

By Margot Gordon

## Estate Planning

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# Minimizing Taxes

in Illinois Minor Guardianship Estates

**WHAT ARE A GUARDIAN'S OBLIGATIONS TO ENGAGE** in estate planning for a minor's estate? These obligations were changed by the amendments to the Probate Act in 2000 that permit a minor's estate guardian to create a will or revocable or irrevocable trust on the minor's behalf. Since this legislation's enactment, there has been only limited activity in Illinois and, until recently, Cook County courts refused to authorize estate plans for minors. Recently, however, the Cook County Probate Court authorized execution of a revocable trust on a minor's behalf, which, upon the minor's death, would create generation-skipping tax exempt trusts for the minor's heirs.

### **Guardian's Obligation to Estate Plan for A Minor**

A guardian's limited ability to estate plan is set out in Section 11-13(b) of the Probate Act:

(b) . . . The Court, upon petition of a guardian of the estate of a minor, *may* permit the guardian to make a will or create a revocable or irrevocable trust for the minor that the court considers appropriate *in light of changes in applicable tax laws that allow for minimization of State or federal income, estate or inheritance taxes*; however, the will or trust must make distributions only to the persons who would be entitled to distributions if the minor were to die intestate and the will or trust must make distributions to those persons in the same amounts to which they would be entitled if the minor were to die intestate. (Emphasis added) 755 ILCS 5/11-13(b)

Unlike planning for adult disabled persons under Section 11a-18(a-5) of the Probate Act, this statutory language is very limited and authorizes the creation of wills or trusts for the *sole* purpose of minimizing taxes. In contrast, the statute for disabled adults provides a laundry list of estate planning actions that a guardian may take on the ward's behalf. The silence in the minor's statute is important because, under common law, minors have no independent ability to engage in estate planning and lack testamentary capacity.

The minor's statutory language is not directive -- it does not state that a guardian must engage in estate planning. Rather the court *may* authorize planning on a guardian's petition. It does not follow, however, that a guardian never has a fiduciary duty to engage in estate planning. A fiduciary's safest course of conduct is to assume that estate planning, like any other aspect of a minor's financial affairs, should be considered by the estate guardian. Specifically, a guardian should determine whether estate planning for the minor is needed to avoid potential estate tax or generation-skipping transfer taxes either in the estates of the minor or minor's heirs. The guardian then should pursue appropriate estate planning. While Section 11-13(b) also provides for income tax planning on the minor's behalf, the author is unaware of any requests or significant opportunities to reduce a minor's income tax exposure.

In the only substantive comment on the scope of this legislation, Senator Berman stated the statute's purpose was to provide the guardian of the minor "the authority to do tax planning and estate planning for the minor's estate in order to save and reduce the tax exposure of that minor's estate." 91<sup>st</sup> General Assembly,

Senate transcript March 24, 1999. This suggests that the legislature intended to authorize a guardian to take measures to reduce a minor's potential estate taxes. The only real way, however, to decrease a minor's estate taxes would be to transfer some of the minor's estate during the minor's lifetime. After reviewing the legislative history and the statutory language, it is this author's opinion that the statute must mean that a minor's estate guardian may, with a court's permission, create and fund irrevocable gift trusts from a minor's estate. The author does not believe that any Illinois court has yet authorized lifetime transfers for tax planning purposes from a minor's estate. Of course, no guardian would want to request asset transfers from a minor's estate unless the guardian was convinced the minor's estate was large enough that such transfer would never diminish the minor's lifetime care.

