but many things to consider. In many cases it will depend on the personality and temperament of the person chosen as guardian.

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[30] Va. Code § 26-17.6.

[31] http://www.fairfaxcommissionerofaccounts.org/open/docs/resource.comfees.guardfees.pdf

Because the role of guardian is that of a substitute parent and care-giver, clients must decide whether the guardian (who will handle the day-to-day affairs of the children, as well as manage their education, extra-curricular activities and religious upbringing) is best suited to handle the financial aspect of managing the child's assets. Clients must decide whether tasking the same person with both jobs will be overwhelming, and whether they are comfortable with there being less oversight involved if the guardian also controls the child's assets. On the other hand, if one person has custody of the child and one person has control of the financial assets, clients must be absolutely certain that the two can work together to provide for the child's needs.

Ensuring the care and well-being of children is the primary responsibility of parents. Part of that responsibility includes planning for situations in which parents may be unable to provide for children themselves. It is critical that parents think about these difficult issues and make decisions so that a plan is in place in case the unexpected happens.

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