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Making Gifts to Minors Under UGMA and UTMA

There are numerous considerations when contemplating making gifts to minor children. Outright gifts are frowned upon because, under the eyes of the law, children are under a legal disability, which means that they do not have the legal capacity to administer property. That means that a guardian is necessary to hold or manage property for a minor child. Without some planning, it may be necessary for a court to appoint that guardian- a process that may outweigh any benefits of making the gift to a minor child in the first place.

One option that parents, grandparents and other loved ones who wish to make gifts to minor children, yet avoid the above scenario, have, is to make transfers under the Uniform Gifts to Minors Act (UGMA) or its successor, the Uniform Transfers to Minors Act (UTMA). Adopted as statutes in some form in every state, UGMA and UTMA provide methods for which to make transfers to minor children without some of the legal consequences of simply making outright gifts. They do so by replacing the requirement of a legal guardian with a custodian and allow for discretionary management of the property under the custodianship.

SO HOW DOES ONE QUALIFY A GIFT FOR UGMA AND UTMA?

Any adult (over 18 years of age) may make a gift to a minor under both Acts by transferring property to himself or herself as a custodian of the gift for that child. The specific manner depends on state statute, but the requirements are typically the same. The custodian then has the power to manage and disburse the gifted property for the minor's benefit.

WHAT POWERS DOES THE CUSTODIAN HAVE?

A fair amount, actually. The custodian receives the property on behalf of the minor child and then has the discretion to pay any amount for the "support, maintenance, general use, and benefit of the minor." Perhaps most beneficially, the custodian can act without court supervision or oversight and has very few accounting requirements.

WHO CAN SERVE AS CUSTODIAN?

Eligibility varies by state. But, generally speaking, the custodian must be an adult, even the donor himself, or a trust company.

WHAT ABOUT TAXES?

Income on gifts under UGMA and UTMA are taxed to the minor recipient. That means that an individual return may need to be filed, but the administrative work involved in the filing is much less headache than potentially dealing with court supervision of a guardianship had funds not been transferred to the minor under UGMA or UTMA. Additionally, with the income shifted from the adult donor to the child,

with his or her own personal exemption and lower tax bracket, tax rates on the property can be much lower than if the property simply sat in the hands of the donor. What about estate taxes? Well, typically, the assets transferred under UTMA are removed from the donor's estate for estate tax purposes, with one substantial caveat. If the donor appoints himself or herself custodian of the account and dies while serving as custodian (i.e. prior to the minor child reaching the age of 21 and the funds being distributed outright), then the assets will be included in the donor's gross estate for estate tax purposes.

WHAT ARE THE NON-TAX ADVANTAGES?

The main non-tax advantage of a UTMA account is simplicity. They are relatively easy to set up compared to another form of vehicle to transfer funds to a minor while retaining some form of control over their disbursement, such as a Crummey Trust. There are also much simpler and less administratively complex than a guardianship.

ARE THERE ANY DISADVANTAGES TO UGMA AND UTMA GIFTS?

As with any estate planning mechanism, UTMA gifts are not without disadvantages. One glaring drawback is the requirement that all funds be distributed outright to the child upon reaching the age of 21. That means that the protections in place throughout childhood to prevent the beneficiary from squandering the gift disappear just as the child is reaching legal drinking age during college. That very obviously may not be the most ideal time for unlimited access. Note, that there may be ways around this, but additional careful advanced planning is necessary to potentially stretch the time period for distribution to a later age.

CONCLUSION

UGMA and UTMA offer methods for making gifts to children with relative ease when considering other potential options. Careful planning is necessary to ensure that tax implications to the donor and custodian are minimized and required distributions match the goals and objectives of the donor as well as the predicted maturity of the beneficiary. When used correctly, they can be effective additions to any estate plan.

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