

Montana Uniform Transfers to Minors Act (UTMA): Custodial Accounts for Children Under Age 21

by Marsha A. Goetting, PhD, CFP®, CFCS, Professor and Extension Family Economics Specialist, Montana State University-Bozeman.

The Montana Uniform Transfers to Minors Act (UTMA) allows for a custodial account as one alternative for a parent or other adult who wants to make gifts of assets during life, bequests with a will, or distributions from a trust for the benefit of a child who is under 21 years of age.



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MANY PARENTS, GRANDPARENTS OR OTHER

adults may wish to give assets such as money or property to a child using a will, trust or some other estate planning method. However, many adults think 18 – the legal age of adulthood in Montana – is still too young for the child to take responsible control of a large sum of money or other assets. They believe that the child's lack of financial experience and expertise could result in unwise use of the property.

A custodial account (UTMA) is one alternative for a parent or other adult who wants to make gifts of assets during life, bequests with a will, or distributions from a trust for the benefit of a child who is under 21 years of age.

This MontGuide explains custodianships that are permitted under the Montana Uniform Transfers to Minors Act (UTMA). The Act applies to anyone making asset gifts to minors – children, grandchildren, nieces, nephews, and other relatives or friends.

What is a custodianship?

A *minor* is defined for purposes of this law in Montana is a person who has not reached the age of 21.

An individual who gifts assets to a custodial account is referred to as a *transferor*. Although assets placed in the account are for the benefit and use, control is not given to the child until he or she reaches age 21.

A custodian manages the property that has been irrevocably gifted to a custodial account for the benefit of a child who is under the age of 21. The custodian can be the transferor (such as a parent or grandparent), another adult or a trust company.

The Act applies to gifts of property to a child while a transferor is alive, as well as a transferor's bequest in a written will. If a trust or custodianship is not used, children can gain complete control and access of their deceased parents' property at age 18.

The Act also pertains to distributions to a custodian from a trust arranged while the transferor is alive or from a testamentary trust established by the transferor's will.

Custodians, guardians, conservators, trustees? What is the difference?

A *guardian* is one who is legally empowered by the district court to take care of a child, who is considered by law to be too young to care for himself. The guardian takes care of the child until he or she reaches age 18. A parent can nominate a guardian in a will.

A *conservator* is legally empowered by a district court to manage the financial affairs of a protected person, such as a minor child. A parent can nominate a conservator in a will. The conservator manages the assets of a child until he or she reaches age 18. A child's guardian and conservator do not have to be the same person.

Although children under the age of 18 may receive gifts of assets (such as cash, stocks, and bonds) and hold title to property, Montana law significantly limits their legal capacity to act on their own behalf. Children under 18 are unable to enter into binding contracts such as the purchase of real estate, credit card agreements, and loans.

A *custodian* is named by a transferor and is responsible for managing the assets in a custodial account for the benefit of a child until he or she reaches 21 years of age. A custodian can be named while the transferor is alive.

A *trustee* named in a trust instrument is given the power to manage trust assets under the purposes outlined in the trust agreement. Typically, a trustee is directed to use assets for the health, maintenance, support, and education for a child. The trust agreement can indicate any age at which the trust terminates and the proceeds are distributed to the child.

Many adults believe that age 21 is too young to give a person control of substantial sums of money or property. If the transferor hopes to make a number of substantial gifts to a child over time this may be more of a concern. A transferor who desires to defer a child's access to property beyond age 21 could create a trust for the benefit of the child. A trust agreement can establish any age for trust termination and distribution of property to a child, well beyond age 21. A trust is a very flexible estate planning tool, but the trust agreement

is a legal document that should be prepared by an attorney. Thus, a trust will usually involve more complexity and expense than setting up a custodial account. For further information go to the MSU Extension MontGuide, *Revocable Living Trusts* (MT199612HR).

What assets can be gifted to a custodial account?

Almost any type of property, including money, securities (stocks and bonds), certificates of deposit, savings accounts, U. S. savings bonds, and real estate can be placed in a custodial account.

In addition, a custodian may be designated as the beneficiary of insurance policies, pension or profit sharing plans or similar future payment rights. Any income or proceeds from the custodial property, such as interest, dividends, or rental income also becomes custodial property.

Whom should I designate as custodian?

A transferor can designate himself or herself, another adult, or a trust company to serve as custodian. Only one custodian can be named for each account – joint custodianships are not allowed.

A transferor, however, may designate another person as a *substitute* or *successor* custodian to whom the property must be transferred if the first custodian dies, is unable, declines, or is ineligible to serve.

What are the duties of the custodian?

The custodian manages registers or records title to custodial property (if appropriate, such as in the case of real property), and collects, holds, manages, invests, and reinvests custodial property.

