Estate Planning Basics for Families With Young Children

When you hold your newborn child for the first time, you instinctively protect them from harm, handling their fragile frame as if it were made of the thinnest porcelain. On the trip home from the hospital, after inspecting the seatbelt nine or 10 times, you drive well below the speed limit. During the first few weeks you spend more sleepless nights than they do—wondering about their future and worrying about their safety. When you imagine their first day of school, college graduation, and wedding day, you picture yourself right beside them, beaming with pride. But what if tragedy strikes and you are taken from your children before they reach these milestones?

It's nearly incomprehensible for a parent to consider, but part of loving and protecting your family is providing for the possibility of events unfolding differently than you've envisioned. The question of what will happen to your children without you or your partner will be answered one way or another. The amount of control you have over how that question is answered is entirely up to you. Without sufficient planning, your family's future will be decided by the judicial system. Setting up an estate plan makes sense for any individual, no matter their financial or personal situation, but for families with young children, drafting an estate plan is absolutely essential.

WHAT IF I DON'T HAVE AN ESTATE PLAN?

If you pass away without an estate plan, you die *intestate*, which means that your estate will be distributed by predetermined state guidelines, and the courts get to decide who is awarded custody of your children and who controls the inheritance you've left for them.

CUSTODY OF YOUR CHILDREN

Without even a basic will, you won't have any say about who assumes custody of your children. A judge who has no knowledge of your wishes will appoint a guardian for them in family court. Initially, the judge will appoint a temporary guardian, with a full hearing being held possibly months later to award final custody and guardianship to the person the court deems to be the most capable.

Potentially, your family and friends could end up battling over custody arrangements, causing emotional rifts among your loved ones for years to come. Or, worse yet, your children could temporarily or permanently be placed in foster care.

If you had nominated a guardian in a will or the Pour-Over Will of your Living Trust, the judge would have taken into consideration the person you named and most likely awarded custody to that individual, unless that person were deemed unfit to care and support your children.

CONTROL OF YOUR CHILDREN'S INHERITANCE

To make matters even more complicated, there may be a separate court hearing to determine who will be in charge of the inheritance that you leave for your underage children. The financial

guardian, or guardian of the estate, may or may not be the same person who was awarded custody.

The financial guardian will be in control of your children's inheritance until they come of age. At which point they will receive their full inheritance outright. Due to the young adult's financial inexperience and immaturity, their inheritance may be squandered.

PROBATE OF YOUR ESTATE

Furthermore, without a will or a Revocable Living Trust, any assets including life insurance proceeds will be divided according to predetermined state guidelines for *intestacy* in probate court. These guidelines are based on a one-size-fits-all approach to division of wealth. This formula, written by state legislators, does not take into account non-traditional families, such as those with children who are not yet adopted or unmarried partners, and may instead distribute the estate only to legally-recognized relatives. Additionally, each state has different rules, so if you own physical property in more than one state, it can become excessively difficult and expensive to sort out. Even without this complication, probate may be an extremely costly, time-consuming, and potentially distressing process in many states and can be avoided easily with a proper estate plan.

Moreover, having your estate settled in probate court makes all of your finances and personal information a matter of public record. Not only is this embarrassing and invasive, but it can also be dangerous for your surviving family members, as it makes them easy targets for predators, solicitors, and scam artists.

JOINT TENANCY PROPERTY OWNERSHIP

When you and your spouse open a checking account, buy a car, purchase a home, or acquire just about any other asset you can think of, the first — and usually only — impulse is to put the title in both your names as Joint Tenants.

Additionally, many families, including parents with young children, choose Joint Tenancy as their estate plan because they've heard it is a cost-free replacement for a will and that it avoids probate. These individuals focus on the fact that at the death of one of the owners, Joint Tenancy immediately passes full ownership of an asset to the surviving Joint Tenant by operation of law. So, yes, it does circumvent probate and avoid the need for a will, at least temporarily. Unfortunately, they're overlooking the fact that upon the death of the surviving Joint Tenant, the entire estate will have to pass through probate. It also brings with it a slew of problems that more than offset any short-term convenience it provides. In fact, Joint Tenancy can end up costing you — and your loved ones — many times the expense and headaches you thought you were avoiding.

