



# Custodial Accounts for Minors

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**B**y definition, custodial accounts are established by adults as custodians for minor children. Both the custodian and the minor must be residents or resident aliens of the United States or its territories. The accounts are established under the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA) on a state-by-state basis. While custodial accounts are available in the vast majority of states, they differ slightly regarding the age for distribution. Therefore, each separate state's law must be consulted.

## WHAT IS A CUSTODIAL ACCOUNT?

A custodial account is simply an account established with property gifted by an adult. It is a gift under Internal Revenue Code Section 2503(c) and can be used for annual gift tax exclusion gifts.

You establish the account in the name of the custodian for the minor child as, for example, “[Custodian Name], as custodian for [Minor Child Name] under the [Name of State UGMA/UTMA Act].” Income generated by the account is reported to the Internal Revenue Service under the social security number of the child.

The custodian manages the account for the benefit of the minor to whom the gift has been made. Management includes keeping records of all transactions for the account/property. Generally, the custodian has broad management powers, both as to the type of investments which comprise the account and as to the uses, if any, by the minor prior to reaching the stated age for distribution (usually 18 years of age). The custodian has a duty to act as a prudent person responsible for the property of another and not invest in risky or speculative investments.

The account, once established, is irrevocable. “Irrevocable” means the account cannot be terminated by the adult once established, and it cannot be taken back. It is a completed gift.

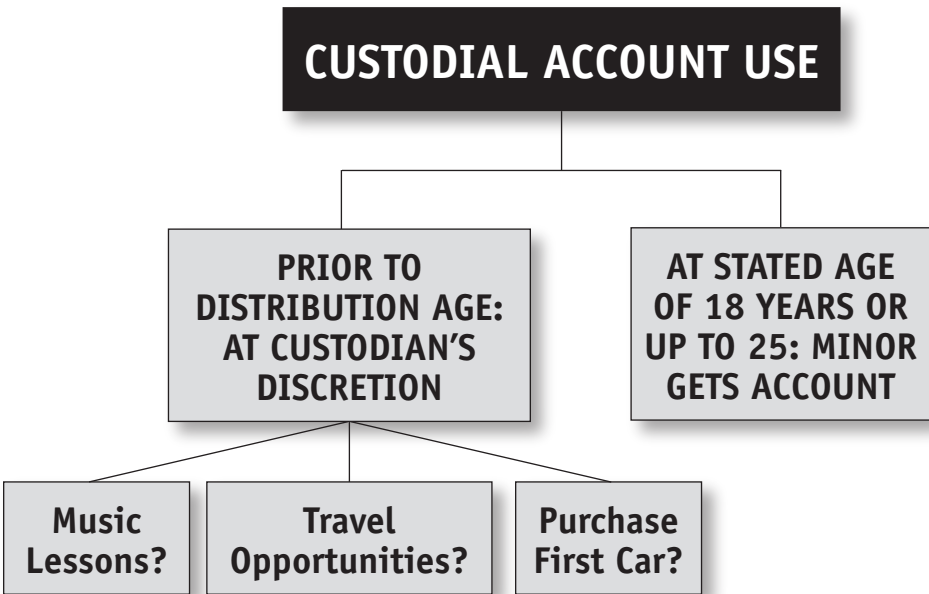
## WHAT TYPES OF PROPERTY CAN BE TRANSFERRED TO CUSTODIAL ACCOUNTS?

The UTMA/UGMA Act permits transfer of any kind of property to title ownership in custodial format. For example, money, securities, U.S. savings bonds, life

insurance, annuities, partnership interests, real property, and tangible personal property can be transferred under the Act. You must refer to your own state's version of the act to verify the foregoing, however.

## **CAN THE ACCOUNT BE USED BY THE MINOR, IF NEEDED, PRIOR TO THE MINOR ATTAINING THE AGE OF MAJORITY?**

If you establish a custodial account, the account can be used for the benefit of the minor prior to the minor reaching the age of majority. The adult custodian is the only one who can access the account and must determine that the minor's access to the account satisfies the purpose for which you established the account, for example, to pay for music lessons, to buy a car, or to participate in an after-school program.



## **AT WHAT AGE CAN A CHILD ACCESS THE ACCOUNT?**

Normally a child can access the account upon attaining the age of majority, usually age 18. In some states, a custodian can state a slightly higher age before allowing access, age 21, for example, or, in some states, even up to 25 years of age. You will have to check the requirements in your state before establishing the account.

## **WHAT ARE THE BENEFITS OF A CUSTODIAL ACCOUNT?**

Custodial accounts are easy and inexpensive to set up. You can establish a custodial account for any minor. There is no minimal amount required to establish a custodial

account. There is no requirement that additional contributions be made, nor is there any requirement that the account be used for a specific purpose (e.g. education).

## **WHAT ARE THE DISADVANTAGES OF CUSTODIAL ACCOUNTS?**

As previously stated, the custodial accounts are irrevocable, meaning that once you establish one, the account belongs to the minor, with only the requirement being that he or she attain a stated or statutory age. While the accounts can be accessed by the custodian prior to the minor attaining the age of majority, you may be nervous about giving an 18 year old, or even a 21 year old, a substantial amount of money or a valuable asset. The accounts are statutory so they are inflexible. If you change your mind about the age for distribution, it is too late. The account, as established, stands.

For larger value assets, a custodial account may not be the best option for dealing with minor beneficiaries due to the inflexibility of the account.

## **WHAT IF THE CUSTODIAN DIES BEFORE THE MINOR REACHES THE AGE OF MAJORITY?**

What happens when the custodian dies prior to distribution to the minor is extremely problematic. In this case no one has access the account and the minor must wait until the stated age to claim the property. It may require a court order to install a new custodian. Most state statutes, however, allow a personal representative or trustee to name a successor custodian.

## **WHAT HAPPENS IF THE MINOR DIES?**

If the minor dies prior to the stated age for distribution, the account passes according to state law, not necessarily back to you as donor. The beneficiaries of the account are likely to be the parents of the minor child according to state laws of intestate succession.

## **WHO PAYS THE TAXES ON INTEREST OR DIVIDENDS EARNED ON THE ACCOUNT?**

The tax identification number on a custodial account is the minor's social security number. Any income earned will be reported to the IRS under the minor's social security number and taxed to the minor. One exception arises if the custodian uses the account to discharge a parent's obligation of support to the minor child, in which case the income is taxed to the parent.

## **TO WHOSE ESTATE DOES THE CUSTODIAL ACCOUNT BELONG?**

Custodial accounts are part of the minor's estate in the event of the minor's or custodian's death prior to the minor attaining distribution age unless you, as the donor who established the custodial account, are also the custodian. If estate taxes

are an issue for you, name someone other than yourself as custodian on the account.

## WHAT ALTERNATIVES TO A CUSTODIAL ACCOUNT EXIST?

There are alternatives to a custodial account, which you should examine before making a final decision. Some alternatives are Coverdell accounts, 529 plans for education, and traditional or Roth IRAs. You can also explore establishing a trust for the minor child. Considerations in making your decision include: 1) the amount of money or value of property involved; 2) the purpose for which you want to set aside the assets for the minor child; 3) the terms for management and distribution of the assets to the minor child; and 4) the cost to effectuate the plan.

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