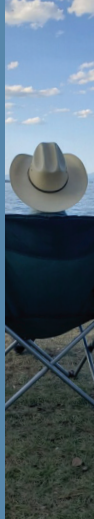


Custodial Accounts for Children Under Age 21: Montana Uniform Transfers to Minors Act (UTMA)

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The Montana Uniform Transfers to Minors Act (UTMA) allows for a custodial account as one alternative for a parent or other adult 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.

DURING THEIR LIFETIMES MANY PARENTS, grandparents or other adults wish to give assets such as money or property to a child. Then after death some may use a will to make a bequest to a child. Others use distributions from a living or testamentary trust as a gift.

Children under the age of 18 (the legal age of adulthood in Montana) may receive gifts of assets (such as cash, mutual funds, stocks, and bonds) and hold title to property. However, Montana law significantly limits their legal capacity to act on their own behalf. Children under age 18 cannot sign binding contracts, such as a purchase agreement for real estate, credit card agreement, and loan contract.

However, in Montana, children can gain complete control and access of their deceased parents' property at age 18, unless the parent establishes a trust or custodianship. Many adults believe age 18 is too young for a child to take control of a large sum of money or other assets. They believe the child's lack of financial experience could result in unwise use of the property, especially money.

A custodial account is one alternative for a parent or other adult who wants to gift assets during the adult's lifetime, make a bequest in a will, or make distributions from a trust for the benefit of a child who is under 21 years of age. This MontGuide explains how custodial accounts are allowed under the Montana Uniform Transfers to Minors Act (UTMA).

What is a custodial account?

The term **custodial account** generally refers to an account controlled by an adult representative for a minor. An individual who gifts assets to a custodial account is called a **transferor**. A **custodian** manages the property gifted to a custodial account for the benefit of the child. The custodian can be the person making the gift (such as a parent or grandparent), another adult, or a trust company.

Custodial accounts include savings accounts at a financial institution (such as a bank or credit union), mutual fund company or brokerage firm. Although assets placed in the account are for the benefit of the child, control over the assets is not handed over until the child reaches age 21.

Is there an alternative if I believe age 21 is still too young for a child to wisely manage large sums of money?

Many adults believe age 21 is still too young to give a person control of substantial sums of money or property. If you plan to make substantial gifts to a child over a period of years this may even be more of a concern. If you want to defer a child's access to property beyond age 21, consider creating a trust as opposed to a custodial account.

A **trustee** named in a trust instrument manages trust assets for the purposes outlined in the trust agreement. Typically, a trustee uses the assets for the health, maintenance, support, and education for a child.

Typically, a trust will usually involve more complexity and expense than setting up a custodial account. A trust agreement is a legal document that should be prepared by an attorney. For further information read the MSU Extension MontGuide, *Revocable Living Trusts* (MT199612HR, <https://store.msuextension.org/publications/FamilyFinancialManagement/MT199612HR.pdf>).

What type of assets can be gifted to a custodial account?

Almost any type of property can be gifted to a custodial account: real estate, securities (stocks and bonds), money in certificates of deposit, savings accounts, and U. S. savings bonds. In addition, a custodial account may be the beneficiary of life insurance policies, annuities, pension or profit-sharing plans. Any income or proceeds from the custodial property, such as interest, dividends, or rental income become a part of the custodial account.

Whom should I select as custodian?

The custodian can be the person making the gift, another adult, or a trust company. Montana law places a limit of one custodian for each custodial account. The person making the gift may also designate another person or entity to whom the property transfers if the first custodian dies, is unable, declines, or is ineligible to serve. The **substitute** or **successor custodian** then takes over the management of the custodial account.

What are the duties of a custodian?

The custodian manages, registers or records title to custodial property (if appropriate, such as in the case of real property). The custodian collects, holds, manages, invests, and reinvests custodial property (if appropriate, such as in the case of real estate or securities). A custodian keeps records of all transactions for the custodial property, including information necessary for the preparation of income tax returns for the child.

A custodian must observe the standard of care observed by a “prudent person” when dealing with property of another. The custodian must identify and keep custodial assets separate from the custodian’s property. Custodians may not pledge a custodial account as collateral for any loans to themselves.

