Advisor Article

An Overview of UGMA and UTMA Accounts

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Introduction

Uniform Gifts to Minors Act (UGMA) and Uniform Transfers to Minors Act (UTMA) accounts are custodial investment accounts that allow parents, grandparents, relatives, and other individuals to transfer assets to a minor child. These accounts provide a relatively simple way to establish savings and investment funds for children while allowing an adult custodian to manage the assets until the child reaches the age of maturity specified under applicable state law.

Unlike 529 plans and Section 530A (Trump) Accounts, UGMA and UTMA accounts are not specifically designed for education savings or retirement planning. Instead, they provide a flexible way to transfer assets to a child for any purpose that benefits the child. Once assets are transferred into the UGMA/UTMA account, they legally belong to the child, even though an adult manages the investments and distributions while the child is under the applicable custodial age.

UGMA and UTMA accounts can be useful tools for family gifting, investment education, and transferring wealth to younger generations. However, families should understand their contribution rules, tax implications, ownership structure, beneficiary requirements, and distribution restrictions before establishing an account.

Understanding UGMA and UTMA Accounts

UGMA and UTMA accounts operate under state laws that establish rules for transferring and managing assets belonging to minors. These laws may vary by state, and tax rules can change.

Uniform Gifts to Minors Act (UGMA). UGMA accounts were established to allow adults to transfer certain financial assets to minors without creating a formal trust. Traditionally, these accounts have been used for cash, stocks, bonds, mutual funds, and other financial securities.

Uniform Transfers to Minors Act (UTMA). UTMA legislation expanded the types of property that could be transferred to minors. Depending on state law, UTMA accounts may hold a broader range of assets, including real estate, certain business interests, and other forms of property.

UTMA legislation has been adopted in most states and generally provides greater flexibility than the original UGMA legislation.

Both account types have the same basic structure:

- A donor transfers assets into the custodial account.
- A minor is designated as the account beneficiary.
- An adult custodian manages the account on behalf of the minor.
- The custodian invests and administers the assets for the child's benefit.
- The beneficiary receives control of the assets when the applicable custodial period ends.

Although the terms UGMA and UTMA are often used interchangeably, the specific account structure and applicable rules depend on state law and the financial institution administering the account. Families should consult their financial advisor, tax professional, and estate planning attorney before making substantial custodial gifts.

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Contribution Limits and Funding Rules

One of the advantages of UGMA and UTMA accounts is that there is no federally established annual contribution limit. However, although there is no specific annual contribution limit, federal gift tax rules must be considered.

Parents, grandparents, relatives, friends, and other individuals can contribute to a custodial account on behalf of a minor. Contributions can consist of cash, stocks, bonds, mutual funds, and other eligible assets, depending on the account type and custodian.

Annual gift tax exclusion. For 2026, an individual can generally gift up to $19,000 per recipient without using any of their lifetime gift and estate tax exemption. Married couples can generally give up to $38,000 per recipient if both spouses make qualifying gifts.

Contributions exceeding the annual exclusion may require the donor to file a federal gift tax return (Form 709). However, exceeding the annual exclusion does not automatically mean gift tax is owed. The excess generally reduces the donor's remaining lifetime gift and estate tax exemption.

Important ownership consideration. Unlike a 529 plan, contributions to UGMA and UTMA accounts are generally irrevocable. Once the gift is made, the donor cannot take the assets back or change the beneficiary simply because circumstances change. This makes it important for families to consider the potential consequences of transferring assets into a custodial account before making substantial contributions.

Tax Treatment of UGMA and UTMA Accounts

UGMA and UTMA accounts are taxable investment accounts. Unlike 529 plans, which offer tax-free withdrawals for qualified education expenses, custodial accounts do not provide tax-free investment growth.

However, because the assets legally belong to the child, investment income is generally reported under the child's Social Security number and may be taxed at the child's applicable income tax rates.

Interest, dividends, and capital gains. Investment income generated within a custodial account may include:

- Interest from savings accounts and bonds.
- Dividends from stocks and mutual funds.
- Capital gains from the sale of appreciated investments.
- Distributions from mutual funds and other investment holdings.

These earnings are generally taxable to the child, even though the custodian manages the account.

The Kiddie Tax. One of the most important tax considerations associated with UGMA and UTMA accounts is the federal Kiddie Tax. The Kiddie Tax was established to prevent parents from shifting large amounts of investment income to their children simply to take advantage of lower tax brackets.

Under the Kiddie Tax rules, a child's unearned income above the applicable annual threshold may be taxed at the parents' marginal income tax rate. For 2026, the general federal framework provides:

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- The first $1,350 of a child's unearned income is generally covered by the child's standard deduction.
- The next $1,350 is generally taxed at the child's tax rate.
- Unearned income above $2,700 may be subject to the Kiddie Tax and taxed at the parents' marginal rate, assuming the child meets the applicable eligibility requirements.