For example, if you should pass away unexpectedly and your surviving spouse remarries, your jointly owned assets may end up being considered community property, causing you to lose control on how you would have wanted your children's inheritance to ultimately be distributed.

A solution many rely on is to establish a Revocable Living Trust and re-title their assets in the name of the trust. The trust will avoid probate and provides protection in case your surviving spouse remarries, allowing you to specify when and how you want your assets distributed to your children.

ESTATE TAX LIABILITY

Lastly, in addition to enduring the expense and delay of probate, without an estate plan, your beneficiaries may have to pay unnecessary federal estate taxes on their inheritance. In 2016, an individual can pass $5.45 million without federal estate tax. However, many states have state estate or inheritance taxes at much lower levels. The survivor of a married couple might be able to use the exclusion of the predeceasing spouse, as well as their own. However, in order to be able to get "portability" of the deceased spouse's exclusion, a federal estate tax return must be timely filed, even if it would not otherwise be necessary to do so. There are many reasons that a couple might plan to have the first spouse leave their assets in a "Family" or "B" Trust for the benefit of the survivor and children, rather than relying on portability. A Family Trust not only locks in the deceased spouse's exclusion amount, even growth of the trust would be excluded from the survivor's estate. Further, the trust could be exempt from tax even in the estate of the children. Portability does not allow for this.

A separate Family Trust allows for many protections that portability does not provide. The trust can provide creditor protection, both in the event of remarriage and divorce from other creditors. Also, a Family Trust can lock in the ultimate beneficiaries of the assets. This can be important to blended families.

SPECIAL CONSIDERATIONS FOR DIVORCED PARENTS AND BLENDED FAMILIES

In this age of divorce, remarriage, and blended families, parents who are divorced or remarried have an even greater need for estate planning – and more difficult challenges to overcome. Without a carefully designed estate plan there is much at stake for blended families and the children involved.

NAMING A GUARDIAN

Single and divorced parents have a higher need for estate planning than anyone because they may not have a partner to care for their children if something should happen to them. The guardianship or custody of children whose parents are divorced usually falls to the ex-spouse, as long as he or she is the biological parent. However, in the rare case of that individual being unable

or unwilling to care for the children, then another guardian would be appointed by the court. Nominating a guardian in a will would allow you to have a say in who should take care of your children.

Problems with Outright Distribution of Assets

Another concern is the management of the minor children's inheritance. When assets are distributed outright to minor children being cared for by an ex-spouse, the ex-spouse may have control over how the inheritance is managed. Similarly, if a step-parent has been appointed as the guardian, then he or she has authority to manage the inheritance of the children. In either case, your wishes regarding your children's inheritance may not be followed. However, your minor children can't be expected to manage their own money at such a young age. So what's the solution? Holding assets in trust with a Successor Trustee to manage those assets, instead of outright distribution, ensures that your children's inheritance is handled fairly and distributed in exact accordance with your wishes.

Dying Intestate

As we've discussed before, if you die without an estate plan, your estate will be subject to the intestacy laws in your state and go through probate court. The division and distribution of your estate will be subject to a predetermined formula, usually providing half of your estate to your new spouse, and the remaining half being allocated in equal portions to your biological children. For many parents in blended families, the state's distribution plan is worlds apart from how they would have chosen to distribute their assets themselves.

For example, if your blended family includes your spouse's children from a prior marriage, whom you have raised, but never formally adopted, this formula would not provide an inheritance for them. Similarly, if you have adult children from a prior marriage and minor children with your new spouse, you may want to provide more financial support to your minor children than provided by state guidelines.

Ownership of Property

When it comes to ownership of property, most married couples are joint owners of all of their assets. However, with blended families, this may not be the wisest choice. If you've remarried and established joint ownership of property with your new spouse, you may be unintentionally disinheriting your children from a prior marriage. In the event that you pre-decease your new spouse, they will get the ultimate say in who inherits your jointly-owned property or if your new spouse dies intestate, the state will decide for them. This could very likely result in those assets being inherited exclusively by your new spouses' children from their prior marriage – completely disinheriting your children. A proper estate plan can help address matters of property ownership among blended families and ensure that your children's inheritance is preserved.

