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North Carolina Enacts The Uniform Transfers To Minors Act

"The manner of giving is worth more than the gift." 1

Gifts to minors, either outright or through the use of trusts and guardianships, have long been used as a means by which donors can exercise their generosity, shift income-producing and appreciated property to achieve income tax benefits, and reduce the donor's wealth for estate planning purposes. Statutes authorizing and governing custodial accounts 2 were originally enacted to facilitate the giving of gifts of securities to minors without the expense, legal involvement, and tax implications of a trust, and to avoid the problems inherent in an outright gift to a minor. 3 These problems previously had discouraged, and in some cases prevented, small gifts of securities to minors. 4

In 1987, the North Carolina General Assembly repealed its custodianship statute 5 and enacted the North Carolina Uniform Transfers to Minors Act (UTMA), which became effective October 1, 1987. 6 The UTMA increases the allowable duration of a minor's custodial account and, by broadening the scope of permissible custodial property, affords greater flexibility to the account as an investment and tax planning vehicle. This Note will review the UTMA's modifications, the consequential implications for gift giving, and the general assembly's rationale for the changes. In addition, the Note will examine taxation issues raised and unresolved by the UTMA. Finally, the Note will critique the underlying policy of the UTMA and suggest improvements to the current statute.

Before statutory custodial accounts became available, a donor could transfer property by an outright gift to the minor or by transferring the property to a guardianship account or trust for the minor. 7 Outright gifts to the minor may be ill-advised for large transfers and transfers of securities. Donors often hesitate to place large amounts of property in the hands of financially irresponsible donees. In addition, the minor may be limited in his effective management of the property by a prohibition against registration of securities in a minor's name 8 and the reluctance of third parties to deal with the minor because of his

2. A custodial account is a vehicle by which a donor may transfer property to a minor. An adult custodian manages and distributes the property for the minor until the minor reaches majority, at which time the account is terminated and custodial property is delivered to the minor.
3. See infra notes 8-9 and accompanying text.
4. UNIF. GIFTS TO MINORS ACT, prefatory note, 8A U.L.A. 405-06 (revised 1966).
7. See UNIF. GIFTS TO MINORS ACT, prefatory note, 8A U.L.A. 405-06 (revised 1966).
8. See S. KESS, CCH ESTATE PLANNING GUIDE ¶ 135 (1987). Although commentators recognize the lack of statutory or judicial support for an issuer's refusal to register securities in a minor's name, they nonetheless encourage issuers to refuse such registration in order to avoid the risks associated with minor registrants. C. ISRAELS & E. GUTTMAN, MODERN SECURITIES TRANSFERS ¶ 13.07 (1967). These risks include the minor's power to avoid a transaction in the security and the
inability to execute a binding contract.\textsuperscript{9}

Trusts and guardianships are not wholly satisfactory alternatives to outright gifts. Guardianships are expensive and inflexible investment and tax planning vehicles.\textsuperscript{10} In addition to the attending legal involvement, the fiduciary responsibilities,\textsuperscript{11} and the investment limitations involved in a trust,\textsuperscript{12} a trust may be a deficient vehicle for shifting and reducing income tax liability. Income accumulated in the trust is taxed to the trust, in many instances at a rate higher than the donor's individual rate.\textsuperscript{13} The Tax Reform Act of 1986 further reduced the income-shifting benefits of a trust by providing that gains from the sale of appreciated property transferred to the trust will be taxed at the grantor's marginal rate if the property is sold within two years of transfer.\textsuperscript{14}

The enactment of statutes authorizing custodial accounts for minors provided a simple, effective means to transfer property to a minor without the use of a trust, while insuring that the property will be controlled by a responsible adult chosen by the donor until the child reaches maturity. In 1955 North Carolina enacted a custodianship statute—later titled the Uniform Gifts To Minors Act (UGMA)—to facilitate the transfer of securities to minors without the problems inherent in trusts, guardianships, and outright gifts.\textsuperscript{17} The UGMA allowed an adult donor to transfer securities to a minor simply by delivering or registering the securities in the name of any adult member of the minor's family or in the name of the minor's guardian as custodian for the minor.\textsuperscript{18} Such gifts

potential invalidity of corporate actions effected by the vote or consent of an infant who may later repudiate that consent. \textit{Id.}

\textsuperscript{9} See Restatement (Second) Of Contracts § 14 (1981) (infant may disaffirm contract executed prior to age eighteen absent statutory restriction).


