Investment Accounts for Minors

Understanding UGMAs and UTMAs

The Uniform Gifts to Minors Act (UGMA) and the Uniform Transfers to Minors Act (UTMA) are sometimes called the “granddaddies” of college savings accounts. Both allow parents to establish custodial accounts for a minor child, and a grandparent can then make gifts to the account. Because the account is in the name of the child, the tax liability is often shifted to the child, who presumably is in a lower tax bracket than the grandparent or the grandchild's parents. Gifts to such accounts are irrevocable, but the gift-giver retains control of the money and decides how it will be invested.

UGMA and UTMA differ in the type of property they permit a person to transfer: States usually restrict UGMA investments to life insurance, cash and certificates of deposit, while UTMA allows a wider variety of investments, including mutual funds, stocks, bonds, real estate -- even artwork. Banking institutions and brokerage firms offer UGMA and UTMA accounts.

Either type of account should be managed by someone other than the parent; otherwise, the parent will be responsible for taxes on the account income. For children, or students under age 24, income below $1000 is not taxed, income from $1000 through $2,000 is taxed at the child's rate, and income over $2,000 is taxed at the grandparent's rate (figures for 2015).

The major downside of these accounts is that custodians must turn the money over to the child when he or she reaches the age of majority (18 or 21, depending on the state). The child may then do as he or she wishes with the money -- and it may not be what you would prefer. In addition, as with custodial accounts, the child's sudden ownership of the account funds could jeopardize his or her eligibility for financial aid for college.

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