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CHAIR'S MESSAGE

Dear Members,

It was a pleasure to see many of you at the Annual Meeting in Virginia Beach. This year, the Family Law Section presented CLE lectures titled, "Will it Ever End? Handling Post-Divorce Issues" and also co-sponsored with the Virginia Joint ADR Committee a CLE presentation titled, "Making Peace at Home for Our Veterans: Skills to Enhance Serving Veterans in Family Law and Other Civil Disputes." During our business meeting at the beach, the Family Law Section elected the following officers for 2013-14: Carl J. Witmeyer, II (Chair), Richard Garriott Jr. (Vice-Chair), and Charles E. Powers (Secretary). I will continue to serve the Section as Immediate Past Chair. New members were elected to the board: Christopher Malinowski (Fairfax), Mary Commander (Norfolk), John Huntington (Christianburg), Judge Richard Wallerstein, Jr. (Circuit Court, Henrico County), and Judge Glen Huff (Court of Appeals of Virginia).

I would like to personally thank Dolly Shaffner, our VSB staff liaison, who keeps this section running day to day. I would also like to welcome Carl Witmeyer as our next Chair. I know that he has many wonderful things planned for us next year.

And I would like to personally thank our exiting board members, William Scott, IV, Judge Rossie Alston, Jr., and Judge Frederick Rockwell, III, for their hard work, dedication, and service during the past four years.

As I sit down to write my last Chair's Message, I again want to encourage our members to become involved with the State Bar and the Family Law Section. During my term on the Board of Governors, I met many hard-working attorneys who exemplify professionalism and civility; it has truly been an honor and privilege. It has also been a thoroughly enjoyable experience, both personally and professionally.

Have a wonderful summer!

Very Truly Yours,

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What Do You Mean It's Not the Child's Money?

College Accounts in Equitable Distribution

By Lawrence Vance, Winchester, and Adrian Taylor, CPA, Winchester

Between the 1999 and 2009 academic years, the cost for undergraduate tuition, room, and board at public institutions rose 37 percent, with comparable costs at private institutions up 25 percent.[2] Couples can have many different plans to save for these expenses. Two common methods of saving for a child's higher education are transferring money to the child though a Uniform Transfers to Minors Accounts and doing it through a Qualified Tuition Program. While both types of plans provide savings for college expenses, the two methods receive vastly different treatment in divorcing parents' equitable distribution.

Uniform Transfers to Minors Act

The older of the two plans is the use of custodial accounts under the Uniform Transfers to Minors Act (UTMA)[3] and its predecessor, the Uniform Gifts to Minors Act (UGMA). There is no contribution limit to a UGMA or UTMA.[4] A transfer to a child under Virginia's Uniform Transfers to Minors Act (UTMA) is an irrevocable gift for the benefit of the child.[5]

Ownership of the account belongs to the child with a custodian established to control the account for the minor. A few states allow joint custodianship for UGMAs and UTMAs but most restrict custodianship to one account owner. Regardless, the custodianship automatically terminates when the child reaches the age established under individual state law, generally 18 or 21. Thereafter the child, as the owner, is free to spend the money however he or she may choose.[6]

The custodian is required to keep all UTMA funds separate and distinct, using a statutory standard of care in the investment of the funds with certain record keeping requirements.[7] The custodian retains all authority over the funds that "an unmarried adult owner" would have.[8] The person providing the funds, an adult member of the minor's family, a guardian of the person of the minor, the conservator of the minor, or the minor, if the minor has attained the age of 14 years, may petition the court to remove the custodian of the account for cause and to designate a successor custodian, and for an accounting.[9]

Earnings in UGMAs and UTMAs are taxed as ordinary income of the child, subject to the "Kiddie Tax Rules".[10] However, the funds are not limited to education expenses. They merely need to be used for the "benefit" of the child.

Qualified Tuition Programs

The more recent method is the qualified tuition program. These programs are also called §529 Plans, getting their name from Section 529 of the Internal Revenue Code which establishes federal tax advantages for certain college savings plans.

§529 plans come in two basic types: prepaid programs and savings programs. Virginia offers one prepaid program: the Virginia Prepaid Education Program (VPEP) and offers three savings programs:

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2 U.S. Department of Education, National Center for Education Statistics. (2011). *Digest of Education Statistics, 2010* (NCES 2011-015), *Chapter 3* . (adjusted for inflation)

3 Virginia Code §§64.2-1900, 64.2-1922, re-codification effective October 1, 2012.

4 Depending on the size of the contribution, the donor may have to file a gift tax return which might result in the payment of gift taxes.