\textsuperscript{11} A trustee, for example, must file annual fiduciary income tax returns, and may be required to file annual accountings with the clerk of court. \textit{Id.} § 36A-107 (testamentary trustee).

\textsuperscript{12} The trustee may be under a fiduciary obligation to diversify investments held in the trust. \textit{See id.} § 36A-2(b) (allowing trustee to retain property originally placed in trust only if retention satisfies fiduciary standard of care).

\textsuperscript{13} See S. Kess, supra note 8, at ¶ 135.3 (discussing taxation of trust income after 1986 Tax Reform Act).


\textsuperscript{17} See Korschun v. Clayton, 13 N.C. App. 273, 185 S.E.2d 417 (1971) (discussing impetus for North Carolina's enactment of custodianship statutes); Unif. Gifts to Minors Act, prefatory note; 8A U.L.A. 405-06 (revised 1966) (discussing rationale for states such as North Carolina to have adopted counterparts to the model act for custodianships).

The transfer therefore qualified for the annual federal gift tax exclusion. The custodian, acting under statutorily-prescribed administrative powers, duties, and immunities, would manage the custodial property and make discretionary distributions of the property to or for the minor. Income and gains from the sale of the property, with some exceptions, were taxed as earned by the minor at the minor's rate. The minor would receive the remainder of any undistributed custodial property outright upon reaching majority. This property became part of the minor's estate if the minor died prior to that time.

The popularity of the custodianship as a trust and guardianship substitute later prompted the general assembly to enlarge the scope and flexibility of the UGMA. The statute was revised to allow gifts of money and life insurance to a custodial account, as well as to permit testamentary transfers to the account. The revised UGMA permitted the donor to designate any adult or trust company as custodian, and to name successor custodians in the event the original...
nominee was unable or ineligible to serve. The revised UGMA granted broad enumerated powers to the custodian and, to encourage the appointment of nonprofessional custodians, immunized the noncompensated custodian from liability for any losses to custodial property which occurred other than through the custodian's bad faith, intentional wrongdoing, gross negligence, or breach of fiduciary duty.

Even after the revision of the UGMA, the efficacy of the custodianship as an alternative to the use of a trust or guardianship remained significantly limited. Transferors who wished to make gifts of real property, business, and property interests, or other tangible or intangible property not permitted to be held in a custodianship were restricted to the use of trusts and guardianships. Transfers to a custodianship could be made only by inter vivos gift or pursuant to an express provision in a will. In addition, the UGMA mandated termination of the custodial account and distribution of the property to the minor upon attainment of age eighteen. Transferors who were hesitant to place large amounts of property in the hands of an eighteen-year-old of indeterminate financial capability and maturity continued to utilize trust vehicles to delay disposition of the minor's funds until a later age. As trusts became less attractive receptacles for appreciated property and accumulated income, there arose a corresponding need to reform the UGMA. Other states responded to this need by expanding the permissible kinds of custodial property and by permitting transfers to custodianships from sources such as trusts.

In 1987, the general assembly enacted similar reforms through the UTMA. The UTMA allows a donor to transfer any interest in property to a
custodial account, where it will be managed and distributed by the custodian. Termination of the account can occur as late as the minor's reaching age twenty-one. Transfers to the account may be made from a trust or under a will, by a fiduciary of the donor or minor, by an obligor of the minor, or under a contract for future payment in which the donor has named the custodianship as beneficiary. All accounts held by the same custodian for the same minor must be consolidated, regardless of their date of creation or source of funds. The UTMA limits the custodian's liability to third parties from transactions occurring in the custodian's fiduciary capacity, but imposes a more stringent standard of fiduciary care than did the UGMA. Finally, the UTMA directs the custodian to consider only the minor's needs in making distributions from the custodianship.

