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HOW TO MAKE SUBSTANTIAL LIFETIME GIFTS TO MINORS

Parents or grandparents, particularly those with higher incomes or larger estates, often wish to make substantial lifetime financial gifts to their children or grandchildren. They may gift for a variety of reasons, but two of the most common are to shift some of their income-tax liability to the minor's lower tax bracket (perhaps to build a college fund) and to move assets out of their estate to reduce estate taxes. But making gifts should be done with care, not only to accomplish your goals and minimize taxes, but to avoid having the minor waste the gift.

Gift outright. The simplest form of gifting is to simply transfer stock, mutual fund shares, cash or other property outright to the minor (gifts over \$10,000 a year to a single person is subject to gift tax). However, because the child is a minor, they won't be able to transact any necessary financial business with the gift (such as selling and buying stock or property) without a court-appointed guardian. That guardian will probably be severely restricted as to what they can do with the property, and may not even be able to use the property to pay for college if the parents have adequate resources. When the child reaches the age of majority, 18 to 21 depending on the state, the child can do whatever they wish with the property.

Income the child earns from the assets is subject to the "Kiddie" tax if the child is still under age 14 at the end of the tax year. Under the Kiddie tax, the first \$700 in unearned investment income is not taxed. The next \$700 is subject to the child's tax rate, and any investment income above \$1,400 is taxed at the parent's rate. For children 14 or older when the tax year starts, investment income is taxed solely at their marginal rate, which usually is 15 percent.

Establish a custodial account. Particularly popular for

funding a child's education are custodial accounts, called Uniform Transfers to Minors Act (UTMA) or Uniform Gifts to Minors Act (UGMA) depending on the state. You can set up these accounts at financial institutions such as banks, brokerage firms or mutual funds. The custodian manages the assets until the minor reaches the age of majority. Investment income is subject to the Kiddie tax depending on the child's age, but you can minimize the income by donating such assets as growth-oriented stocks or tax-free bonds.

The major drawback to custodial accounts is that the child assumes control of the assets when they turn 18 to 21. They might then spend the money on a new car or a trip to Europe instead of college.

While parents typically name themselves as custodians for UTMA's or UGMA's, estate planning experts point out that property in the account will be included in the custodial parent's estate should the parent die before the custodianship ends when the child reaches the age of majority.

Consider using trusts for larger gifts. More expensive to set up, but more flexible, are a variety of trusts, such as a Crummey or a 2503 (c). With some trusts, you can extend control of the assets beyond age 21-say to 25 or 30 or even later. However, there are several tricky tax issues to watch out for. Another drawback is that trust distributions used to pay for what would normally be considered legal obligations of the parents, such as medical expenses, are taxed at the parent's rate instead of the child's. There also may be a window of opportunity for the child to assume outright control of the assets. You'll definitely want to consult a qualified estate planning attorney here.

Consider tuition or medical gifts. Grandparents can directly pay the college or medical provider for a grandchild's college tuition or medical needs without the payment being subject to gift tax, even for payments above \$10,000. They may also want to consider contributing to pre-paid tuition plans or college savings plans, though the payments may be subject to gift tax.

Contribute to the child's Roth IRA. If the child earns income, you could gift to a Roth IRA in the minor's name up to the amount of income earned or \$2,000 annually, whichever is lower. The Roth can be later used for the college or for the child's retirement.



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