These thresholds are subject to annual inflation adjustments.

The Kiddie Tax generally applies to children under age 19 and full-time students under age 24, subject to additional requirements and exceptions.

Capital gains considerations. If appreciated investments are sold within the custodial account, the resulting capital gain is generally taxable to the child. Depending on the child's income and circumstances, the gain may be subject to the Kiddie Tax. This is particularly important when transferring highly appreciated securities into a custodial account. Families should consider the potential tax consequences before selling investments or making substantial changes to the portfolio.

Tax reporting. Depending on the child's income and circumstances, the child may need to file an individual income tax return. In certain situations, parents may be able to elect to report a child's qualifying interest and dividend income on their own return using IRS Form 8814.

Families should consult a tax professional to determine the most appropriate reporting method.

Account Ownership and the Role of the Custodian

One of the most important characteristics of UGMA and UTMA accounts is the distinction between legal ownership and account management.

The child owns the assets. Once a contribution is made, the assets legally belong to the minor. The donor cannot reclaim the money, redirect it to another beneficiary, or use it for personal purposes.

The custodian manages the account. A parent, grandparent, or another responsible adult is generally designated as the custodian. The custodian is responsible for managing the investments and making decisions in the child's best interest.

The custodian's responsibilities generally include:

- Selecting and monitoring appropriate investments.
- Maintaining accurate account records.
- Making distributions that benefit the minor.
- Avoiding transactions that improperly benefit the custodian or other family members.
- Preserving the assets until the beneficiary becomes legally entitled to control them.

The custodian has a fiduciary responsibility to manage the account for the benefit of the child. Although the custodian has investment and administrative authority, the assets cannot be treated as the custodian's personal property.

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Account ownership versus account control. This distinction is especially important when planning for a child's future. Parents may establish and manage an account, but they cannot determine how the child will spend the money after the custodianship terminates.

For example, a parent might establish a UTMA account to help pay for a child's college education. However, once the child reaches the applicable termination age, the child gains control of the assets and may decide to use the money for purposes unrelated to education. This lack of long-term parental control is an important consideration when comparing custodial accounts with 529 plans or irrevocable trusts.

Funding Strategies and Investment Considerations

UGMA and UTMA accounts can be funded in several ways, making them flexible tools for family gifting and wealth transfers.

Cash contributions. Parents and grandparents can make regular cash contributions to build an investment portfolio over time. Monthly or annual contributions can help establish a disciplined savings strategy.

Gifting appreciated securities. One particularly attractive strategy is transferring appreciated stocks, bonds, or mutual fund shares into a custodial account rather than making a cash gift.

For example, a grandparent who owns appreciated stock may transfer shares directly into a grandchild's UTMA account. This can accomplish several objectives:

- Transfer wealth to a younger generation.
- Potentially remove the gifted assets from the donor's taxable estate.
- Avoid triggering an immediate capital gains tax simply because the shares are gifted.
- Allow the investments to remain invested for the child's benefit.

However, the child generally receives the donor's carryover cost basis in gifted securities. If the investments are eventually sold, the capital gain may be taxable to the child, subject to applicable Kiddie Tax rules.

Birthday and holiday gifts. Relatives and family friends can contribute to custodial accounts instead of giving cash or physical gifts. This can help establish a long-term investment fund while encouraging children to develop an understanding of saving and investing.

Investment selection. Unlike 529 plans, which generally offer plan-specific investment portfolios, UGMA and UTMA accounts typically allow access to a broader range of investment choices, depending on the financial institution.

Potential investments include:

- Individual stocks.
- Bonds and fixed-income securities.
- Mutual funds.
- Exchange-traded funds (ETFs).
- Cash and money market investments.

The investment strategy should reflect the child's age, the account's intended purpose, the time horizon, and the potential need for liquidity.

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A diversified portfolio can help manage investment risk. However, because the child eventually receives control of the assets, families should also consider whether the investment strategy should become more conservative as the beneficiary approaches the termination age.

Coordination with other savings vehicles. Custodial accounts should generally be evaluated alongside other savings options rather than used as the sole method of saving for a child. For example, parents may use a 529 plan for education expenses while maintaining a UTMA account for more flexible financial gifts. This approach allows families to separate education savings from assets intended for broader future needs.

Beneficiary Rules and Age of Termination

UGMA and UTMA accounts are established for one specific minor beneficiary. Unlike traditional 529 plans, the beneficiary generally cannot be changed simply because another child needs the money.

This is an important distinction for families with multiple children.

If a child receives a scholarship, decides not to attend college, or otherwise does not need the funds for their original intended purpose, the custodian cannot transfer the assets to a sibling. The assets must continue to be used for the original beneficiary's benefit.