The removal of the previous restrictions on permissible property and duration of the custodial account is the UTMA's most significant reform. The statutory age of majority for distribution of property received from an inter vivos transfer, by transfer under a power of appointment, or from a will or trust authorizing distributions to a custodial account is increased to age twenty-one unless the transferor designates an earlier age of distribution, but the transferor may not designate an age earlier than eighteen. The increased permissible duration of the custodianship may make the account amenable to larger transfers, since final distribution of the funds may be delayed until the minor is presumably more mature and, in many cases, the account has been depleted by the cost of the minor's post-secondary education. By contrast, in the several states which have refused to extend the duration of custodial accounts beyond age eighteen, the attractiveness of custodianships as a trust or guardianship substitute remains limited.

43. Id. § 33A-12, -13.
44. Id. § 33A-14.
45. See id. § 33A-20.
46. Id. § 33A-5.
47. Id.
48. Id. § 33A-6.
49. Id. § 33A-7.
50. Id. § 33A-3.
51. Id. § 33A-10.
52. Id. § 33A-17.
53. Id. § 33A-12.
54. Id. § 33A-14.
55. Id. § 33A-20 (1). Cf. CAL. PROB. CODE § 3920.5(e) (West Supp. 1988) (custodianship created under will may continue until minor reaches age 25).
57. Transferors who wish to delay the ultimate distribution of the funds until the minor reaches 21 most likely will use a § 2503(c) trust. Gifts to these trusts qualify as present interests for the annual federal gift tax exclusion under § 2503(b) of the Internal Revenue Code so long as the trust property may be expended for the minor's benefit and all unexpended amounts are delivered to the
In addition, the custodianship now may hold "any interest in property."\(^5\)\(^8\) This broad language is intended "to encompass every conceivable legal or equitable interest in property of any kind, including real estate and tangible or intangible personal property."\(^5\)\(^9\) As a result of these modifications, the custodial account now resembles "a statutory form of trust or guardianship that continues until the minor reaches 21."\(^6\)\(^0\) The UTMA also expands the permissible sources of custodial property in an effort to facilitate the use of a custodianship as an estate and tax planning device. A donor may nominate a custodian, as well as alternate custodians, to receive property such as retirement or deferred compensation benefits,\(^6\)\(^1\) or the proceeds from life insurance and annuity policies, which is transferable upon the occurrence of a future event.\(^6\)\(^2\) The nomination of the custodian does not create custodial property until the irrevocable transfer of the proceeds to the custodian is made.\(^6\)\(^3\) Even if the donor has not nominated the custodianship as recipient under the contract, the UTMA authorizes the holder of proceeds which are payable to a minor to transfer the proceeds to the custodial account.\(^6\)\(^4\) Obligors who may make this election include, for example, an insurance company holding life insurance or benefit plan proceeds payable to a minor, a tort judgment debtor of the minor, or a bank holding a joint or payable-upon-death account on which the minor is the surviving payee.\(^6\)\(^5\)

In addition to the previously authorized testamentary transfers to a custodianship, transfers now also may be made from a trust.\(^6\)\(^6\) In the absence of a designation of the custodian as recipient in the trust or will, a personal representative or trustee nevertheless may make an irrevocable transfer to the transferor, another adult, or a trust company as custodian for a minor.\(^6\)\(^7\) These transfers are allowable only if the transferor determines that payment to a custodial ac-

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60. Id. prefatory note, 8A U.L.A. at 154.

61. The ability of the transferor to shift tax liability from future income interests through the use of a custodianship is limited by the general rules governing the assignment of income. See Helvering v. Horst, 311 U.S. 112 (1940); Lucas v. Earl, 281 U.S. 111 (1930).


63. Id. § 33A-3(c).

64. Id. § 33A-7. When a custodian has not been nominated or is ineligible to serve, the obligor may transfer the property to an adult member of the minor's family or to a trust company as custodian. Such transfers are allowed only to the extent that they do not exceed $10,000 in the aggregate. Id. § 33A-7(c). Property transferred pursuant to this provision will be fully distributed to the minor at age 18. Id. § 33A-20(2).