5 Virginia Code §64.2-1903, re-codification effective October 1, 2012.

6 The child upon reaching the legal age becomes the account owner of assets in a §529 plan that was liquidated from a UGMA or UTMA account.

7 Virginia Code §64.2-1911, re-codification effective October 1, 2012.

8 Virginia Code §64.2-1912, re-codification effective October 1, 2012.

9 Virginia Code §§64.2-1917 to 1918 , re-codification effective October 1, 2012.

10 Department of the Treasury, Internal Revenue Service Publication 929, Tax Rules for Children and Dependents.

the Virginia Education Savings Trust (VEST), College America with American Funds, and College Wealth with Virginia's §529 bank partners.[11] There is a $350,000 account limit per beneficiary across all Virginia §529 programs held for that child.[12] Virginia §529s grow tax free and are tax free when distributions are made for qualified higher education expenses defined for §529 plan purposes.[13] In addition, they are eligible for a Virginia income tax deduction for the account owner.[14]

The VPEP contract can be cancelled by the owner at any time with a return of payments, reduced by a service fee. After three years the plan can be cancelled and the refund will include all payments plus a reasonable rate of return.[15] If distributions from a VEST account exceed the qualified education expenses, a portion of the earnings (or all of the earnings if none of the distributions were used for qualified education expenses) will be taxable at the taxpayer's federal and state marginal income tax rates, plus an additional 10% federal tax on the earnings. The principal portion is not subject to tax or penalty. [16]

Coverdell Education Savings Accounts (ESA) are yet another §529 option to fund qualified education expenses with federal tax advantages. [17]Coverdell ESAs have a $2,000 annual contribution limit subject to modified adjusted gross income limitations and also limited to $2,000 for each beneficiary regardless of the number of Coverdell ESAs set up for that beneficiary. [18] The Coverdell ESAs also grow tax free and distributions are tax free if they are used for qualified education expenses.[19] Definitions of qualified education expenses vary between plans.

Commonly, a §529 is owned by a parent individually, not as the custodian for the child. The Virginia §529 account owner controls the account assets and distributions. There can only be one account owner per account. The person who may benefit from the Virginia §529 is the beneficiary.[20] Virginia §529 account benefits may be transferred tax free to a member of the current beneficiary's family without tax consequences.[21] However, the contributions and earnings on the account can be withdrawn by the account owner subject to taxation at the account owner's marginal tax rate on the earnings, a 10% tax penalty on the owner's Federal return.[22]

Treatment in Divorce

Unless the divorcing couple are in agreement[23], courts faced with the presentation of college accounts in the context of the parent's divorce are tempted to treat the parties' contributions toward college savings accounts as money that belongs to the children, or direct that the money be used only for the children.[24] Courts typically may direct that both UTMA accounts and §529 accounts be held for the benefit of the children.

In the case of UTMA accounts, the typical court direction to hold the account for the benefit ignores the basic nature of UTMA accounts: that the child, and not the custodian, is the owner of the account. The value of the account is not owned by a party to the divorce and not subject to equitable distribution.[25]

[11] Virginia 529 College Savings Plan – 2011/2012 Program Guide, Key Terms, page 2.

[12] Virginia 529 College Savings Plan – 2011/2012 Program Guide, VA529 Program Comparison Chart, page 4. Depending on the size of the contribution, the donor may have to file a gift tax return which might result in the payment of gift taxes.

[13] Department of the Treasury, Internal Revenue Service Publication 970, Tax Benefits for Education, Chapter 8.

[14] 2011 Virginia Form 760 Residential Individual Income Tax Booklet, Deductions from Income, page 22.

[15] Virginia Prepaid Education Program – Master Agreement, Article VII, ¶6.

[16] Department of the Treasury, Internal Revenue Service Publication 970, Tax Benefits for Education, Chapter 8.

[17] Department of the Treasury, Internal Revenue Service Publication 970, Tax Benefits for Education, Chapter 7.

[18] Department of the Treasury, Internal Revenue Service Publication 970, Tax Benefits for Education, Chapter 7.

[19] Department of the Treasury, Internal Revenue Service Publication 970, Tax Benefits for Education, Chapter 7.

[20] Virginia 529 College Savings Plan – 2011/2012 Program Guide, Key Terms, page 2.

