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**UGMA & UTMA Custodial Accounts**

In most states, minors do not have the right to contract, and so cannot own stocks, bonds, mutual funds, annuities and life insurance policies. In particular, parents cannot simply transfer assets to their minor children, but instead must transfer the assets to a trust. The most common trust for a minor is known as a custodial account (an UGMA or UTMA account).

The Uniform Gift to Minors Act (UGMA) established a simple way for a minor to own securities without requiring the services of an attorney to prepare trust documents or the court appointment of a trustee. The terms of this trust are established by a state statute instead of a trust document. The Uniform Transfer to Minors Act (UTMA) is similar, but also allows minors to own other types of property, such as real estate, fine art, patents and royalties, and for the transfers to occur through inheritance. UTMA is slightly more flexible than UGMA.

To establish a custodial account, the donor must appoint a custodian (trustee) and provide the name and social security number of the minor. The donor irrevocably gifts the money to the trust. The money then belongs to the minor but is controlled by the custodian until the minor reaches the age of trust termination. (The age of trust termination is 18 to 21, depending on the state and whether it is an UGMA or an UTMA. Most UGMAs end at 18 and most UTMA's at 21, but it does depend on the state.) The custodian has the fiduciary responsibility to manage the money in a prudent fashion for the benefit of the minor. Custodial accounts are most often established at banks and brokerages.

Any money in custodial accounts for which you are the custodian will be counted as part of your taxable estate if you are the legal guardian of the child and the child has not yet reached the age of trust termination.

It is important to title the account correctly. An "In Trust For" account, also known as a Totten Trust or guardian account, is not an UGMA/UTMA account. It is a revocable transfer that passes to the beneficiary without probate upon the death of the donor. (Totten Trusts are assets of the account owner, not the beneficiary, for financial aid purposes.) The proper way of titling a custodial account is "[Custodian's Name] as custodian for [Minor's Name] under the [Name of Minor's State of Residence] Uniform Gift to Minors Act". Substitute the word "Transfer" for the word "Gift" if you intend to establish an UTMA account instead of an UGMA account. Note that this method of titling is only correct for the US. In Canada, for example, one would title the account "[Custodian's Name] as trustee for [Minor's Name], a minor".

Account Title	Account Type	Whose Asset on FAFSA
Parent <u>in trust for</u> Child	Totten Trust	Parent
Child <u>in trust for</u> Parent	Totten Trust	Child
Parent <u>and</u> Child	Joint Account	Split Evenly
Child <u>and</u> Parent	Joint Account	Split Evenly
Parent <u>as custodian for</u> Child	Custodial Account	Child
Parent <u>as trustee for</u> Child	Custodial Account	Child

The income from a custodial account must be reported on the child's tax return and is taxed at the child's rate, subject to the Kiddie Tax rules. The parent is responsible for filing an income tax return on behalf of the child. There is no special tax treatment for UGMA accounts. Children aged 14 and older must sign their own tax returns.

Neither the donor nor the custodian can place any restrictions on the use of the money when the minor becomes an adult. At that time the child can use the money for any purpose whatsoever without requiring permission of the custodian, so there's no guarantee that the child will use the money for his or her education. Also, since UGMA and UTMA accounts are in the name of a single child, the funds are not transferrable to another beneficiary.

For financial aid purposes, custodial accounts are considered assets of the student. This means there is a high impact on financial aid eligibility.

If money is transferred from an UGMA/UTMA account to a section 529 plan, the section 529 plan should be titled the same as the UGMA/UTMA account. When the child reaches the age of trust termination, the child will become the account owner for the section 529 plan. The custodian is not permitted to change the beneficiary of the section 529 plan, because the responsibility of the custodian to use the assets of the UGMA/UTMA account for the benefit of the child does not terminate when the funds are withdrawn from the account. Since the funds for the 529 plan derive from an irrevocable gift to the child, the funds in such

a section 529 plan would be treated as an asset of the child for financial aid purposes. (Due to a legislative drafting error in the Higher Education Reconciliation Act of 2005, custodial 529 plan accounts are not reported as an asset on the FAFSA. In the College Cost Reduction and Access Act of 2007, Congress corrected this error by treating qualified education benefits as an asset of the student if the student is an independent student and an asset of the parent if the student is a dependent student, regardless of whether the student or parent owns the account.)

**Undoing a Transfer/Gift**

It is not possible to transfer money back to the parent from a child's custodial account because the original transfer was an irrevocable gift. Once the money has been given to the child, it is owned by the child. The child does not have the capacity to gift the money back to the parent, and the custodian would be violating his or her fiduciary responsibility if he or she transferred the money back into his or her own name or used it for his or her own personal benefit. (If a custodian does this, or otherwise behaves in a fashion that the IRS interprets as indicating that no gift was actually ever made, the custodian would owe back taxes at his or her rate, plus penalties. Also, the child could sue to recover the funds.)

