

The Personal Perspective

Personal Finance Issues You Need to Know

Custodial Accounts – Pros and Cons

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Specializing in organizing, maintaining and consolidating finances for busy people, families and seniors.



Credentials of Evan Gilder:

- Accountant
- Personal Financial Organizer
- Registered Financial Gerontologist
- Daily Money Manager

The Uniform Gifts to Minors Act (UGMA) and Uniform Transfers to Minors Act (UTMA) both provide methods by which to give gifts of assets (money, investment securities) to children, whether they are your own, your nieces and nephews, your grandchildren, or other children with whom you have a close relationship.

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 (UMGA) 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 UTMAs 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.

An adult "custodian" chosen by the giver manages the accounts until the child reaches the age of majority. Here is a quick reference guide that summarizes the major advantages and disadvantages of custodial accounts.

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Here are the pros of the accounts:

- The UGMA and UTMA provide convenient, uncomplicated ways to give gifts and otherwise transfer money, stocks, and bonds to minors.
- The giver designates himself, herself, or another responsible adult to be the custodian of the account, which means that he or she will manage the money for the minor until the minor reaches maturity and make withdrawals from the account as deemed appropriate.
- Custodial accounts can be used to fund a child's education.
- A UGMA or UTMA custodial account can be used like a trust in order to give nontaxable gifts of money during your lifetime, up to a certain limit, thereby avoiding both gift taxes and estate taxes on the amounts given.
- The income from a custodial account is charged to the child. If the child is paying taxes at a lower rate than the parent, this can result in further tax savings.

Custodial accounts are much simpler to establish than trusts, which have more complicated legal requirements and can be more costly.

Here are cons of the accounts:

- Once you transfer money into a custodial account, you can't take it back, even with the child's consent.
- The money in the account is automatically turned over to the "child" once he or she becomes twenty-one, or sooner in some states, regardless of the recipient's maturity. With a trust, the trustee can designate that the beneficiary receive the funds as late as age twenty-five.
- The existence of the account can cause a reduction in the amount of financial aid that is available to the child when he or she attends college. Assets held in a child's name weigh more heavily against financial aid eligibility than do the parents' assets.
- If the custodian dies before the account terminates, it is included in his or her estate, so the money in the account could end up subject to estate tax in that manner.
- If a parent uses income from the account to satisfy his or her legal obligation to support a child, the income becomes taxable to the parent, since parents have a legal obligation to support their children.



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- The UTMA does not allow for you to designate what happens to the money in the account if the child dies before receiving the money. Under a trust you are allowed to make this determination.

Some people I have spoken with said they would have made their decisions much differently had they better understood the behavior and purpose of these accounts.

Hopefully, we can learn from other people's mistakes.

Questions/Comments:
[Email me.](#)

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