A custodian keeps records of all transactions regarding the custodial property, including information necessary for the preparation of the child's tax returns.

A custodian must observe the standard of care that would be observed by a "prudent person" dealing with property of another. The custodian is required to identify and keep custodial property separate from other property. Custodians are not allowed to pledge the account as collateral for any loans to themselves.

A custodian may resign at any time by delivering written notice to the child, if he or she has reached the age of 14. The written notice must also be sent to the successor custodian.

Where can a custodial account be set up?

Custodial accounts can be established at a bank, a savings bank, a credit union, with a mutual fund company, or at a brokerage firm. The child's social security number is the taxpayer identification for the custodial account.

Gifts under the Montana Uniform Transfers to Minors Act, §72-26-603

I, _____, (name of transferor or name and representative capacity if a fiduciary) hereby gift to _____ (name of custodian), as custodian for _____ (name of minor) under the Montana Uniform Transfers to Minors Act, the following: _____

(insert a description of the custodial property sufficient to identify it)

Dated: _____

Signature: _____

(Name of custodian) _____

acknowledges receipt of the property described above as custodian for the minor named above under the Montana Uniform Transfers to Minors Act.

Dated: _____

Signature of Custodian: _____

What is the wording used on a custodial account?

A parent can designate a custodian to manage the property for his or her child by naming the custodian followed by the words "*as custodian for (name of the minor) under the Montana Uniform Transfers to Minors Act.*"

An instrument in the form above also satisfies the requirements of Montana law. Most financial institutions have their own forms to be completed.

What happens to custodial assets when the child becomes 21?

When the child reaches age 21, the custodian is responsible for closing the account. The custodian transfers the property to the child, who can use it in any way he or she chooses. Neither the transferor nor the custodian can place any conditions on the custodial assets once the child reaches age 21.

The financial entity in which the custodial funds have been placed (*bank, savings bank, credit union, mutual fund, brokerage firm*) does not keep track of the age of the minor and is not obligated to close the account when the child reaches age 21. That is the responsibility of the custodian. Most account agreements indicate the responsibilities of the financial institutions.

What is the tax effect of a custodianship?

Income Tax. A custodianship is not considered a separate taxpayer. Any income earned, such as interest, dividends or proceeds derived from the custodial property, is taxable to the child. The custodian may use custodial funds to pay any state or federal income tax that is due.

Under the “kiddie tax” provisions, unearned income (interest from a certificate of deposit or dividends from stocks) up to \$2,000 is taxed as follows. The first \$1,000 falls into the child’s zero bracket. The next \$1,000 is taxed at the child’s tax rate. Unearned income of more than \$2,000 is taxed to the child at the parent’s tax bracket as long as the child is under age 14. If the parent is deceased, the “kiddie tax” does not apply. The child would be taxed as an unmarried individual at the standard rates.

Once the child reaches 14 and has unearned income beyond \$2,000, the tax is based on the child’s income tax bracket. These rules are for the 2013 tax year. Check the IRS Form 1040 instructions for the appropriate figure, as the amount is indexed annually for inflation.

Federal Estate Tax. If you are a parent who is gifting property to an adult custodian such as a grandparent, brother or sister, the value of the gift amount will not be included in your taxable estate for federal estate tax purposes. If, however, you appoint yourself as custodian and die while serving in this capacity, the value of the custodial property will be included in your taxable estate for federal estate calculation purposes.

If your estate value in 2013 is less than \$5.25 million, federal estate taxes are not due. If your estate value is over this limit, you may want to appoint another adult or a trust company as a custodian. This will eliminate the value of the custodial property from your taxable estate. The amount is indexed annually for inflation.

Federal Gift Tax. When a parent gives a child money, clothing, or other types of personal property, the gifts are ordinarily considered as satisfaction of a parent’s legal obligation of support. If the gift to the child goes beyond a parent’s legal obligation of support, such as substantial investments or a large amount of money, it will be deemed a gift for federal gift tax purposes.

Gifts of up to \$14,000 each year to as many minor children as the transferor wishes may be placed in custodial accounts without triggering federal gift tax liability. For married taxpayers, the annual exclusion is \$28,000 to each child, if they make an election to split gifts on a federal gift tax return. If a husband and wife contribute to the gift, each can give \$14,000 for a total of \$28,000 without filing a gift tax return. Married couples who make joint gifts must file a 709 federal gift tax return.

For example, Rod has established custodial accounts for each of his five grandchildren. He plans to gift \$14,000 to each account each year. Rod’s wife, Nora, also plans to gift \$14,000 to each account each year thus, lowering the value of their estate by \$140,000 annually.