A custodian may resign at any time by delivering written notice to the beneficiary and financial institution where the account was established. The successor custodian must also be notified of the resignation of the primary custodian.

What wording is used on a custodial account?

A parent can designate a custodian to manage assets for a child by naming the custodian on the account followed by the words “*as custodian for (name of the minor) under the Montana Uniform Transfers to Minors Act.*” Most financial institutions provide forms developed by their legal counsel.

What happens to the custodial account when a child reaches age 21?

When a child reaches age 21, the custodian is responsible for closing the account, not the entity holding the funds. The custodian transfers the property to the child beneficiary, who can use the funds for any purpose. Neither the person making the gift nor the custodian can place any conditions on use of the custodial assets after the child reaches age 21.

Once the custodianship terminates, the child’s creditors may be able to access these funds to pay the child’s debts.

What are the tax effects of a custodianship?

Income Tax. A custodial account is not treated as a separate taxpayer. Any income earned, such as interest, dividends or proceeds derived from any sale of custodial property, is taxable at the state and federal levels. The custodian may use custodial funds to pay any income tax due on the earnings in the account.

Unearned income (interest from a certificate of deposit or dividends from stocks) up to \$2,200 becomes taxable as follows.

- The first \$1,100 falls into the child’s zero bracket;
- The next \$1,100 becomes taxable at the child’s tax rate; and
- Unearned income of more than \$2,200 becomes taxable to the child at the parent’s tax bracket if the child is under age 19.

If the parents are deceased, the child’s income is taxable as a single individual at the standard rates, 10% up to income of \$9,875. These rules are for the 2020 tax year. Check the Internal Revenue Service, Topic Number 553, as amounts change annually to reflect inflation: *Child’s Investment and other Unearned Income* instructions <https://www.irs.gov/taxtopics/tc553>

Federal Estate Tax. If a parent gifts property to a custodial account and the custodian is a grandparent, brother or sister of the child beneficiary, the value of the gift is not included in the parent’s taxable estate upon death. If, however, you appoint yourself as custodian and die while serving in this capacity, the value of the custodial property is included in your estate for federal estate tax calculation purposes.

However, if your estate is valued at less than \$11.7 million (current as of 2021 but subject to change), federal estate taxes are not due. The exemption amount increases each year based on the Consumer Price Index. 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 for federal estate tax purposes.

Federal Gift Tax. An individual may place gifts of up to \$15,000 each year (current as of 2021) in custodial accounts for minor children without triggering a federal gift tax liability. For married taxpayers, the annual exclusion increases to \$30,000 for each child.

Example A: Rod established custodial accounts for each of his five grandchildren. He plans to gift \$15,000 to each account each year. Rod’s wife, Nora, also plans to gift \$15,000 to each account each year. With these

gifts Nora and Rod are lowering the value of their estate by \$150,000 annually (\$30,000 x 5 grandchildren = \$150,000).

There are special rules applying to gifts of life insurance to a custodial account. The person making the gift of life insurance must live three years after making the gift to have the proceeds excluded from the deceased's estate.

Example B: Fred gifted a life insurance policy with a face value of \$250,000, to the custodial account of his minor child in 2018. Fred died in 2021. Fred's wife was worried about the IRS including the proceeds from the policy (\$250,000) in his estate because he did not live three years after making the gift. However, Fred's wife was relieved to learn no federal estate tax was due estate tax because the value of Fred's estate was less than the \$11.7 million exemption.

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

After you gift assets to a custodial account, *you cannot take the gift back*. The assets in the account now belong to the child. For example, parents who established a custodial account for their daughter cannot access those funds to benefit the family, even if the parents are experiencing a financial hardship caused by COVID-19 or other unforeseen family financial emergency.

If, however, the daughter is experiencing medical expenses because of COVID-19 or increased educational expenses, then the custodian can pay those expenses for the daughter's benefit. The custodian can also pay for any item for the child's benefit, such as sports activities, registrations, camps, and piano lessons.