### **When Estate Planning for Minor's Estate is Appropriate**

So, when would a minor's guardian have potential estate or generation-skipping transfer tax concerns? Essentially, any time a minor's estate exceeds the current estate and generation-skipping tax exemption, an investigation is warranted. Under current federal tax laws, each person may transfer up to \$2,000,000 at death without estate tax liability. The exemption will increase to \$3,500,000 on January 1, 2009, disappear altogether in 2010 and decrease to \$1,000,000 in 2011. Any amount in excess of the exemption is subject to estate tax. In addition to the estate tax exemption, each person also has a \$2,000,000 generation-skipping transfer tax (GST) exemption. Under current law, the GST exemption is scheduled to increase and decrease at the same rate as the estate tax exemption. The GST exemption does not reduce estate taxes, which might be imposed upon a person's estate at his or her death, but it can benefit future generations with proper planning.

By way of illustration, assume an estate of \$9 million for a disabled minor, Child, whose current potential heirs are his parents and sibling, Brother. If Child were to die in 2006 he would owe estate tax of \$3,404,000, leaving approximately \$2,000,000 for each family member. If one of Child's family members died with the money received from Child's estate in his name without GST planning, that family member might also owe estate tax on his subsequent death. For example, if Brother died in 2050 after having received Child's inheritance (and Brother's funds grew 3% annually), then Brother's estate (based on Child's funds alone) would have grown to \$7,342,905. At Brother's death, he would owe \$3,333,598 in estate tax. In contrast, if Brother's estate grew 5%, his estate would be worth \$17,114,301 and his tax liability would be \$9,063,581. For this example, we assumed the exemption per person is \$1,000,000, as will occur in 2011, and that Brother had no other assets. Clearly, Brother's estate tax liability resulting from the funds he received from Child could be significant.

If, however, Child's GST exemption were used by segregating this exemption amount into separate trusts for his heirs' benefit, then his GST exemption would not be lost after his death. Instead, Child's GST exempt assets, including all subsequent appreciation in those assets' value, would be held in trust for his family's benefit without being included in their estates at their deaths. These trusts are called "GST Exempt Trusts" and are created to separate

a person's GST exemption to benefit his family for their lifetime. Assuming any portion of a GST Exempt Trust remains at a beneficiary's death, that portion will pass to the remainder beneficiaries without imposition of estate tax. Thus, in our example, *all of Brother's assets could pass estate tax free to his descendants.*

GST Exempt Trusts could be created through Child's Revocable Trust for his heirs after Child's death. The GST Exempt Trusts would not be subject to estate tax at the death of Child's heir and could ensure that Child's funds benefit his family's future generations. Also, by funding Child's Revocable Trust during lifetime, it would eliminate the delays and administrative costs of probate. Child's Revocable Trust could also be changed at any time during Child's lifetime, either by a court hearing Child's guardianship matter or by Child, if he were a competent adult, as his trust would be revocable throughout his lifetime.

In addition to generation-skipping tax planning, guardians may want to request a lifetime transfer of a minor's estate assets to a trust to save estate taxes at the minor's death, in some cases. Under current federal law, each person may make lifetime gifts of up to \$1,000,000 without being subject to gift tax. In addition, each person may make tax-free gifts of up to \$12,000 per person each calendar year that are not applied against the donor's \$1,000,000 lifetime

exemption. While making gifts to a trust appears to be authorized under the statute, it has not yet been done in Illinois. In the appropriate case, however, it could result in dramatic estate tax savings for the minor's family.

For example, assume the facts as before except Child's estate is worth \$19 million. If Child were to die in 2021 he would owe estate tax of approximately \$10,104,200, leaving \$8,895,800 for family members. Instead, if during Child's lifetime in 2006, Child's guardian had obtained court authority to create and fund an irrevocable trust to benefit Child's heirs with Child's lifetime exemption amount of \$1,000,000, then that money could grow estate tax free. If the trust grew 5% annually, Child's heirs would receive another \$1,078,938 due to the growth in the trust during Child's lifetime. In addition, if the guardian obtained authority to make \$12,000 annual exclusion gifts to the trust each year for each of Child's family members, the family would receive an additional \$540,000 (even without any growth in the gifts) from Child's estate.

