« Advisor Insights

5 Reasons to be Skeptical of UTMA Accounts

Daniel Timins, CFP® | April 18, 2018

Parents and grandparents sometimes look for tax-efficient ways to give money to younger family members while also minimizing legal fees. The challenge arises where the recipient is a minor, because minors cannot own property in their own name until age 18, with some exceptions.

A Uniform Transfer to Minors Act (UTMA) account, which leaves funds to the child when he/she turns 21, used to be viewed as an appropriate way to leave funds to the minor when they reached adulthood. However, UTMAs do not protect the beneficiary from themselves, or family detractors, creditors or future changes in the law. In my professional experience, UTMA accounts almost never fulfill the donor's desired end result.

UTMAs are inexpensive. You only need to set up the account at a financial institution, name an adult custodian for the account, and let the custodian buy a suitable investment. No complex trust documents are necessary. In addition, UTMAs are taxed at the income tax rate of the child, who tends to have a low-income tax rate. But if this was the entire story, UTMA accounts would be the preferred way of cheaply transferring funds to a minor. But it is not. Here are five reasons why using UTMA accounts are not a sound financial decision. (For related reading, see: *A Closer Look at Custodial Accounts*.)

1. Bad Custodians

The named custodian either makes transferring the funds an unimportant activity, does not invest UTMA funds appropriately, or feels the beneficiary is not responsible enough to receive the funds and chooses to not inform the beneficiary of the account when the beneficiary turns 21. And since a custodian is a fiduciary, not informing the beneficiary is a breach of the custodian's fiduciary duty and could be subject to legal liability.

2. Bad for Wayward Beneficiaries

Today's world is complicated, enticing and expensive. Twenty-one year olds are often too young to receive substantial funds without supervision. In addition, the beneficiary may have substance abuse or creditor issues. and the funds are now theirs without restraint. The beneficiary can legally compel the custodian to transfer the funds - meaning the UTMA proceeds are not spent in a way the donor would have approved.

3. Bad for Benefits

UTMA funds are includable on a FAFSA form, so significant amounts in an UTMA can hurt student aid. But 529 plan assets owned by anyone other than a parent, do not effect aid. If education funding is the primary goal of the transfer, it's better to leave funds in a 529 plan.

UTMA beneficiaries can't be changed. If worst comes to worst, 529 plan beneficiaries can be changed. If the beneficiary is receiving Medicaid or some other benefit when he/she reaches 21 (remember, some illnesses such as bipolar disorder and clinical depression don't manifest until adolescence) the UTMA funds will be included in the beneficiary's resources, thereby invalidating benefits.

4. Bad for Estate Taxes

Beneficiaries hold constructive title in UTMA funds when they are minors, which vests when they turn 21. However, because the custodian controls the funds until this time, the assets in UTMAs are included in the estate of a deceased custodian for estate tax purposes. This is the opposite of 529 plans, where the funds can still be withdrawn from the plan (with penalties) and are typically outside of the owner's estate for estate tax purposes.

5. Bad for Keeping Track

Because the custodian is the sole recipient of UTMA account statements, if the custodian dies or does not update address changes, the beneficiary may never find out about the account. Remember that the financial institution usually does not ask for the beneficiary's address and does not send them a statement, so UTMA accounts can hang in the lurch for years.

Other Reasons

- UTMA accounts may generate enough money that the child will need to file federal and state income tax returns.
- UTMA custodianship may be contested in a divorce of the child's parents.
- Death of the beneficiary often leads to the UTMA becoming the child's only asset in their estate and any one of several other unforeseen issues.
- Except for the most minimal of transfers, UTMA accounts almost never fulfill the desired end result of properly transferring wealth to another individual.

While I appreciate that clients want to save funds by not having to pay legal fees for every substantial gift they make to a beneficiary, UTMAs are another example of attempting to be penny wise and pound foolish. In my opinion a suitable trust, which allows for written contingencies and future flexibility, always trumps the staunch and inflexible rules governing UTMA accounts. (For more from this author, see: *Why Your Estate Shouldn't Be Your IRA Beneficiary*.)

Disclosure: Attorney Advertising. Please note that prior results do not guarantee a similar outcome. This site and any information contained herein are intended for informational purposes only and should not be construed as legal advice. Seek competent legal counsel for advice on any legal matter.

Timins, Daniel
New York, NY
www.TiminsLaw.com