
The Uses and Abuses of UGMA and UTMA Accounts Established for Minors

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Introduction

- **Today's Agenda:**
 - **Background on gifts to Minors**
 - **Definitions**
 - **Advantages and Disadvantages of giving**
 - **Analysis of vehicles available to plan for minors**
 - **Examples and Case Studies**
 - **Discussion**

Background

- **By law, Minors do not have legal capacity. Minors cannot enter into a contract**
 - **Must be 18 to buy a car, for example**
- **Minors cannot properly own and control property in their own names**
 - **Securities**
 - **Annuities**
 - **Mutual Funds**
 - **Insurance Policies**

Background

- **Parents or third parties cannot simply transfer assets to minor children**
- **Assets must be transferred to a trust or guardian on the child's behalf and for his or her benefit**

Advantages of Giving

- **Advantages to Giving to Minors:**
 - **Provide the Minor with experience in handling money and responsible financial management**
 - **Begin Planning for Change of Control of Family Business**
 - **Provide cushion for support and maintenance obligation in the event of future family adversity**
 - **But Watch: Discharging “support” could carry adverse income or estate tax consequences (accession to wealth and estate inclusion issues)**

Disadvantages

- **Disadvantages of Giving to Minors**
 - **Donor's loss of control over the property upon making the irrevocable gift—clients often do not understand this and think they still control it.**
 - **Cannot get it back if don't like how minor is spending the money or if the donor gets divorced or has a change in financial circumstances and wants to pull it back, he or she cannot**
 - **Loss of income generation for donor and spouse**
 - **Risk you may equip the minor to do more harm to himself/herself than good**

Disadvantages

- **Disadvantages (continued):**
 - **Potential disqualification of Minor for:**
 - **Government benefits for Disability; or**
 - **Tuition assistance**

 - **Loss in Step-Up in Basis: if Donor make inter vivos transfers as opposed to testamentary (usually carry-over basis instead)**

Guardianship

- Parents are **NOT** the de facto natural guardians of the *estate* of their minor children in Pennsylvania and most states, only their *person*
- Parents cannot hold in excess of \$25,000 of children's funds or property
 - The Harley-Davidson and RV problem
 - Obtained via Inheritance or Structured Settlement, for example
- Courts require at least a Co-guardian be appointed for the Minor's "Estate"

Guardianship

- **Disadvantages to Guardianships:**
 - **Court Appointed and Costly**
 - **Must seek court approval for any action taken with respect to the property and must file annual accountings with the Court**
 - **The administrative burden and expense of guardianships make it an unsatisfactory device for gifts to minors in most cases**

Trusts for Minors

- Another method for gifting property to a Minor is in Trust for his or her benefit.
- However, a traditional trust has the disadvantage of requiring an attorney and requires a trust document to be prepared
- The most common trust for a minor is a custodial account, such as an UGMA or UTMA Account...

Custodial Accounts

- Due to the problems associated with outright gifts or guardianship accounts, and the costs associated with a formal trust, many donors and securities dealers wanted a legal device to accommodate the easy transfer of property to minors and developed the “Custodial Account”
- A Custodial Account is essentially a form of trust account. A “Custodian” is named by the Donor to hold the property in trust for the Minor

NCCUSL

- **NCCUSL (National Conference of Commissioners on Uniform State Laws) responded with UGMA – the Uniform Gift to Minors Act – to facilitate gifts to minors in 1956**
- **Applied to gifts of money and securities to minors**
- **UGMA set forth a standard procedure for establishing and maintaining a custodial account and was adopted by all 50 states**
- **Later, NCCUSL developed UTMA – the Uniform Transfers to Minors Act**

UGMA

- A Version of UGMA was adopted in all 50 states and DC, but many have since adopted UTMA
- Advantages of UGMA:
 - Ease of Use: the transfer instrument simply states the property is transferred to the custodian “as custodian for” the minor under the state UGMA
 - Since the statutes provide the custodian with broad powers, a formal trust document is not required
 - Importantly, unlike guardianships, the custodian can act without court approval.
 - Better than a guardianship in ease of use

UGMA

- **Disadvantages of UGMA:**
 - **Most state statutes only allow transfer of securities, money, insurance and annuities**
 - **Real and other personal property is prohibited**
 - **Account automatically terminates when minor turns 21 in most states (some are younger)**
 - **Outright distribution to donee is required; therefore no asset protection**