There are special rules that apply to gifts of life insurance to a custodianship. The transferor must live three years after making the gift to have the proceeds excluded from the estate.

For example, Fred gifted a life insurance policy with a face value of \$250,000, to his minor child in 2013. He died in 2014. The proceeds from the policy (\$250,000) were

included in Fred’s estate for federal estate tax computation purposes because he did not live three years after the gift. But no federal estate tax was due because his estate was valued at less than \$5.25 million.

What if I need the money that was gifted to the custodial account?

You can’t take it back! Your decision is irrevocable. Once assets have been gifted to a custodial account they **cannot be taken back**. The assets belong to the child.

For example, a parent who established a custodial account for a daughter cannot have access to the funds for any reason – even for an unforeseen family financial emergency, such as a catastrophic illness. Nor can the funds be withdrawn to fund college expenditures at age 18.

Even if the child wants to give the money back to the transferor, he or she can not, because the child does not own the account until age 21. Nor is the custodian allowed to return the funds to the transferor.

What happens to assets in the custodial account if a child dies before age 21?

If a child dies, the property held in a custodianship becomes a part of the child’s estate. The property is not returned to the transferor, but rather, is distributed according to a Montana law that provides the disposition of a person’s real and personal property if he or she dies without a written will. For further information, go to the MSU Extension Dying Without a Will website at <http://www.montana.edu/dyingwithoutawill/>. Once a child reaches age 18, he or she can have a written will naming individuals to receive his or her assets including those in the custodial account.

If a child is not married (and has no children of his or her own) the property will pass to the parents who will share equally, if both are alive. If only one parent survives, he or she receives the entire amount of the custodial property.

If there is not a valid will and if the parents are not living, then the custodial property passes equally to brothers and sisters. If any brothers or sisters predeceased the “child” then their descendants (nieces and nephews of the “child”) take the share their parent would have taken.

Payable-on-death (POD) and transfer-on-death (TOD) designations are the naming of a beneficiary to receive an account balance on the owner’s death. While Montana law allows POD and TOD designations on most financial accounts, these designations cannot be used on custodial accounts.

What if the custodian dies?

If the custodian dies before the child reaches the age of 14, and a successor custodian was not previously designated, the *conservator* for the child becomes the successor custodian. A *conservator* is an individual appointed by the district court to manage assets (other than the assets in a custodial account) left to a child until they reach the age of 18. If the

conservator is appointed by the district court as custodian, then he or she manages the assets until the child reaches age 21. If the child has no conservator or the conservator declines to act, the following persons may petition the court to designate a successor custodian:

- the transferor,
- the legal representative of the transferor,
- the legal representative of the custodian,
- an adult member of the child's family, or
- any other interested person.

Does a custodian get paid for managing the account?

A custodian may annually charge reasonable *compensation* for services performed, unless the custodian is also the transferor of the property. The custodian is also entitled to *reimbursement* for reasonable expenses incurred for services performed.

If a friend or relative is named as custodian, the custodian's compensation can be fixed in advance. By separate agreement, the transferor can provide that the custodian will receive a fixed annual fee or an annual fee that is a specified percentage of the value of the custodial assets.

Trust companies generally have rate scales for computing compensation based on the value of the custodial property. Two advantages of naming a trust company as custodian are professional management and impartial distribution of the custodial assets.

What if the custodian is not managing the property effectively?

The transferor, a minor child for whom the custodial account was established (if he or she is at least 14 years of age,) or an adult member of the child's family may petition the district court for an accounting of the use of funds in the custodial account. The court may remove a custodian if he or she is not properly fulfilling his or her custodial duties. The district court judge would then appoint another custodian from the following:

- the legal representative of the transferor,
- the legal representative of the custodian,
- an adult member of the child's family, or
- any other interested person.

What is the impact of custodial accounts on my child's eligibility for college financial aid?

Financial aid formulas require that 20 percent of a student's assets be counted towards college costs before a family qualifies for financial aid. Parents are expected to count only up to 5.6 percent of assets in their names. Custodial accounts are counted as a student's assets because the income from the account is reported under the Social Security number of the child.

Summary

Before you set up a custodial account for a minor child, carefully consider your objectives and other ways you may achieve them. You may find that for educational purposes, a Section 529 College Savings Plan or Coverdell Education Savings Account may be better choices. Another possibility is to set up a trust naming a trustee to manage assets for a child.

Consult an estate planning or tax attorney, certified public accountant or other financial planning professional for specific legal and tax implications of these alternatives.

Acknowledgment

This MontGuide has been reviewed by representatives from the following:

- Business, Estates, Trusts, Tax, and Real Property Section, State Bar of Montana
- Montana Credit Union Network
- Montana Bankers Association
- Montana Independent Bankers Association

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