[21] Department of the Treasury, Internal Revenue Service Publication 970, Tax Benefits for Education, Chapter 8. There are limitations to the number of rollovers allowed for the same beneficiary within a 12 month period.

[22] See 26 U.S.C. §§529(c)(6), 530(d)(4)(federal penalties)

[23] The parties would be bound by any marital separation agreement; the scope of this article is limited to those situations where there is no agreement between the parties.

[24] See e.g., *Johnson v. Johnson,* Fairfax County Circuit Court, Docket #CL2009-18023, February 7, 2011.

[25] *Hyder v. Hyder,* 2006 Ohio 5285 (2006) holding a properly established UTMA account removed the accounts from being marital property subject to division.

A divorce court does not have subject matter jurisdiction to make an order directing a custodian to manage a UTMA fund in a certain way, particularly since the statutory requirement is that the account only need be used for "the benefit" of the child.

A more problematic result occurs when a court directs that the §529 college savings account is to remain in a party's name, to be used only for the children's education, thereby leaving those accounts out of the marital estate. In doing so, a court ignores the nature of the account and the inherent limitations on the court's power in a divorce proceeding.

In the unpublished case of *Jacobson-Kaplan v. Kaplan*[26], a panel of the Court of Appeals affirmed a trial court's inclusion of the balances of the children's Cloverdale §529 college accounts[27] in the equitable distribution of the martial estate. The accounts were established and funded during the time of the marriage. The funds in these accounts, not unlike funds held in Individual Retirement Accounts, can be withdrawn at any time by the account holder, albeit after payment of a penalty and certain tax consequences. Despite the intended purpose of the savings plan to be used for the college education of the children, the Court reasoned that these accounts remained marital property subject to distribution because they remained *de facto* savings accounts due to the revocable nature of the account.[28]

Citing *Wooley v. Wooley*[29], the Court further opined that, since it is beyond the power of the Court to distribute property to any person other than the parties in a divorce, the trial Court is prohibited from distributing those accounts to the children.[30] "Code §20-107.3 does not authorize the court to make an equitable distribution of marital property to a non-party."[31] Furthermore, the statute does not allow a court to create a trust against property being transferred or delay the payment of an interest in the marital estate.[32]

The Vermont Supreme Court also used the revocable nature of §529 accounts as the reason to include those accounts in the marital estate for equitable distribution in *Drumheller v. Drumheller*.[33] The Vermont Court reasoned that the power of revocation, even if subject to a penalty, is ownership. The Court noted that UTMA-type accounts are fundamentally different: such an account is the product of an irrevocable gift, creating an indefeasible interest for the child, and therefore is not part of the marital estate.[34]

Under the reasoning of *Jacobson-Kaplan* and *Drumheller*, if non-UTMA college savings accounts are included in equitable distribution of the martial estate, the consequence is that the account holder in the divorce retains ownership of the accounts, as well as having the value of those accounts included in his or her portion of the proceeds of the divorce.[35]

However, such accounts are also fundamentally unlike defined contribution retirement accounts (IRAs, §401(k)s, etc.), in which any value upon revocation, as well as the future use, belong to the owner. If the non-UTMA college savings account is used for the purpose intended, the educational expenses of the child, the owner does not receive the future use of money which was included in that spouse's portion of the marital estate in equitable distribution. Even though it is not the children's money, the only financial value to the owner of the account, in light of the unique nature of a §529 account, is the value of the account, less the penalties required to convert the use of the funds back to the owner.

So it is not really the child's money. It is the parent's, but the account-holding parent, having the value included in his or her portion of the marital estate, will never have the benefit of the money unless that person should take the money from the child.

[26] *Jacobson-Kaplan v. Kaplan,* Record No. 0509-05-1 (Va. App., 2005).
[27] The children's accounts in this case were Mississippi Prepaid Affordable College Tuition plans (MPACT).
[28] Id. at 9.
[29] *Woolley v. Woolley,* 3 Va. App. 337, 349 S.E.2d 422 (Va. App., 1986)
[30] *Kaplan* at 10.
[31] *Woolley* at 341, 349 S.E.2d at 425.
[32] *Stroop v. Stroop,* 10. Va. App. 611, 616, 394 S.E.2d 861, 864 (Va. App., 1990).
[33] 972 A.2d 176 (Vt., 2009)
[34] Id. at 195.
[35] Virginia Code §20-107.3(C)