Each blended family is unique, and similarly, each couple has its own set of goals to accomplish. Preserving the relationships between the step-parent and the step-children after the death of the parent and spouse is usually one of those goals. Proper estate planning can tailor a solution to help meet those goals.

CHOOSING A GUARDIAN

Guardians of minor children are "nominated" in the will by the last parent to die. Guardians are typically "nominated" rather than appointed because the courts will give preference to the nomination but are not bound by it. If a court determines that the best interest of the child would be better served by another choice, they need not heed your suggestion. However, while the nomination of a guardian is not a guarantee, it does allow you to give the court guidance, which it will use to make its determination. If all other things are equal, the court will heed your advice.

Nominating a guardian for your children is the most important – and, in many cases, the most challenging – part of the estate planning process. Here are some factors that you should consider when choosing a guardian:

AGE

You need to consider both the age of your children and the age of the potential guardian. If your kids are young, you need to select someone who will be emotionally and physically able to care for them in the long-term. While a grandparent may have the best emotional connection, they may not be able to make the kind of commitment necessary to raise your children to adulthood. On the other hand, it's also possible to choose a guardian that's too young to handle such a large responsibility. Therefore, it's important to consider both the age and emotional maturity of your guardian candidates.

PARENTING STYLE, RELIGION, AND VALUES

Every parent has differing opinions on discipline, education, and even curfew. Therefore, it's vital that you take these things into consideration when choosing a guardian. Ask yourself what's most important to you in terms of values and religion, and then assess whether the guardian you have in mind shares those views. If you're unsure, ask them. You might be surprised by their answers.

STAGE OF LIFE

Think about the stages of life your potential guardians are in. Are they married or single? Are they likely to get married or divorced? Do they have their own children, and if so, are yours likely to fit in? If they are single now, is a future spouse going to be supportive of their guardianship? What about their career? Are they married to their job, or close to retirement? All of these factors will have a tremendous impact on your children's lives, so take your time and choose carefully.

LOCATION

Sometimes we underestimate the effect of a location on our everyday lives. But, where a child grows up has an enormous influence on the person they become later in life. Things like neighborhoods, school systems, and nearby relatives seem like obvious variables when thinking about the location of a potential guardian. But what about less obvious factors like climate? Moving from a warm climate to a cold one, or vice-versa, can be a big adjustment for a child. Lastly, it's important to weigh the likelihood of frequent changes in location. Will the guardian have recurrent moves or job changes? In some cases, this is impossible to predict, but nevertheless helpful to consider.

RELATIONSHIP

It's not necessary for your chosen guardian to be a blood relative, but it's best if they are at least familiar to your children. If you have never seen this person interact with your kids, how will you know what kind of parental role this person would play with your kids? It would be much easier for both the guardian and your children to grieve and adjust if they already had a good relationship with each other. Obviously, in rare cases, it is necessary to choose a person who is distant from your family. This option should be exercised only as a last resort. It's important to note that even if your children are particularly close to one aunt, uncle, or friend, remember that this person would potentially fill the role of parent, not best friend. So be sure to keep all of the other considerations in mind as well.

WILLINGNESS

Speak to all of your guardian candidates before you make a decision. After all, having to assume a guardianship is a life-changing responsibility, and not to be undertaken lightly. Although, in reality, it's unlikely that your chosen guardian will need to fulfill that role, it's important to secure their consent before naming them.

FINANCIAL POSITION AND RESPONSIBILITY

An important part of the estate planning process is making sure that your loved ones are provided for financially. Ask yourself whether your chosen guardian is financially stable enough to raise a family. Do they have problems hanging on to money? What are their spending habits? If you have doubts about their abilities to manage finances, but you're convinced that they would make the best guardian for your children, you may want to consider talking to a qualified attorney about trust provisions that can make this easier.

In addition to discussing your wishes with your chosen guardian, it is recommended that you and your partner write letters of intent for your children. These letters can vary significantly, but most people use the opportunity to describe their expectations and hopes for their kids. A letter can be a much more comfortable format for expressing these desires than a verbal discussion, and it also serves as a permanent record. It is recommended that individuals update their letters of intent yearly or bi-yearly as their circumstances evolve.

Whether you have several guardians in mind or just one, it's vital that you weigh each and every variable to determine if he or she is the right person to care for your most valued treasures: your children.

