

CONTRA COSTA TIMES

Posted on Mon, Feb. 19, 2007

PEOPLE IN MOTION

Options vary when helping children buy homes

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Investment panel

Q: What is the best way to help your children purchase their first home?

A Buying a home with your children is fraught with complications. How do you hold title and handle the taxes? Will they pay you rent? What is the fair market price when they want to buy you out? How do you handle the estate planning?

Many parents want to help their children, but they don't want to favor one child over another or they can't afford to make a substantial gift.

One possible solution is to lend part or all the funds your children need to buy a home. The loan will act like a bond in your investment portfolio. You'll receive monthly interest payments and can structure the return of principal any way you'd like. Your child can then own a home and begin to build equity. It is a simple win-win solution.

There is a third-party administrator that specializes in private loans between family members called CircleLending, 800-815-6613. If you are going to lend money to relatives or friends, I highly recommend that you use a third-party administrator. It will ensure a smooth professional process with proper loan documentation and repayment management.

Q What is the best way to invest for my children now that they are taxed at my rate until they turn 18?

A The "kiddie tax" rules were recently toughened, raising the age to which the tax applies from 14 to 18. So until age 18, children earning investment income greater than \$1,700 will be taxed at their parents' rate.

The old strategy of gifting appreciated stock to your teenager and then selling it to qualify for a lower capital gains tax treatment no longer works.

You can still establish an UGMA (Uniform Gifts to Minors Act) or UTMA (Uniform Transfers to Minors Act) account for your child and gift \$12,000 a year in appreciated stocks, bonds, or mutual funds, but you'll have to hold them until the child reaches 18. I would also consider only gifting assets that don't pay dividends.

This new law significantly erodes the tax-saving benefits of UGMA and UTMA. Instead, you may want to consider contributing to a 529 plan, ESA or Roth IRA depending on your situation.

A 529 plan is a tax-advantaged investment account used to accumulate savings to pay for college tuition and expenses.

A parent or grandparent establishes the plan and designates herself or himself as the owner of the account and the student as the beneficiary.

There is no tax deduction for making a contribution to one of these accounts, but assets grow tax-deferred as long as money withdrawn from the account is used to pay for qualified educational expenses.

Education Savings Accounts is a trust established to pay the qualified education expenses of a specified person younger than 18.

The maximum annual contribution is \$2,000 and is not tax deductible. Assets grow tax-deferred and withdrawals are not taxed as long as they are used to pay qualified educational expenses.

ESAs differ from 529s in several ways. Contributions are limited (\$2,000 per year) and the contributor is subject to income limitations. For instance, married-filing-jointly taxpayers are not allowed to gift the full \$2,000 when income exceeds \$190,000.

The advantage of ESAs is that they can be used to pay for qualified elementary, secondary education (K-12) and college expenses unlike 529s, which can be used for only college.

A Roth IRA can be established for your child if he or she has earned income from a job. If you own your own business, you can employ your children part time or during the summer and fund a Roth IRA for them. A Roth IRA cannot be funded with gifts, investment income or scholarships.

Contributions to a Roth IRA are not tax-deferred, but all the earnings will never be taxed when withdrawn at retirement. Roth IRAs are great savings vehicles for your child's retirement, but the ESAs or 529 plans are better vehicles for a college savings plan.

I don't recommend buying your children life insurance, annuities or savings bonds. There are better ways to save or mitigate risk than using these vehicles.

It is great to take advantage of some of these savings vehicles, but it is also important to spend time teaching your children about money. Here is a simple money management experience that teaches children as young as 4 years old about budgeting, planning and spending.

"The Kid's Wealth Money Kit" (\$39.95) serves as a personalized system that lets children manage their money with your help. For more information about the kit, visit www.kidswealth.com or call 866-954-KIDS(5437).