



## **Custodial Accounts for Children**

Because individuals must be of legal age to own property, many parents use custodial accounts as ways for moving funds and assets into their children's names.

The concept of custodial accounts was originally established under the Uniform Gifts to Minors Act (UGMA). These accounts were an easy and legal way to transfer the ownership of assets to a child. UGMA accounts were fine for financial assets such as cash, bonds or stocks. Recently, most states have adopted the Uniform Transfer to Minors Act (UTMA) that provides some additional capabilities for the property to consist of real estate or other more complicated types of property.

With a UGMA or UTMA account, the parent creates a custodial account on behalf of the minor child. Assets are transferred into the account and the custodian, usually a parent, manages the account until the child reaches legal age. At that point, the child can do whatever he or she wishes with the assets.

These accounts are often used to save for college educations or to create some net worth for a child. While they are usually established by a parent, other adults (such as grandparents) can establish UGMA or UTMA accounts and act as custodian.

### **Transfers are irrevocable**

If you are considering transferring assets into a custodial account, remember that the gift is irrevocable. You cannot change your mind later and take the assets back. Your child becomes the owner when you make the transfer. Most states set 21 as the age when the custodial accounts end. However, some states set age 18, between 18 and 21 or between 18 and 25. Check the laws of your state.

### **Gift tax implications**

Transfers into a custodial account are just like any other gift. You can make annual gifts up to \$13,000 in cash, securities or other property to anyone without owing any federal gift tax and without filing a gift tax return. The annual exclusion applies to each person receiving the gift.

If you are married, gifts can be considered to be one half from you and one half from your spouse. In other words, two parents can give up to a total of \$26,000 per year to a child without owing any gift tax. However, a simple gift tax return may be required if you use this gift-splitting technique. Consult your tax advisor.

### **Income tax implications**

When the assets become the child's, any income the assets produce is taxed to the child. There are special tax rules that apply to children under the age of 18, 18 year olds with earned income less than half of their support, and 19 to 23 year old students with earned income less than half of their support. These rules are commonly called the "Kiddie" tax.

The tax laws provide that the first \$950 in 2010 of investment income from assets held in the child's name is tax free. The next \$950 is taxed at the child's tax rate (usually the lowest rate of 10%). Investment income greater than \$1900, is taxed at the parent's rate until the child is no longer subject to the Kiddie tax. The Kiddie tax rules were changed in 2007 and you may want to consult a tax advisor to determine how the rules may apply in your situation.

### **Qualifying for College Financial Aid**

Using a UTMA or UGMA account to receive assets transferred from parents may limit or reduce your child's ability to qualify for needs-based financial aid to cover college costs. This is because many financial aid programs require the student to use 35% of their assets for college before being eligible for aid. The same programs may only require 5% of the parents' assets to be used in the calculation. You may want to investigate this if your child's qualifying for financial aid is going to be important.

### **Summary**

Custodial accounts are an easy and convenient way to transfer funds to children. There are limited income tax benefits and there may be negative implications for your child's ability to qualify for college financial aid. However, often the major factor to consider is that your children will be able to use the funds as they please once they reach a certain age. This is all the more reason to make sure your children have a proper financial education.