Acorn Financial Advisory Services

The Best Ways to Give a Financial Gift to Children

Here are some of the key strategies to consider when giving children and grandchildren a financial boost. There's no one-size-fits-all answer: The right choice for your situation will depend on how much you intend to give as well as on your grandchild's life stage and the goal of financial assistance.

Set up a UGMA/UTMA account: UGMA/UTMA accounts provide a way to save on behalf of a minor child without setting up trust funds or hiring attorneys. As a donor, you appoint yourself or other adults (such as the child's parents) to look after the account. One of the key advantages with UGMA/UTMA accounts is flexibility: You can put a huge range of investment options inside a UGMA/UTMA, including stocks and mutual funds. If you're saving fairly small sums, these accounts can be a decent way to go, but there are two major hitches. The first is that the assets become the child's property when he or she reaches the age of the majority (18 or 21, depending on state of residence). This leaves the donor with no real control over how the money is spent. The second is that for college-bound children, substantial UGMA/UTMA assets can tend to work against them in financial-aid calculations.

Contribute to a 529 Plan: These plans may build college savings while possibly obtaining a tax break. If you're saving for a college-bound child or grandchild, section 529 college-savings plans may help you avoid the two key pitfalls of UGMA/UTMA accounts. First, the assets are the property of the account owner, not the child. So if one grandchild doesn't end up going to college, you can use the 529 assets for another grandchild. Second, because 529 plan assets are considered the property of the account owner, they can have a relatively limited impact on financial-aid eligibility. In addition, you won't owe taxes on 529 plan investment earnings from year to year, and withdrawals from a 529 plan account will be tax-free provided you use them to pay for qualified higher-education expenses, such as tuition and room and board. Finally, you may be eligible for a state tax break on your contribution to a 529 Plan. The availability of such tax or other benefits may be conditioned on meeting certain requirements.

Fund a Roth IRA: If your grandchild is older and working, you can contribute an amount equal to his or her earned income, up to $5,000, to a Roth IRA. As with a UGMA/UTMA account, you can put a range of investments inside a Roth; there are no investment minimums or age limits on contributions. The money inside the Roth can grow tax-free until retirement, and the vehicle also offers some flexibility for withdrawals before that time. Specifically, contributions to a Roth IRA can be withdrawn at any time and for any reason, to pay for college or anything else. Those who need to tap the investment-earnings piece of an IRA will owe income tax on that portion of the withdrawal, but they'll circumvent the 10% penalty on early withdrawals if they use the money for qualified college or certain other expenses. Despite the big tax benefits, Roth IRAs for children carry one of the key drawbacks that also accompany UGMA/UTMA accounts: The child maintains control over the assets and can use the money for whatever he or she wants at the age of majority.