Use Caution in Taking Advantage of the Law Allowing Custodial Accounts to Last Until Age 25

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The 2001 Oregon Legislature changed the Oregon Uniform Transfer to Minors Act (the Oregon UTMA), ORS 126.805 to ORS 126.886, to allow custodial accounts established for minors to last until age 25. The change may be helpful for many clients, but presents a gift tax trap if the custodial account is used for lifetime gifts.

Many clients make gifts to their minor children or grandchildren using custodial accounts as a simple way to give valuable assets to a minor. The custodianship, of course, is a form of statutory trust, but is easier and less expensive to set up than a custom trust.

Generally speaking, gifts in trust are considered gifts of future interests and therefore are ineligible for the annual exclusion from gift tax. IRC § 2503(b). Gifts to a traditional custodianship are treated as gifts of present interests by IRC § 2503(c), and consequently are eligible for the annual exclusion from gift tax. Rev Rul 56-86, 1956-1 C.B. 449.

As a result of the 2001 legislation, donors to custodial accounts can now elect to have the account last until the beneficiary attains age 25. ORS 126.872. This may allow practitioners to simplify estate plans where a trust for a child or grandchild lasting until age 25 would otherwise be needed. However, caution in using the new provision is required in connection with lifetime gifts.

Because present interest treatment under IRC § 2503(c) is limited to gifts to trusts which terminate when the beneficiary attains age 21, a gift to a custodial account lasting until age 25 will not qualify for annual exclusion treatment. Therefore, most clients making lifetime gifts should not take advantage of the ability to extend the custodianship to age 25. Fortunately, a more attractive alternative may exist for some clients in the form of gifts to the Oregon College Savings Plan, or similar plans offered by other states under IRC § 529. Such gifts qualify for the annual exclusion under IRC § 529(c)(2)(A), and give extraordinary powers to the account owner, including the power to withdraw the contribution at a later date, change the account beneficiary, and control the timing of distributions. ORS 348.841 to 348.873, and IRC § 529(c). However, contributions to such plans must be in cash, and the account owner has only limited control over investment decisions. IRC § 529(b).

Therefore, clients who wish to make lifetime gifts of appreciated securities or other property, or who want to give the custodian complete investment control, may prefer the Oregon UTMA. If

annual exclusion treatment is important with respect to such gifts, the custodial account should be set up to terminate at age 21.

Another issue sometimes overlooked in using custodial accounts is that if the custodian is the donor to the account, and dies before the custodial property is transferred to the account beneficiary, the property in the account will be included in the donor's estate. IRC § 2038, and Rev Ruls 70-348, 1970-2 C.B. 193, and 57-366, 1957-2 C.B. 618. Because of this problem, it is best if the account donor is not the custodian, particularly if a grandparent with a potentially taxable estate is making gifts to a grandchild.

If you have questions, please contact any member of The Estate and Business Planning Practice Group:

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