STRATEGIC
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PRIVATE TRUST SERVICES

TAKING CARE OF THE KIDS: **MINOR'S TRUSTS**

TRUST CONNECTION CLIENT INSIGHTS

A Monthly Report on
Trust News and Information

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Taking Care of the Kids: Minor's Trusts

One of the greatest feelings for parents or grandparents in life is the ability to share one's wealth with children or grandchildren. It can also be one of the most significant decisions that parents or grandparents face when they gift wealth to minors. Because of the importance, they need to decide whether to title the assets under a state Uniform Transfers to Minors Act (UTMA) or to place them in a trust fund. Both options have advantages and disadvantages. Here is a look at both options.

Uniform Transfers to Minors Act (UTMA)

A Uniform Transfers to Minors Act (UTMA) A UTMA is a special type of ownership arrangement that is an extension of a state's Uniform Gift to Minors Act. First introduced in 1983, a UTMA serves as a way for a minor to receive gifts such as money, real estate and fine art without the aid of a trustee.

Using the UTMA statute, the child is the actual owner of the asset(s) when they are titled. The gift is irrevocable, meaning that it cannot be undone or reversed. The child has no right to access the funds until they reach the age of majority, typically 18 or 21, as specified in the UTMA documents. The property is held in the name of a custodian for the benefit of the child until they reach that majority age. In the event the majority age is silent in the document, the age is determined by the governing state law, which is usually 18 or 21.

UTMAs can be used for nearly any type of asset, including royalties, intellectual property, precious metals and ownership in family limited partnerships. But the more common purpose is to facilitate a minor's ownership of securities and alternative investments.

UTMA custodianship works well for older children or when there is not much property involved because they tend to be cheaper, simpler to create, and easier to convey. Additionally, any income that is held at the close of the tax year by a UTMA is taxed less than income in a trust. However, annual income above $5,000 that is retained at the close of tax year is taxed at a higher rate than in a trust.

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Keep in mind that the UTMA assets belong to the child, not to the custodian. Unlike a college 529 Savings Plan or a bank account with the parent listed as a joint account owner, the assets are not considered part of the estate if the parent or custodian files for bankruptcy.

Using Trusts for a Child's Benefit

A child's trust is one which holds specified property for one child. A separate trust can be set up for each individual child, however, all the property can also be put in the family trust, which provides for more than one child. Both trusts are legal in all states. The trust document lays out the trustee's responsibilities and the beneficiaries' rights. It can be established by either will or living trust.

The trustee pays for the health, education, medical needs, and living expenses of the beneficiaries. An advantage of a family trust is that the trustee can spend differing amounts on each beneficiary, depending on their needs.

The main advantage of a trust compared to the UTMA is that children can be prevented from receiving the trust property until they reach an older age (25, 30, or 40). However, the family trust exists until the youngest child reaches the majority age (18 or 21), depending on state law, in which case, a family trust can be converted into an individual child's trust. A family trust is less desirable when there is a large difference in the ages of the children, since the oldest child must wait a long time to receive his remaining entitled property from the trust until the youngest beneficiary reaches majority age.

If the trust only becomes effective after the children are no longer minors, or beyond the age when they were supposed to get the trust property, then the trust is never created and the property will simply pass to them.

Minor's Trusts

Another option to transfer money to a child is through an §2503(c) irrevocable minor's trust. The primary advantage of a minor's trust is that the contributions qualify for the annual gift tax exclusion even though they are gifts of a future interest. Contributions will also be exempt from the generation-skipping transfer tax. Generally, only gifts of a present interest, where the child receives the gift immediately, qualify for the gift tax exclusion. However, contributions to trusts that conform to IRC §2503(c) rules qualify for the annual exclusion.

The trust must be irrevocable because gifts made to the trust must be unconditional — the grantor must not retain any right to revoke the gift or have the gift revert to them. Because irrevocable trusts are separate entities, each trust will need a taxpayer identification number to file tax returns. Additionally, a separate trust must be set up for each child.

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To qualify for a minor's trust, the trustee must have unrestricted discretion to either distribute or accumulate trust income. Any restrictions by the trust document on the trustee's discretion may be disqualified as a minor's trust. For example, one must mandate that the trustee consider any other assets available to the minor before making distributions. The trustee can also distribute trust principal for reasons specified in the trust document or at the trustee's discretion. Any distributions of principal or income must be for the benefit of the minor. The minor beneficiary must have an unconditional right to the trust assets when reaching age 21, regardless of state law. This ensures that contributions are not treated as gifts of future interests so that they qualify for the annual exclusion. If the child dies before reaching 21, then the trust assets must be transferred to the estate of the child or to whom the child appointed under a general power of appointment.

If the grantor serves as trustee, then the trust may be included in the grantor's estate if the grantor should die before the child reaches 21. Therefore, neither the grantor nor a spouse should serve as sole trustee. However, they can serve as co-trustees. Trust assets will also be used to determine educational financial aid for the child.

Final Thoughts

Determining whether a UTMA or a trust fund is better in any given situation depends upon a number of factors:

- The amount of money being set aside for the child: If the amount is smaller, most likely a UTMA will be used.
- The conditions desired to be placed on the money: A UTMA is not going to be ideal if you want to insist that the funds be used for a specific purpose and within the limits permitted by law.
- The need for asset protection: Financial planning professionals can use trust funds in creative ways to protect beneficiaries that may not be possible with a UTMA.

Based on what you are trying to achieve, there are planning options that can be used for the children's benefit. While we have discussed some options above, there is much more to consider with each option. Please consult with estate planning attorneys and financial planning professionals to determine the path that is best for your family situation.

See disclosures and contact information on last page.

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