DISABILITY PLANNING AND POWERS OF ATTORNEY

In addition to naming a guardian for your children, every parent needs a Power of Attorney to authorize someone to make financial decisions in the event you become incapacitated by an unexpected accident or illness. The appointment of a trusted individual to make these financial decisions helps ensure financial stability for your spouse and your children during your incapacity. The Power of Attorney and nomination of a guardian allow someone you have chosen to care for your minor children in a loving and attentive manner, rather than as the subject of a cold impersonal court bureaucracy.

When executing a financial Power of Attorney, you will want to discuss the implementation of a Health Care Directive and Health Insurance Portability and Accountability Act (HIPAA) Authorization Form with your estate planning attorney. A Health Care Directive will allow you to select an agent to make health care decisions for you, in the event that you are unable to do so for yourself, and to state your wishes for the types of life-sustaining or invasive medical treatments that you do and do not want administered. A HIPAA Authorization Form will allow the individuals you select to have access to your medical records and authorize doctors to release information to them about your current medical status.

FINANCIALLY PROVIDING FOR YOUR CHILDREN

If you are like many Americans and do not currently own sufficient assets to secure your minor children's financial future, you may want to purchase, at the very least, a term life insurance policy. For as little as a few hundred dollars a year, you can gain several-hundred-thousand dollars in coverage. It is wishful thinking and risky to assume that whomever you name as a guardian will be willing and able to financially provide for your children. Taking out an insurance policy is truly one of the easiest and most beneficial things you can do to protect them.

However, selection of life insurance beneficiaries is an often-misunderstood process with potentially devastating consequences. Unfortunately, directly naming minor children as the beneficiaries will seldom achieve your estate planning goals and creates unnecessary delay and expense in providing for your children. A better option is naming a trust as beneficiary of the policy and providing terms to a Successor Trustee for management of the children's inheritance. Consult with an estate planning attorney to determine the best way to ensure your life insurance proceeds are used for the benefit of your children, while maximizing asset protection and minimizing taxation.

ESTATE TAX PLANNING

When you pass away, all assets you own, including your home, vehicles, life insurance policies, retirement plans, and even personal belongings are considered part of your estate. When you total the full value of those assets, it may be quite easy to exceed the federal estate tax threshold. With a proper estate plan in place, various tax planning strategies can be employed to reduce or even eliminate, in some circumstances, the need to pay federal and state estate taxes.

PLANNING OPTION #1 - PLANNING WITH A WILL

A will is oftentimes one of the most basic and widely used estate planning tools. Simply put, a will is a legal document that describes how you want your assets distributed at your death. It also names the guardians of your children.

A will only goes into effect at your death. Upon your passing, an executor, whom you name in your will, oversees the distribution of your estate to any heirs named, however, the actual distribution of your assets is controlled by the probate court. Additionally, a will also does not provide you with lifetime planning, an increasingly important consideration now that Americans are living longer. Of course, passing away with a will expressing your wishes is much better than dying with no plan at all.

A Contingent Trust for Your Child's Benefit

An estate planning strategy popular among parents who choose to plan with a will is the setup of a contingent trust for a child's benefit. In the case of the parents' death, the will initiates the formation of a trust to hold your child's inheritance and functions in the same way as a Living Trust, with the ability to hold assets for distribution when your child comes of age or reaches milestones which you stipulate. The assets are managed by a trustee that you appoint. This type of will-based plan is called a Testamentary Trust.

The main drawback to this type of planning is that assets must still go through probate prior to being transferred to the trust. However, a Testamentary Trust is still far superior to a Simple Will and avoids any problems that may result from outright distribution of assets to children, which may be supervised by the court, as a result of using only a Simple Will.

PLANNING OPTION #2 - REVOCABLE LIVING TRUST

Why It Is Often the Best Choice

One of the most comprehensive and well-designed estate plans is the Revocable Living Trust. A Living Trust is set up in such a way that the trust owns the assets to be left to the heirs, thereby avoiding probate. In most cases, the parents name themselves as the trustees and someone else

(a family member, friend, guardian, banker, or investment expert) is named as the Successor Trustee. Upon the death of the trustee or co-trustees, the Successor Trustee becomes responsible for the management of the trust assets. Like the executor of a will, he or she is required to manage and distribute the estate strictly according to the terms of the trust.