When does the child receive control?

The age at which custodial control terminates depends on the applicable state law and the type of property transferred.

In many states, the custodianship terminates when the beneficiary reaches age 18 or 21. Some states allow certain transfers to remain under custodial management until a later age. Therefore, families should review the governing state statute and account documentation when establishing a custodial account.

Once the custodianship terminates, the custodian must transfer the assets to the beneficiary. The beneficiary then has complete control over the account and can decide how the money will be invested or spent.

This can create both opportunities and risks. A financially responsible young adult may use the funds for college, a first home, or other long-term financial goals. However, there is no requirement that the beneficiary use the money for those purposes.

For families who want to maintain greater control over the timing and purpose of distributions, a properly structured trust may be a more appropriate alternative.

Distribution Guidelines and Permitted Uses

One of the most attractive features of UGMA and UTMA accounts is their flexibility regarding distributions.

Unlike 529 plans, custodial accounts are not restricted to qualified education expenses. While the account owner is a minor, distributions may generally be made for any purpose that benefits the minor. Examples include:

- College tuition and educational expenses.
- Computers, books, and school supplies.

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- Summer educational programs.
- Medical and dental expenses.
- Certain extracurricular activities.
- Other purchases or services that benefit the child.

However, the custodian must always act in the child's best interest.

Restrictions on distributions. Although the rules are relatively flexible, the custodian cannot use account assets to satisfy personal financial obligations or improperly benefit themselves.

For example, a parent generally cannot withdraw money from a child's UTMA account simply to pay the parent's mortgage, personal credit card bills, or other household expenses.

The custodian should also be careful about using custodial funds for expenses that the parent is legally obligated to provide, such as ordinary parental support obligations. The precise treatment can depend on state law and the circumstances.

Documentation and recordkeeping. Custodians should maintain records of withdrawals and document how distributions benefit the minor. This is especially important when making larger distributions or using funds for expenses that could benefit multiple family members.

What happens when the child reaches the termination age? Once the child reaches the applicable age, the custodianship ends and the assets are transferred to the beneficiary. At that point, the former custodian no longer has authority to direct how the assets are used.

Financial aid considerations. Another important consideration is the potential effect on college financial aid. Under federal financial aid methodology, UGMA and UTMA assets are generally treated as student assets rather than parental assets. Student assets can have a greater impact on financial aid eligibility than assets held by parents.

Consequently, families planning for college should consider the potential financial aid implications before making substantial custodial account contributions. A custodial account may provide flexibility and tax advantages in certain circumstances, but it may also reduce eligibility for need-based financial aid.

Advantages and Disadvantages of UGMA and UTMA Accounts

Before establishing a custodial account, families should weigh the benefits against the potential disadvantages.

Advantages	Disadvantages
No federal annual contribution limit.	Contributions are irrevocable gifts.
Assets can be used for purposes beyond education.	Beneficiary generally cannot be changed.
Simple and inexpensive to establish.	Child receives control at the applicable termination age.
Investment income may receive favorable tax treatment at lower income levels.	Kiddie Tax may apply to investment income.

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Wide range of investment choices.	Assets are generally treated as student assets for financial aid.
Appreciated securities can be gifted.	Parents cannot reclaim assets or control how they are spent after termination.

Summary

UGMA and UTMA accounts can be valuable financial planning tools for families seeking to transfer wealth to children while providing an opportunity for long-term investment growth. Their flexibility, relatively straightforward administration, and ability to accept a variety of assets make them attractive alternatives to traditional education savings accounts. They can also provide grandparents and other family members with an effective way to make financial gifts to younger generations.

However, the irrevocable nature of contributions and the eventual transfer of control to the beneficiary are important considerations. Parents and grandparents should understand that assets placed in a custodial account legally belong to the child and cannot be redirected to another beneficiary.

Tax treatment is another important factor. Although investment income may receive favorable tax treatment at lower income levels, the Kiddie Tax can significantly reduce the tax advantages when investment income exceeds applicable thresholds.

Ultimately, UGMA and UTMA accounts should be evaluated within the context of a family's broader financial, education, and estate planning objectives. When used appropriately, they can provide an effective means of transferring assets, teaching children about investing, and establishing a financial foundation for adulthood.

Resources

1. Office of the Comptroller of the Currency – What Is a UGMA or UTMA Account? Provides an overview of custodial account ownership and administration.
2. FINRA Regulatory Notice 20-07 – UGMA/UTMA Accounts Discusses custodial responsibilities, irrevocable transfers, and account termination.
3. IRS – Frequently Asked Questions About Gift Taxes Explains annual gift tax exclusions and gift reporting requirements.
4. IRS – Kiddie Tax Rules for 2026 Provides information on the taxation of children's unearned income.

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