Estate Planning Fast Faxts

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Estate, Tax and Family Wealth Preservation Planning For Advisors

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Gifts to Minors: Those Pesky UTMA Accounts

Parents who use custodial accounts to save for their children usually suffer from the Porsche syndrome. Even if little Joey is enraptured with geometry today, you can't help but wonder whether he'll blow his college fund on an overpriced sports car the minute he turns 21 (or 18 in some states) and gains control of the money himself.

When the magic time comes, there's not much you can do to steer the cash towards its intended destination. Money mom and dad stashed in the account was an irrevocable gift — they can't just take it away. Joey could sue them to get it back or the IRS could come after them for paying childlike taxes on money they wind up using themselves.

What's UTMA, Doc? For tax and other reasons, parents or grandparents sometimes want to transfer ownership of cash and other financial assets to children who are too young to handle them. One way to do this is to establish a trust. The Uniform Transfers to Minors Act (UTMA) provides an alternative that is usually simpler, faster and cheaper than a trust.

Custodial Accounts 101: UGMA ("G" for gift) was developed in 1956, providing a convenient way to make gifts of money and securities to minors. In 1986 UTMA was developed, expanding the types of property you can transfer to a minor.

UTMA's vs. Trusts: Custodial accounts are similar in some ways to trusts. Both place property under the control of a person who isn't the *beneficial owner*-that is, the person who has the ultimate right to enjoy the fruits of the property.

Instead of a *trustee* managing assets for the *beneficiary*, the *custodian* manages the property for the benefit of the minor. The whole point of UTMA is to permit transfers to a minor without the usual complexities of a formal guardianship or establishing a trust, which is generally more expensive, time-consuming and complicated than a custodial account. Trusts definitely provide more protections and flexibility. While you should think of using a trust for transfers totaling tens of thousands of dollars, UTMA's are more suitable for smaller transfers.

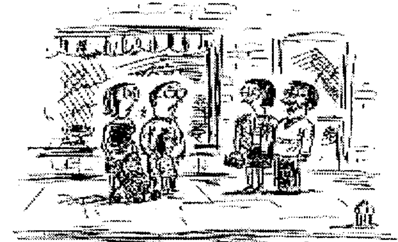
Ownership: Property held in a custodial account is *owned by the child* even though the child won't have control of the property until later. A gift is legally complete when it is made; you're not allowed to change your mind and take the property back. And in Washington the account terminates when the child turns 21.

Advantages: For relatively modest gifts an UTMA account may be the best vehicle. They are quick, cheap and simple to open up at a bank or brokerage house. Gifts to UTMA accounts are eligible for the $10,000 annual exclusion even though they are not of a "present interest". Income generated in the account is taxed to the child, who may be in a lower marginal tax bracket than the parent. The so-called kiddie tax, however, eliminates most of the benefit from shifting income to children under age 14, and the income tax benefit for relatively small accounts is likely to be negligible.

Problems With Custodial Accounts:

- ☞ Once you've transferred assets in, you can't take them back; they belong to the child.
- ☞ The custodian must turn the assets over to the child at age 21. How will you feel if she uses it to buy equipment for her boyfriend's rock band?
- ☞ The account causes a reduction in financial aid. Under current law, assets owned by a child (including assets in an UTMA account for the benefit of that child) count much more heavily than parental assets in determining how much college aid the child qualifies for.
- ☞ If you're concerned about estate taxes, avoid naming yourself as custodian. The reason is that if you die before the account terminates, it will be included in your estate. As the donor (grandparent, parent etc.) you are considered the owner of the account by the IRS for estate tax purposes if you are also the custodian. Even though the transfers are completed gifts, you retained the power to determine how your gift will be applied for the benefit of your child. You can avoid the problem by naming as custodian someone who will not make any gifts to the account. For example, a grandparent might name the parent as custodian.
- ☞ If you use income of the UTMA account to satisfy your legal obligation to support your child, the benefit of that income goes to you, not to your child. The IRS will tax the income to *you*. To avoid the problem, use the account only for items that supplement your legal support obligation. Exactly where to draw the line is a subject of much debate.
- ☞ If your child dies before receiving the account, the assets will pass according to state law. Often the result is not what you would have wished. UTMA doesn't provide the flexibility of trusts in this regard.

Alternatives: Before establishing a custodial account, carefully consider your objectives and other ways you may be better off achieving them: an education IRA; a Roth IRA; a Section 529 college savings plan; a 2503(b) or 2503(c) trust; or a Crummey trust. There's cost in setting up a trust, but often it is less than you expect and the advantages and flexibility may be far greater than the cost. ***Call us and we will be happy to discuss effective gifting and planning options for children.***



"We found we really missed going to the theatre and eating in nice restaurants, so we gave our kids away."

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