UTMA

- **NCCUSL significantly revised UGMA and introduced UTMA**
- **In 1992, Pennsylvania adopted UTMA – 20 Pa.C.S. Sections 5301-5321**
- **Advantages:**
 - **Allows the transfer of any type of property to the custodianship– real estate, intangible property, out of state property, etc.**
 - **Considered much more useful and versatile than UGMA accounts**
 - **Terminates when beneficiary reaches the age of 21**
 - **PA permits termination until age 25, but only for transfers by a personal representative of a decedent or a trustee. See 20 Pa.C.S. sections 5305 and 5321**

UTMA

- **Disadvantages:**
 - **Termination when donee is quite young and may lack the responsibility and judgment to effectively manage the money**
 - **No asset protection**

Trusts

- Due to the mandatory payout required by the terms of UGMA/UTMA at age 21, discretionary trusts may be a better vehicle if the donor is concerned about:
 - Asset Protection
 - Divorce Protection
 - Special Needs
 - Spendthrift
 - Growth of Principal over the Long Term
 - Other?

Special Planning Concerns

- **Special considerations come into play as to gift planning concerning:**
 - **minor children with Special Needs, and**
 - **Planning for education expenses for a minor child or grandchild due to:**
 - **(i) financial aid concerns, and**
 - **(ii) tax-favored vehicles available, such as 529 Plans**

Taxation

- Since UGMA/UTMA property is irrevocably vested in the minor, not custodian, the custodianship is ignored for federal income tax purposes
- Income is reported directly by the minor
- Custodianship does not file a return or pay tax
- Kiddie Tax rules will apply and may negate possible income tax savings of shifting income to the minor via use of UTMA accounts (e.g. minor in lower tax bracket)
 - Essentially provides that net unearned income of minor under age 18 is taxed at the parents' marginal rate. Alternatively, parents can report child's unearned income directly on the parents' return.

Example #1

- Parents let 6 year old son go to home of a friend for a birthday party. Their son is bitten in the arm and hand by the family dog, requiring plastic surgery and rehabilitation. The insurance co. wanted a prompt settlement for medical bills, injury, pain and suffering of \$250,000. Structured settlement was proposed to be paid into UTMA account for benefit of minor until age 21. Parents wanted access for college, but also concerned about asset protection and wanted discretionary distributions if possible. Parents preferred to establish a tax advantaged 529 plan as opposed to a standard UTMA account.

Example #1 (Continued)

- **Solution: The court approved the following planning alternative to a Standard UTMA Account:**
 - **Parents set up an irrevocable trust for son as sole beneficiary.**
 - **Parents were NOT trustees, rather the fin. advisor was trustee.**
 - **Trust P&I was available for H,E,M standards for son.**
 - **When son turns 21, he has a demand right for period of 90 days to take out of trust. If not exercised, corpus remains in the discretionary trust for his life for H,E,M. Son has GPOA.**
 - **We specifically defined “education” in the trust to include establishing a 529 plan with the funds for sole benefit of son.**

Example #1 (Continued)

- College is a legitimate education expense at age 18 and funds would be available at that age, not having to wait until 21.
- Parents were pleased to also avoid the beer-drinking account problem at age 21 by preserving the ability of positive influence by themselves and financial advisor to recommend keeping funds in account for life
 - UTMA account would provide no such influence, distribution is mandatory at 21

Example #2

- Grandpa set up a joint account with himself and granddaughter by putting her name on the account. Account was funded with a million dollars. Account has continued to grow.
- Grandpa now has severe dementia and health problems. Granddaughter is now 22 and has shown no responsibility to handle money and has struggled with drugs and alcohol for over 3 years.
- Son is a longstanding client and comes to us worried about father's health, as well as daughter soon having unfettered access to well over a million dollars on her grandfather's death and wants to know what to do.

Example #2 (Continued)

- If granddaughter were to die first, grandpa pays tax to get his money back (incurred gift tax on transfer, now back in estate and owes estate/inheritance taxes)
- Grandpa now cannot do additional planning due to his dementia, such as revocable or irrevocable trust planning
- Granddaughter will not agree to do a self-settled trust or listen to any planning advice

- **Result: The money goes to granddaughter outright. Nothing we can do now.**

Conclusion

- **Recommendation: Let's carefully consider all options available and counsel clients on the problems that can arise when advising them on a gifting strategy, especially strategies involving gifts to minors**

The End.

Thanks for Attending!