65. See UNIF. TRANSFERS TO MINORS ACT § 7 comment, 8A U.L.A. 164 (Supp. 1983).

66. N.C. GEN. STAT. § 33A-5. The UTMA also removes the requirement that the custodian post a bond for testamentary transfers to a custodianship in excess of $10,000. Id. § 33-69.1(d) (1966), repealed by Act of July 6, 1987, ch. 563, 1987 N.C. Sess. Laws 973.

67. Id. § 33A-6. The uniform act on which the UTMA was modeled does not allow the personal representative or trustee to name herself as custodian absent specific authorization in the will or trust. See UNIF. TRANSFERS TO MINORS ACT § 6, 8A U.L.A. 163 (Supp. 1983). The UTMA allows the personal representative or trustee to make such transfers with court approval. N.C. GEN. STAT. § 33A-6 (1987).
count is in the minor's best interest, and if payment to a custodianship is not inconsistent with the terms of the applicable will, trust agreement, or other governing instrument. A spendthrift clause in the governing trust, a provision for mandatory distributions of income and principal at specific times, or a provision terminating the trust at any age other than the statutory age of majority for custodianships would be an inconsistent term precluding the trustee's election to transfer trust property to a custodianship. In the event aggregate transfers to a custodianship from a will or trust not specifically authorizing the transfer exceed $10,000, the personal representative or trustee first must obtain court approval. Property transferred without express authorization of the grantor or testator must be fully paid to the minor at age eighteen. This age of termination corresponds to the age of termination under a guardianship account, the creation of which the grantor may have contemplated in providing for an outright bequest or devise. By allowing the grantor or the grantor's fiduciary to elect payment of trust proceeds to a custodianship, the UTMA provides additional flexibility in premortem and postmortem estate planning.

Section 33A-10 of the UTMA mandates that all custodial property held by the same custodian for the same minor constitute a single custodianship. While this provision apparently requires the consolidation of accounts created under the UTMA with any existing accounts originally created under the superseded UGMA, the property held in the UGMA account at consolidation, as well as any income from that property, remains subject to statutorily required distribution to the minor at age eighteen. When custodial accounts with different termination dates are consolidated, the custodian must maintain separate records detailing which property and income is attributable to each account, and must distribute the property of each account at the appropriate date. States such as

68. Id.
70. N.C. GEN. STAT. § 33A-6(c) (1987). The requirement of prior court approval ensures that court supervision of a guardianship is not necessary.
71. Id. § 33A-20(2).
72. See id. § 35A-1225(a).
73. See id. § 35A-1227 (allowing personal representative, trustee, or obligor to petition the court for creation of guardianship for disbursements).
74. The UTMA provides for consolidation of all custodial property "held under this Chapter," N.C. GEN. STAT. § 33A-10 (1987), and further provides, "This Chapter applies to all transfers made before October 1, 1987" and pursuant to the UGMA. Id. § 33A-22(b). By contrast, the uniform act prohibits consolidation of accounts created prior to the statutory revisions with accounts created pursuant to the revised statute by allowing consolidation only of custodial property "held under this Act." UNIF. TRANSFERS TO MINORS ACT § 10 comment, 8A U.L.A. 169 (Supp. 1983). See also Smith & Woodburn, Custodianships Invigorated: The Uniform Transfers To Minors Act, 66 BOSTON B. J. Mar.-Apr. 1987, 20, 23 (drafting committee of Massachusetts statute, MASS. GEN. LAWS. ANN. ch. 201A, §§ 1-24 (West 1986), interpreting statutory language identical to consolidation language of North Carolina statute as mandating consolidation of all custodial accounts that have common custodians and beneficiaries, irrespective of date of their creation).
75. See N.C. GEN. STAT. § 33A-22(b) (1987) (providing for application of UTMA to transfers prescribed in UGMA "except insofar as the application ... extends the duration of custodianships in existence on October 1, 1987"); see Smith & Woodburn, supra note 74, at 23 (citing preservation of different statutory termination dates of custodial accounts consolidated under Massachusetts statute).
Alabama\textsuperscript{76} and California,\textsuperscript{77} as well as the drafters of the uniform act, apparently foresaw the potential administrative complexity caused by consolidating accounts with differing termination dates, and consequently do not allow the consolidation of custodianships created under the UGMA with UTMA accounts.\textsuperscript{78} The ease in managing consolidated accounts indeed may be outweighed by the corresponding record-keeping burden, particularly for a nonprofessional custodian.

