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Wills, Trusts, Probate
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Updating Beneficiary Designations is Quick, Simple and Inexpensive—and Can Save Money and Heartache Later

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The Dangers of Naming Minors as Beneficiaries of Life Insurance and Retirement Accounts

Avoid Costly Problems and Nightmare Consequences

Sometimes, a seemingly simple act can have unwanted, enormous life consequences. A case in point is designating beneficiaries of life insurance policies and retirement accounts. Beneficiaries are sometimes designated as an “incidental” matter, i.e., when a life policy is purchased or retirement account opened. At the time we name beneficiaries, our primary concern may not be ensuring that our beneficiary designations are coordinated with

counts are paid to their two children. If the children are minors (i.e., under age 18 years), the financial company will not pay out the proceeds to the minor children because they do not have legal capacity to accept the money. The company is required to pay the funds only to the “guardian of the estate” for the minor children. A guardian of the estate is available only via opening a court proceeding called a “guardianship”.

A guardianship is a public, costly and time-consuming court process that severely constricts the use, distribution and investment of funds until the child reaches age 18. All guardianships are conducted through the public court system. If parents have not nominated a guardian themselves, a judge will decide who manages their children’s funds. If many relatives come forth to be guardian, those relatives may fight for appointment and family discord could result. Unfortunately, the children’s funds may be used to fight the battle for guardianship. The children’s best interests may get lost in the court fight.

To make matters worse, when a child turns 18, the law considers the child a responsible adult with privileges of adulthood. Therefore, at age 18, the child is distributed all guardianship funds *outright*. In Example 1, if parents owned a \$2,000,000 life insurance policy on their lives, each child could receive \$1,000,000 or more outright upon reaching age 18. **Can you imagine what an 18 year old will do with \$1,000,000?** By using a trust, the parents could have safeguarded these funds until the

our estate plan and our goals for children. Unfortunately, after the policy or account is in place, most of us tend never to go back and review our beneficiary designations. Changing a beneficiary designation is a very simple, easy and cheap form of estate planning. Nevertheless, beneficiary designation errors are fairly common, with sometimes devastating results.

Common Nightmare Scenario One. Typically, a married couple will name beneficiaries as follows (Example 1):

Primary: Spouse.
Secondary: Two Children Equally.

Although these designations may seem logical, they can create complicated situations in the future.

In Example 1, if both parents pass away in a car accident, the parents’ life insurance and/or retirement ac-

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Dangers of Naming Minor Children as Beneficiaries (continued)

child reaches a more mature age, say 25 or 30, and avoided court.

Common Nightmare Scenario Two. Sometimes, one parent will own a policy on his/her life and name beneficiaries as follows (Example 2):

Primary : Spouse and Child Equally

Again, these beneficiaries make sense to the parent since the goal is for the family to benefit from the policy. However, if the child is a minor, when parent dies in Example 2, the surviving spouse

life insurance and retirement accounts. The parent then informally instructs the family member to use the proceeds for their children's benefit. I call this method "moral obligation". There are many problems with this scenario. First, we do not know that the parent will pass away before the family member named as beneficiary. Second, the family member may have the best intentions, but may become incapacitated or pass away shortly after inheriting the funds. Thereafter, the funds are passed to the family member's spouse or children who may not share the same goal. Third, the family member may incur debts or go through a bankruptcy which will

A Trust Can Be Used To Eliminate Court Costs, Publicity and Intervention



(SS) must petition the court to serve as guardian over the child's one-half share of the policy proceeds. So if the policy is worth \$1,000,000, the SS receives \$500,000 outright and the child's guardianship estate contains \$500,000. In the guardianship proceeding, the court explains to the surviving spouse (SS) that the child's funds cannot be used for the child's support expenses, since SS is under a legal obligation of support for the child and cannot discharge this obligation via use of the child's own money. Thus, the child's \$500,000 is virtually untouchable. The SS must scrimp and struggle to work and pay living and child care expenses on his or her own. Meanwhile, when the child turns age 18, the child will receive \$500,000 outright.

Common Nightmare Scenario Three. To avoid a guardianship, some parents name a sibling or parent, instead of their minor children, as beneficiary of their

deplete the funds earmarked for the child. Even if dollars are used for the minor child's benefit as intended, the transfer of funds is considered a legal gift. If more than the annual gift tax exclusion (\$13,000 for 2009) is transferred, then the law requires the filing of a gift tax return and the family member may irreversibly damage his/her gift and/or estate tax situation.

Trusts as a Solution. Where minor children are involved, a trust can be set up to receive the life insurance proceeds or retirement account funds. The parent establishes the trust, selects the trustee and sets the terms under which assets can be used and distributed from the trust (i.e., funds distributed outright at age 25 or 30). In this way, the courts are kept out of the process, costs are reduced, plan predictability is added, and a legal structure still exists to monitor the trustee and enforce the parent's wishes. Trusts can also provide asset protection for your heirs from their own rightful creditors. ☺

About Me & My Practice. I graduated cum laude from the University of the Pacific in Stockton, CA. I received my law degree from UC Davis and graduated from Golden Gate School of Law with a Masters in Taxation. For the last 10 years, I have practiced exclusively in the area of estate planning, probate and trust administration. In my off hours, I support Pacific and Cal athletics, the SF Giants, the Sacramento Kings, and play (and watch) tennis! ☺