UGMA & UTMA Accounts

Vehicles designed to help you amass college savings & make gifts to minors.

Don Akridge, MBA, CFP®, CPA/PFS
U.S. Marine Corps Veteran – Emory University Alumnus

If you want to save for college, you may wish to consider a UGMA or UTMA account. These custodial accounts are typically created by parents and other relatives who want to gift minors without having to set up a trust.

Many parents and grandparents create UGMA or UTMA accounts as college savings vehicles. You can invest for a child's education while transferring income-producing assets to that child (and their presumably lower tax bracket).

UGMAs were created by the Uniform Gifts to Minors Act (UGMA), which allows a donor to irrevocably gift cash and securities to a child or teenager. The parallel Uniform Transfers to Minors Act (UTMA) created the UTMA, which extends the UGMA parameters: a UTMA lets minors receive gifts of art, real estate, patents, and other non-securities assets.[1,2,3]

UGMA & UTMA accounts address a minor concern. You may be thinking, "Well, I know outright gifts to a minor aren't subject to federal tax, so why set up a UGMA or UTMA? Why don't I just gift the money or securities outright?"

Do you really want to do that?

You probably want some control. Most likely, you don't want your teenager buying and selling securities – and neither do brokerages. And in many states, minors are not allowed right of contract, and therefore cannot own stocks, bonds, life insurance, or other such assets. You might also want to see that any cash you gift is not spent frivolously. If these concerns speak to you, UGMA and UTMA accounts are worth a look.[1]

You can use these accounts to gift up to $14,000 in money or property to a minor in 2016. Because the gift is irrevocable, you are the custodian of the asset(s) and the minor is the owner. In colloquial terms, these UGMA or UTMA accounts are "trust funds," yet they are not trusts that would require the involvement of an attorney. While the minor owns the cash or property within the UGMA or UTMA account as soon as the asset transfer occurs, the custodian manages that cash or property until the child reaches the vesting age (the age at which the trust term expires).[1,3]

As custodian, you are not the only one who can make irrevocable transfers of cash or property into the account; parents, grandparents, relatives, and friends may all do so. A sizable college fund may be built with a UGMA or UTMA account, whether the assets are held in cash or invested. When the account owner reaches "maturity," he or she may spend that money for college.[1,3]

Is there a potential downside of UGMA or UTMA accounts? Yes. To repeat, you are the custodian, the minor is the owner. When that minor becomes a legal adult, the account terminates and the account owner gets to spend the funds as he or she wishes. It's a free country… and it is possible that today's college fund will become tomorrow's Corvette. So you do want the owner and the custodian on the "same page" when it comes to the intent of the account, and on good terms as well.[1]

Another potential issue to consider: if you are custodian of one of these accounts and you pass away before the account terminates, the assets within the UGMA or UTMA account will be considered part of your taxable estate.[1]

An underpublicized option worth exploring. UGMA and UTMA accounts may give your family the potential to create a nice pool of money for college while lowering your income taxes in the process.

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Citations.

1 - finaid.org/savings/ugma.phtml [1/18/16]
2 - finance.zacks.com/difference-between-529-custodial-account-1404.html [1/18/16]
3 - merrilledge.com/college-savings/custodial#tab2 [1/18/16]