



~ Trust Chat ~  
**Testamentary Trusts**  
**July 28, 2009**



302 3<sup>rd</sup> Avenue SE  
Cedar Rapids, IA 52406  
319-286-6200  
[www.guaranty-bank.com](http://www.guaranty-bank.com)

***In Conjunction with***

**Maureen Kenney, [mkenney@bradleyriley.com](mailto:mkenney@bradleyriley.com)**  
**Jessica Doro, [jdoro@bradleyriley.com](mailto:jdoro@bradleyriley.com)**

**Bradley & Riley PC**  
**2007 First Avenue SE**  
**PO Box 2804**  
**Cedar Rapids, Iowa 52406-2804**  
**319.363.0101**

## **TESTAMENTARY TRUSTS**

- Overview
  - Trust that comes into effect upon an individual's death through his or her testamentary document (i.e. Will).
  - The trust provisions are contained within the individual's Will, not in a separate trust document.
- Not to be confused with revocable or living trust (which are separate documents).
- A testamentary trust remains dormant until an individual's death.
- When individual passes away, then the trust is funded according to the directions contained in the individual's Will.
- Assets used to fund the testamentary trusts are assets held in the individual's name that form his or her probate estate.
- Additionally, assets that are not part of the individual's probate estate, but pass pursuant to a beneficiary designation can also fund the testamentary trust.
- For non-probate assets which pass pursuant to a beneficiary designation to fund a testamentary trust, the beneficiary designation must specifically reference the trust.
- The Trustee (named in the Will) has the ongoing duty of administering the trust according to its terms.
- The Trustee's duties include:
  - Making distributions from the trust according to its provisions;
  - Managing the trust's assets and investing the assets for the benefit of the trust's beneficiary or beneficiaries.

## **USES OF TESTAMENTARY TRUSTS**

- Testamentary trusts are most commonly used to hold property for the benefit of minor beneficiaries.
- What are the advantages of using a testamentary trust?
  - Control over types of distributions to beneficiaries;
  - Control over timing of distribution to beneficiaries (staggered distributions);
  - Control over who manages and invests the trust's funds.

## **COMMON MISTAKES IN LEAVING PROPERTY TO MINORS**

- Naming a minor to receive property outright or naming a minor as the beneficiary of life insurance proceeds, 401(k) assets, or IRA assets
  - The problem is that if the amount left to the minor exceeds \$25,000, then a conservatorship must be opened and a conservator named to manage funds for the minor (Iowa Code 633.108).

## **EXAMPLE**

- H and W have two minor children, ages 5 and 7.
- H and W have a residence, bank accounts, life insurance policies, and retirement assets (401(k) and IRAs) with a total value after debts of \$400,000.
- H and W pass away in a car accident and do not have Wills or have Wills that merely leave everything outright to their children.
- Accordingly \$200,000 will be distributed to each child.
- The amount for each child exceeds \$25,000, so it cannot be distributed directly to the child or to a UTMA account.
- A conservator will need to be appointed for each child to manage the funds on behalf of such child.

## **DISADVANTAGES TO CONSERVATORSHIP**

- Court proceeding
  - Expensive;
  - Time consuming;
  - Continuing reporting requirements to the court show all income received and all expenses paid in given time period.
- Powers
  - Conservators are limited in the ways they can invest funds for the benefit of the minor;
  - Handcuffed in many ways in ability to act without court approval or involvement.
- Age of distribution
  - Entire amount of remaining funds distributed to each child when that child turns 18 (inconsistent with most individual's wishes);
  - Envision situation where 18 year old receiving lump sum distribution.
- Identity of Conservator
  - Court makes the ultimate determination of identity of conservator;
  - Preference is governed by Iowa Code Section 633.571;
    - Parents or parent of minor are preferred over all others, if parents or parent are qualified and suitable;
    - If parents are deceased (like in our example) or not qualified and suitable, then the person nominated as conservator in child's custodial parent's Will;
    - If child is 14 years or older, than child's request for conservator is honored provided the requested individual is qualified and suitable;
    - Preference is then given to a petition executed by a person having physical and legal custody of a minor.
  - The default preference rules under Iowa law can prove especially problematic in second marriage situations or in situations where person receiving custody of minors lacks the ability to successfully manage funds.

## SAME EXAMPLE WITH TESTAMENTARY TRUST

- H and W have two minor children, ages 5 and 7.
- H and W have a residence, a bank account, life insurance policies, and retirement assets (401(k) and IRAs).
- H and W pass away in a car accident and do have Wills that create a testamentary trust (or testamentary trusts) for the benefit of their children.
- Their Wills also name a trusted individual or bank as Trustee of the trust or trusts.
- H and W also have completed their beneficiary designations for life insurance and retirement assets to name the Trustee of the trusts as the beneficiary.
- Upon H's and W's death, the Executor of their estates will administer their estates and distribute the remaining assets to the Trustee of the trust or trusts.
- Their Wills specify the uses for the funds in the trust or trusts.
  - Health, education (including college) and support of each beneficiary;
  - Will specifies the ages at which funds can be distributed to a minor child
    - ½ at age 25 and the remainder at age 30.

## RESULT WITH TESTAMENTARY TRUST

- No need for conservatorship to be established.
- Assets are distributed according to parents' preferences.
- Trusted individual or bank is managing the assets and has greater flexibility in such management.
- 18 year old is not receiving lump sum distribution on 18<sup>th</sup> birthday.
- It is important to note that the example worked because of coordination between probate and non-probate assets.
- If H and W had created the trusts under their Wills, but designated their children directly as the beneficiaries of life insurance policy proceeds or retirement asset proceeds, then those assets would not be distributed to the trust.

## ADDITIONAL BENEFITS OF TESTAMENTARY TRUSTS

- Can be used to provide creditor protection for beneficiaries who are not minors, but have difficulty managing funds
- Essential for minors/beneficiaries with special needs to ensure continued eligibility for governmental assistance
- Can designate child/beneficiary as Co-Trustee of the trust upon reaching specified age to assist child/beneficiary with learning financial managements skills

**These materials are made available for informational purposes only and should not be construed as legal advice. You should contact your attorney to obtain advice with respect to any particular issue or problem.**