Legal Brief

Michael P. Thomas

Michael P. Thomas is an associate at the law firm of MacDonald, Illig, Jones & Britton LLP. A graduate of Juniata College and the Dickinson School of Law of the Penn State University, he practices in the areas of estate planning, administration, tax and business law. He is licensed to practice law in Florida and Pennsylvania.

Growing Up: UTMA Accounts Revisited

Transferring funds to a minor under the Uniform Transfer to Minors Act ("UTMA") is a very convenient way for parents and family members to help children develop financial independence. Accounts established under the UTMA are a flexible alternative to Section 2503(c) (Minors') Trusts, Section 529 College Savings Plans, Educational Savings Accounts, and other similar arrangements. Therefore, UTMA accounts continue to exist as one of the more common estate planning tools.

The appeal of an UTMA account rests in its simplicity. UTMA accounts allow a minor to own property without having the court appointment of a guardian or otherwise tying the property up in a trust. Instead, a custodian is appointed for a minor child and the custodian has the responsibility of collecting, holding, investing, and distributing the funds on behalf of the minor. The funds are at all times considered property of the minor, and all of the funds must be distributed outright to the minor when the minor reaches 21 years of age (unless specific exceptions apply that allow the account to continue until the minor attains 25 years of age).

UTMA accounts are very easy to establish, and can likely be set up in a matter of minutes at your bank or brokerage office. Unfortunately, the ease of establishing such accounts also can be a curse. Taking time to consider how to properly structure such accounts may eliminate future surprises and allow the family to avoid unwanted consequences. When setting up an UTMA account, factors to consider include the identity of the donor(s), the relationship between the donor and the child, the financial condition of the family, the age of both the donor and the child, and any other applicable family dynamics.

The following is a brief list of issues to consider, in light of the foregoing factors, prior to establishing an UTMA account:

1. Custodian. The donor typically appoints the custodian at the time the account is established. Generally, the donor should not appoint himself or herself as the custodian of the account because doing so may cause the account to be includable in the donor's federal taxable estate. Nor should the donor appoint either of the parents of the minor on whose behalf the account is established as the custodian, as this may cause the income from the UTMA account to be taxable to the parents and not the child.

2. Successor Custodian. While most state UTMA legislation contains provisions regarding the replacement of the custodian, it is prudent for the donor to name a successor custodian at the time the UTMA account is established. Doing so will assure that the donor approves of the successor custodian and make the transition between custodians go more smoothly.

3. Contributions. Transfers to an UTMA account qualify for the $12,000 annual exclusion from federal gift tax. Married couples may transfer up to $24,000 per year to an UTMA account by electing to split gifts on their U.S. Gift Tax Return (Internal Revenue Service (IRS) Form 709).

4. Income Tax Consequences. Depending on the size of the account, income earned on an UTMA account may be subject to the "kiddie tax." Based on recent legislation, this tax now applies to children under the age of 19 (and up to age 24 in some instances). As a result, the income earned on the UTMA account may be subject to tax at the parents' tax rate.

5. Ownership and Termination. As mentioned above, all funds held in an UTMA account are considered the property of the minor on whose behalf the account is held and must generally be distributed to the minor when he or she turns 21 years old. Therefore, such funds are considered available resources of the minor when determining his or her eligibility for financial aid. Accordingly, custodians should keep this in mind when making distributions from the UTMA account (especially when nearing termination of such an account).

Conclusion

By considering the foregoing issues prior to or at the time an UTMA account is established, donors can better understand and anticipate the benefits of establishing such accounts. Of course, UTMA accounts have certain drawbacks, the biggest of which is the general rule requiring mandatory outright distribution to the minor when he or she turns 21 years old. Nevertheless, a properly structured UTMA account remains one of the most effective and flexible methods for transferring property to lower generations.

In order to ensure compliance with IRS requirements, please be advised that any tax advice contained in this communication was not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties; or (2) promoting, marketing, or recommending to another party any matter discussed herein. Consult your individual tax adviser for advice based on your individual circumstances.

For more information on UTMA accounts or other estate planning matters, contact Mike Thomas at MacDonald, Illig, Jones & Britton LLP at 814/870-7711 or mthomas@mijb.com.

Legal