However, nothing prevents the custodian from spending the money for the benefit of the child, so long as the expenses aren't "parental obligations" or otherwise benefit the custodian. Parental obligations are expenses a parent is normally expected to provide for his or her child, such as food, clothing, medical care and shelter. But if your child wants a computer or to go to summer camp, it is usually acceptable to spend the child's money on those expenses. Likewise, you can spend the child's money for the child's college education. The parent can then set aside some of his or her own money in a college savings account owned by the parent. Obviously, this only works if there are non-parental obligation expenses that the parent would otherwise have provided for his or her children. *Attempts to undo an UGMA transfer in this fashion should only be done in consultation with a qualified accountant.*

(The model UTMA legislation included a paragraph that would permit the money in a custodial account to be spent for the use and benefit of the minor "without regard to (i) the duty or ability of the custodian personally or of any other person to support the minor, or (ii) any other income or property of the minor which may be applicable or available for that purpose". Although one might argue that this would allow one to spend the money even on parental obligations, it is important to note that this paragraph was not generally included in state UTMA legislation, nor UGMA legislation. Often, when this language was included, an additional clause stating "A delivery, payment, or expenditure under this section is in addition to, not in substitution for, and shall not affect any obligation of a person to support the minor." was added as well as a requirement to "keep custodial property separate and distinct from all other property". In addition, there are tricky tax consequences to spending the money on parental obligations. It is clear that if you spend the money for the benefit of the child on nonparental obligations, you're ok. Anything else, check first with an accountant who is familiar with the laws of your state.)

The Deficit Reduction Act of 2005 added another method of eliminating the negative financial aid impact of a custodial account. Effective July 1, 2006, the custodial versions of 529 college savings plans, prepaid tuition plans, and Coverdell Education Savings Accounts are treated as the asset of the parent for federal student aid purposes when the student is a dependent student. So if you roll over a custodial account into one of these three types of accounts you will shift its financial aid treatment from a student asset to a parent asset.

**Age of Trust Termination**

The following table shows the age at which the minor takes control of the custodial account. It depends on the minor's state of residence and whether the custodial account was created as an UGMA or an UTMA account. Each state may have additional provisions affecting the age of termination. Also, some states permit the donor or transferor to specify a different age of termination at the time the gift or transfer is made.

Note that the age of termination is not necessarily the same as the age of majority in the state. The age of majority is the age at which an individual can sign contracts (i.e., no more "defense of infancy"). The age of termination is not the same as the age of majority. In most cases the age of termination comes later. (The age of majority for signing contracts is 18 in most states, except Alabama and Nebraska, where it is 19, and Indiana, Mississippi, New York and Puerto Rico, where it is 21. For child support purposes, the age of majority is 18 in most states, 19 in Alabama, Colorado, Maryland and Nebraska, and 21 in D.C., Indiana, Mississippi, and New York, with exceptions for a later age of majority if the child is still in secondary school.) The age of termination for UGMA and UTMA accounts is listed in the following table:

State	UGMA	UTMA	UTMA supersedes UGMA (*)
Alabama	19	21	October 1, 1986
Alaska	18	21	January 1, 1991
Arizona	18	21	September 30, 1988
Arkansas	21	21	March 21, 1985
California	18	18	January 1, 1985
Colorado	21	21	July 1, 1984
Connecticut	21	21	October 1, 1995
Delaware	18	21	June 28, 1996

District of Columbia	18	18	March 12, 1986
Florida	18	21	October 1, 1985
Georgia	21	21	July 1, 1990
Guam	21	N/A	N/A
Hawaii	18	21	July 1, 1985
Idaho	18	21	July 1, 1984
Illinois	21	21	July 1, 1986
Indiana	18	21	July 1, 1989
Iowa	21	21	July 1, 1986
Kansas	18	21	July 1, 1985
Kentucky	21	18	July 15, 1986
Louisiana	18	18	January 1, 1988
Maine	21	18	August 4, 1988
Maryland	18	21	July 1, 1989
Massachusetts	18	21	January 30, 1987
Michigan	18	18	December 29, 1999
Minnesota	18	21	January 1, 1986
Mississippi	21	21	January 1, 1995
Missouri	21	21	September 28, 1985
Montana	18	21	October 1, 1985
Nebraska	19	21	July 15, 1992
Nevada	18	18	July 1, 1985
New Hampshire	21	21	July 30, 1985
New Jersey	21	21	July 1, 1987
New Mexico	21	21	July 1, 1989
New York	18	21	July 10, 1996
North Carolina	18	21	October 1, 1987
North Dakota	18	21	July 1, 1985
Ohio	18	21	May 7, 1986
Oklahoma	21	18	November 1, 1986
Oregon	21	21	January 1, 1986
Pennsylvania	21	21	December 16, 1992
Rhode Island	21	21	July 23, 1988
South Carolina	18	N/A	N/A
South Dakota	18	18	July 1, 1986
Tennessee	18	21	October 1, 1992
Texas	18	21	September 1, 1995
Utah	21	21	July 1, 1990
Vermont	18	N/A	N/A
Virgin Islands	21	N/A	N/A
Virginia	18	18	July 1, 1988
Washington	21	21	July 1, 1991
West Virginia	18	21	July 1, 1986
Wisconsin	18	21	April 8, 1988
Wyoming	18	21	May 22, 1987

(\*) All states repealed their UGMA statutes upon enacting their UTMA statutes. Any UGMA accounts in existence before the date of the repeal are grandfathered using the original UGMA age of termination. The relevant dates when UTMA took effect for the various states are listed in this column.

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