So, when would tax planning for a minor guardianship *not* be advised? It does not make sense for smaller minor estates not potentially subject to estate tax when the minor dies. In addition, requesting lifetime transfers from a minor's estate would only be appropriate in much larger estates. Finally, it might not make sense where one parent has

neglected or failed to provide support to the minor because, under intestacy, that parent's share could be reduced or eliminated under Section 2-6.5 of the Probate Act. Of course, it may be possible to draft the minor's plan to account for what would amount to the elimination of an heir's right to inherit.

### Estate Plan Process and Documents

To initiate tax planning, the guardian must determine the value of the minor's estate and the potential estate and generation-skipping tax liability. Next, the guardian must draft estate plan documents and prepare and present a petition with proper notice to all of the minor's potential adult heirs to the court for approval. (For more discussion, see Gordon, Margot and Carey, James R., *Estate Planning in Disabled Adult Guardianships*, IICLE, 2006.) Of course, the guardian's legal counsel should do all of these steps. To the extent that the guardian's counsel does not have estate planning experience, the guardian should seek authority to hire counsel for that purpose.

In most ways the estate plan documents for a minor's estate are like any other estate planning documents. One major difference, however, is who signs the documents and how that person is referenced. For a revocable or irrevocable trust, the guardian should sign the trust document as the Grantor. In most cases, the guardian also will be named to act as trustee of the trust. If so, the guardian also will sign as trustee. Unlike wills, Illinois trusts have no special execution requirements. In contrast, a will must be signed by the testator or at his direction by a person in the testator's presence and attested in the testator's presence by two or more credible witnesses. 755 ILCS 5/4-3. The Probate Act does not specify who should sign wills or codicils executed under Section 11-13(b) and Section 4-3 does not address execution of estate plan documents by guardians. In this author's experience, the will should specify that it is the minor's will, but that the guardian is creating the will with the court's authority and signing, as testator in the presence of the witnesses. Because the guardian is the testator, it will be important to define the minor separately throughout the document.

There also are trust provisions unique to guardianships. For example, Illinois guard-



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ianship courts generally do not authorize creation of a revocable trust without retaining jurisdiction over trust assets. *In re Estate of Ahmed*, 322 Ill.App.3d 741, 750 N.E.2d 278, 255 Ill. Dec. 697 (1st Dist. 2001), (affirmed trial court's refusal to authorize a trust not subject to court's jurisdiction). In Cook County guardianships, the courts require a trust provision that specifically makes such a jurisdictional statement. In addition, those courts also require language that the trustee obtain court authority to amend or revoke the trust, release any rights of the Minor or Grantor, change trustees, or compensate a trustee during any time the court retains jurisdiction over the trust. Finally, those courts also require trustees to invest trust assets under the Probate Act's investment standards. In practice, these special trust provisions mean that the courts treat these trusts just like traditional guardianships, with all trust distributions subject to court authority and the required filing of annual accountings.

Any trust should address what happens after the minor reaches majority. For a

revocable trust, there should be language to allow the minor to act as Grantor if the minor becomes a competent adult or, if not, to allow the new adult disabled guardian to act as Grantor. For an irrevocable trust, the drafter should consider whether to provide the minor a broad limited power of appointment to allow him to direct the disposition of trust assets either during life after reaching majority or through a will.

### Watch Degree of Court Control

An important issue to consider for irrevocable trusts is that the degree of control that a donor retains over a trust may cause the trust to be included inadvertently in the donor's taxable estate at death. This is especially important to consider when the court desires to retain jurisdiction over a trust. Depending on the extent to which the court controls the trust, the court could be viewed by the IRS as an extension of the minor and could cause the trust to be included in the minor's taxable estate. The author is not aware of any reported IRS rulings on this particular issue.

Estate planning for minors' estates present the guardian and guardianship practitioner with many challenges. However, in appropriate cases, this planning can be highly beneficial. Given the court's willingness to address planning, guardians of larger minors' estates should include estate planning on their fiduciary checklist. ■

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