With a Living Trust, or a Testamentary Trust under a will, you can choose to delay the distribution of the inheritance to your heirs until they reach certain milestones, earmark it for college tuition, or reward hard work and career achievements. A Living Trust may also be drafted to protect your assets from your heir's creditors and future ex-spouses, and any financially inexperienced or irresponsible decisions.

In the case of very young children, regular disbursements from the trust can be arranged to cover expenses such as medical costs, maintenance, or travel. A Living Trust ensures that your children will be provided for until adulthood and beyond.

Provisions for keeping assets in trust, such as the examples above, can also be included in a will, directing the creation of a Testamentary Trust after death.

AVOIDING PROBATE

Because the Living Trust technically owns the assets, they are not considered part of the probate estate, and therefore, are not subject to the probate process. Instead, the trustee oversees the distribution of the property according to the specific terms of the trust. This arrangement yields several important benefits.

Avoiding probate means not only avoiding the hassle and expense, but also saving time. When young children are depending on an inheritance, the last thing they need is to have their livelihood tied up in the court system. Even though your children may get a small allowance while your estate is in probate, the time delays of the court process can extend the amount of time before your heirs receive their full inheritance significantly—by months or even years—especially if the will is contested. A trust is a better way to give your family faster, unfettered access to the funds they need.

Your privacy is also maintained through a Living Trust, whereas in the probate system, your personal matters could be broadcasted to the masses. The average Joe off the street has no business knowing the names of your children, who has custody of them, and how much inheritance they are to receive.

MAINTAINING CONTROL

Living Trusts may be harder to contest than wills. Part of the reason is that trusts usually involve ongoing contacts with bank officials, trustees, and others who can later provide solid evidence of the owner's intentions and mental state. A Living Trust that has been in place for a long period of time is less likely to be challenged as having been the product of undue influence or fraud.

POUR-OVER WILL

Every Living Trust has what is called a “Pour-Over Will” as part of the complete estate plan. It has two functions within the plan. First, this is where you will nominate a guardian for your underage children. Secondly, it functions as a safety net for any assets not transferred into your trust, stating that any such assets should be transferred and owned by the trust.

SPECIAL NEEDS CIRCUMSTANCES

A trust can be especially appropriate in the case of heirs with special needs. A Special Needs Trust can be set up to financially provide for your special needs child without jeopardizing their government benefits. Additionally, if your child will be unable to make financial decisions for him or herself even as an adult, then a trustee can be an indispensable aid in making sure he or she will be well taken care of.

THE ROAD AHEAD

One thing should be clear by now; we do our families a great disservice when we fail to plan for every contingency. That’s why a critical first step in your planning process should be a consultation with an attorney who focuses their practice in estate planning. Taking the time to form a thoughtful, detailed, and durable estate plan will ensure that you, your spouse and your children are provided for in the event of a tragedy.

Considering our own mortality may seem like a frightening obligation, especially for parents of younger children, however, undertaking this emotional challenge now will pay off exponentially in peace of mind in the future. Ideally, you will always be around to provide for your family and witness those wonderful milestones in your children’s lives. But at the same time, you will take comfort in knowing that your loved ones will be provided for, no matter what lies ahead.

ABOUT THE ACADEMY

This report reflects the opinion of the American Academy of Estate Planning Attorneys. It is based on our understanding of national trends and procedures, and is intended only as a simple overview of the basic estate planning issues. We recommend you do not base your own estate planning on the contents of this Academy Report alone. Review your estate planning goals with a qualified estate planning attorney.

The Academy is a national organization dedicated to promoting excellence in estate planning by providing its exclusive Membership of attorneys with up-to-date research on estate and tax planning, educational materials, and other important resources to empower them to provide superior estate planning services.

The Academy expects Members to have at least 36 hours of legal education each year specifically in estate, tax, probate and/or elder law subjects. To ensure this goal is met, the Academy provides over 40 hours of continuing legal education each year. The Academy has also been recognized as a consumer legal source by *Money Magazine, Consumer Reports Money Adviser* and Suze Orman in her book, *9 Steps to Financial Freedom*.

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