

REVIEWING YOUR UTMA ACCOUNTS

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Gifts of cash or stock to minors are commonly placed in Alaska Uniform Transfer to Minors Act ("UTMA") accounts. Each account has one custodian and one beneficiary. The custodian may use so much of the funds as the custodian considers advisable for the benefit of the beneficiary. The funds belong to the beneficiary at the designated age. In Alaska the default age for release of funds is 21. The age of release can be modified when the account is set up and can be extended to 25. However, in the case of gifts, an extension beyond age 21 includes a six-month window after the beneficiary's 21st birthday when the beneficiary may demand the funds. If the beneficiary does not demand the funds within that six-month window then they remain under the control of the custodian to age 25 or whatever lesser age is designated. The six-month window is established so that gifts to UTMA accounts qualify for the annual exclusion from gift tax. Currently the annual exclusion is \$11,000 per recipient per calendar year. Without such window of opportunity the transfer would not be a present interest gift and would not qualify for this annual exclusion.

In order to maintain the maximum benefit of UTMA accounts it is appropriate to periodically review them to make sure they are structured to meet your goals. One of the first questions to ask is who is the proper custodian? Often persons making the gift establish themselves as the custodian. The advantage of this approach is that the person making the gift remains in control of the investments and distributions from the account.

On the other hand there are potential estate tax problems with this approach. Under I.R.C. §2038, assets subject to estate taxation include transfers where the giver retains the right to control the timing of distributions. Thus the person gifting funds into an UTMA account who also serves as custodian will have those account assets included in his or her estate for estate tax purposes. The giver should generally not be the custodian unless the family estate situation is such that no estate tax is likely to be imposed.

At the present time the unified credit against estate tax and gift tax is \$1,000,000 and increases to \$1,500,000 in 2004. Thus, many families are not currently in a position where this is a significant issue. However, for relatively wealthy families and those involved in estate planning to take advantage of the unified credit for other purposes, it is important to consider whether someone else should be custodian for such accounts.

Unless all of the gifts really came only from one spouse it is generally not a good idea to use the other spouse as the custodian. Similarly, the IRS can challenge reciprocal gifts where spouses work in tandem to create different accounts with cross-custodians.

The next issue is who should be the successor custodian. At the time the UTMA account is created individuals can be designated as successor custodians to serve if the custodian resigns, dies or is otherwise unavailable. If this was not done when the account was set up, the custodian can designate successor custodians by written

instrument. That document must be witnessed by someone other than the successor custodian. The designation of a successor custodian becomes effective when the current custodian resigns or becomes otherwise unavailable to serve. In the absence of a designation, a beneficiary age 14 or older may designate the successor custodian by selecting among family members, a conservator or an institutional trustee. For younger beneficiaries any properly interested person may petition the court for designation of a successor custodian. Thus it is better to designate successor custodians ahead of time.

Not all children mature at the same rate. Sometimes children are not ready to take over absolute control of funds in UTMA accounts even though they have reached age 21 or the required age of distribution. Under those circumstances the custodian has a limited range of options. First, the release date should be confirmed. Depending on the applicable law the release date could be as young as 18 or as old as 25.

Some custodians in this situation simply ignore the fact that the child is entitled to the fund and continue the account. In many instances financial institutions are willing to "go along" with this. At best this is a temporary solution. Other families work with the child to have them transfer funds to an appropriate trust or other restrictive arrangement by voluntary agreement.

Still another strategy is to invest the UTMA account funds in something that is not easily liquidated. The custodian could buy an annuity and then annuitize it. When the UTMA account terminated the beneficiary would receive a stream of annuity payments, but would not get all the funds at once. This approach does have a lack of flexibility after annuitization. Some people even invest the funds in fractional interests in real estate or minority interests in family controlled limited liability companies or similar entities. However, any of these investment approaches runs the risk that the child could sue the custodian for improper investment or similar claims.

Another approach to the problem of releasing the funds to the beneficiary too early is to use those funds during the legal existence of the UTMA account for the minor's benefit. This could include paying for the child's transportation, education, food and clothing. A custodian must be able to account for where the money went and accordingly permanent records of such a spenddown should be maintained. The parent or other custodian who is concerned about the child getting the money too early could then replace these funds with equivalent gifts to trusts or other vehicles which would extend the period during which the child does not have control of the funds.

Where control of the assets beyond age 25 or where the six-month window at age 21 is unacceptable, there are a number of other devices and trusts where assets can be controlled. However, UTMA is not the best vehicle for those situations.

UTMA accounts are important options in transferring assets to minors. However the accounts, like any other planning or investment vehicle, require periodic review.