

Plan Ahead for College Funding and Financial Security

How can a family *build* a fund for college? They need to look ahead and prepare a "blueprint" as early as possible, and there are a number of ways to do this. The best method will depend on the age of the child, the family's resources and cash needs, and a number of other considerations.

No matter what the age of the child, there are legal techniques for placing money and property in their name. Since it is generally not advisable for minors to own property or have large bank accounts in their own names, gifts to minor children are usually made either to a **custodian** or a **trust**.

The Custodial Account

While some of the tax advantages of a custodial arrangement have been affected by tax law changes, the technique is still worth investigating. It is the simplest method to give money or property to a child, involving very little paperwork, hassle, and legal or other fees.

All states have adopted either the **Uniform Gifts to Minors Act (UGMA)**, which authorizes a custodial arrangement for cash, bank accounts, stocks, and bonds, or the **Uniform Transfers to Minors Act (UTMA)**, which allows the custodian to hold real estate and other property, including limited partnership interests, as well. The law of the state in which the minor lives will govern the account.

In most states, money or property held in custody must be transferred to the child at either age eighteen or twenty-one, depending on state law. Some states allow the custodian to designate the age at which the account may be accessed by the child, even beyond the age of majority. Once the designated age has been reached, the child has complete access to the custodial funds, he or she will be in sole control, and will have the legal authority to use them to buy a Porsche instead of paying tuition, should he or she so choose.

Trust Benefits

Setting up a trust for a child may be more cumbersome and expensive than the custodial arrangement, but it may be desirable in some situations. One important reason to transfer property to a trust for the benefit of a child is to diffuse the "Porsche Syndrome." The money in the trust, whether principal or income, can be used for the purpose which the *creator* of the trust intended— the child's education.

The creator of the trust may wish to use the federal annual gift tax exclusion that allows individuals to give \$12,000 (in 2007), each year to as many donees as they wish (or \$24,000 if a spouse joins in making the gift). This exclusion only works if the trust is structured so that it creates a "present interest" in the child beneficiary. The present interest requirement may be met in a number of ways, some prescribed by the Internal Revenue Code (IRC) and some by case law.

Discretionary trusts can be used, in which the trustee is free to accumulate income to take advantage of the trust's 15% tax bracket or to distribute it to the beneficiary in a bracket lower than that of the trust.

Prior to making gifts or establishing trusts, the effect of either method on long-term financial goals and a college savings program should be studied with care. The aim of providing the best education for the child, while preserving financial security for the family, should be integral to whatever decisions are made.