There are some circumstances that could result in closure of the custodial account between ages 18 and 21 with the balance passing to the child. If the custodian dies and the personal representative of the custodian, a trustee, or a conservator considers the transfer to be in the best interest of the minor, the custodial account could pass to the child. However, if the account exceeds \$10,000 in value, a district court judge must authorize the transfer.

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

The property held in a custodianship becomes a part of the estate of the child. If the child dies without a written will, the assets are not returned to the person who made the gift. Assets in the account pass to heirs based on Montana

statutes that direct who receives the deceased's child's real and personal property. Parents are a child's heirs under Montana law. For further information, go to the MSU Extension Dying Without a Will website at <http://www.montana.edu/dyingwithoutawill>. A child who reaches age 18 can have a written will naming individuals to receive assets, including those in the custodial account.

Payable-on-death (POD) designations and transfer-on-death (TOD) registrations are ways to name a beneficiary to receive an account balance on the owner's death. While Montana law allows PODs and TODs on most financial accounts, beneficiary designations are not available for custodial accounts.

What happens to the account if the custodian dies?

If the custodian dies before the child reaches the age of 14, and if 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 judge to manage assets left to a child until they reach the age of 18.

If the district court judge appoints a conservator as custodian, then the assets are managed by the individual until the child reaches age 21. If the child does not have a conservator or if the conservator declines to act, the following persons may petition the court to designate a successor custodian:

- the person making the gift;
- 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 receive payment for managing the account?

A custodian may annually charge reasonable compensation for services performed for the custodial account, unless the custodian is also the person who made the gift of the property. If you name a friend or relative as custodian, the custodian's compensation is often determined in advance.

By separate agreement, you can provide for the custodian to 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.

What if I believe the custodian is not managing the custodial account appropriately?

The person who made the gift, a minor child who is owner of the custodial account (if the child is at least 14 years of age), or an adult member of the child's family may petition the district court judge for an accounting of the use of funds in the custodial account. The district court judge may remove a custodian if the person does not provide appropriate records. The district court judge would then appoint another custodian from the following:

- the legal representative of the person making the gift (such as a personal representative or conservator);
- the legal representative of the custodian (such as a personal representative or conservator);
- an adult member of the child's family; or
- any other interested person.

What is the effect of a custodial account on a child's eligibility for college financial aid?

The financial aid formula requires 20 percent of a student's assets count towards college costs before a student qualifies for financial aid. On the FAFSA form custodial accounts are considered a student's assets because the Social Security number of the child is used when reporting income.

The financial aid formula requires only 5.6 percent of a parents' assets count towards college costs before the student qualifies for financial aid. Before setting up a custodial account for a minor child, carefully consider objectives and whether there are other ways to achieve them.

If the goal is to use the custodial account specifically for educational purposes such as college savings, consider a Section 529 College Savings Plan (<https://achievemontana.com/>) or a Coverdell Education Savings Account (<https://www.irs.gov/pub/irs-pdf/p970.pdf>). Another possibility is

to set up a trust naming a trustee to manage assets until the child reaches financial maturity.

Summary

A custodial account is savings account at a financial institution (such as a bank or credit union), mutual fund company or brokerage firm controlled by a custodian for a minor in Montana who has not reached the age of 21. The Montana Uniform Transfers to Minors Act (UTMA) applies to gifts of property to a child while the transferor is alive, as well as a bequest in a written will. UTMA also applies to distributions to a custodial account for the benefit of a child from a trust arranged while the person making the gift is alive or from a testamentary trust established by a will.

Consult an estate planning or tax attorney, certified public accountant or other financial planning professional for legal and tax implications of custodial accounts specific to your situation.

Acknowledgment

Representatives from the following professional associations have reviewed this MontGuide:

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

Disclaimer

This publication is not a substitute for legal advice. Rather, it provides information about custodial accounts made possible by the Montana Uniform Transfers to Minors Act. Future changes in laws are not predictable. Statements within this fact sheet are based solely upon those laws in force on the date of the publication.

References

Montana Code Annotated 2019, Title 72, Chapter 26, Parts 5 – 8.
https://leg.mt.gov/bills/mca/title_0720/chapter_0260/parts_index.html



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