The UTMA's allowance of transfers of property of any type increases the potential for claims asserted against the custodial property and creates risks of personal liability for the custodian and minor.\textsuperscript{79} In response to the increased exposure to claims against the property, the UTMA explicitly makes the minor's rights in the property subject to the custodian's statutory "rights, powers, duties and authority."\textsuperscript{80} This qualification is intended to override any homestead, dower, or community property rights which might attach to real estate or other property acquired by the minor after marriage as the result of a transfer to the custodianship for the minor's benefit.\textsuperscript{81} Although the comparable provision of the UGMA impliedly contained this qualification,\textsuperscript{82} the express language operates as additional assurance that no conflicting rights will hinder the custodian's ability to manage the custodial property.\textsuperscript{83}

The UTMA limits claims of third parties to recourse against the custodial property\textsuperscript{84} in an attempt to shield the custodian and minor from the heightened potential for personal liability caused by their holding a wider variety of property, which may now include real estate, automobiles, and business and property

\textsuperscript{76} ALA. CODE § 35-5A-11 (Supp. 1987).
\textsuperscript{77} CAL. PROB. CODE § 3910 & comment (West Supp. 1988).
\textsuperscript{78} UNIF. TRANSFERS TO MINORS ACT § 10 comment, 8A U.L.A. 169 (Supp. 1983). Even without an allowance for consolidation, the custodian may be responsible for keeping separate records if property is transferred pursuant to the UTMA but is subject to different termination dates. Compare N.C. GEN. STAT. § 33A-20(a) (1987) (termination at age 21 allowed for certain transfers) with N.C. GEN. STAT. § 33A-20(b) (1987) (mandating final distribution at age 18 if transfer from obligor, personal representative, or trustee without specific authorization of individual entitled to designate custodian as beneficiary).
\textsuperscript{79} See UNIF. TRANSFERS TO MINORS ACT prefatory note, 8A U.L.A. 154 (Supp. 1983) (discussing increased sources of liability under revised uniform act and statutory responses designed to limit that liability).
\textsuperscript{80} N.C. GEN. STAT. § 33A-11(b) (1987).
\textsuperscript{81} See UNIF. TRANSFERS TO MINORS ACT § 11 comment, 8A U.L.A. 170 (Supp. 1983). The custodial property will become subject to these rights for the first time at the termination of the custodianship. See id.
\textsuperscript{83} To facilitate this ability, the UTMA has replaced the enumerated custodial powers of the UGMA with a grant to the custodian of all the rights, powers, and authority that "unmarried adult owners have over their own property," subject to the custodian's fiduciary standard of care. N.C. GEN. STAT. § 33A-13 (1987). The comment to the corresponding provision of the uniform act states that this breadth of authority is intended to include "powers most often suggested for custodians, such as the power to borrow, . . . to invest in common trust funds, and . . . to enter contracts that extend beyond the termination of the custodianship." UNIF. TRANSFERS TO MINORS ACT § 13 comment, 8A U.L.A. 173 (Supp. 1983). By replacing the enumerated powers, the UTMA sought to be more readily understandable and accessible to the nonprofessional custodian. See id.
\textsuperscript{84} N.C. GEN. STAT. § 33A-17 (1987).
interests. This limitation may be essential for the protection of the minor, who may not be able to disclaim a transfer to a custodian on his behalf during the period of minority. Limited liability for custodians is necessary to avoid discouraging the nonprofessional volunteer from serving as custodian. A custodian still may be personally liable for actual fault or for failure to disclose his custodial capacity in his contracts with third parties. The minor incurs personal liability only for actual fault.

In contrast to the UTMA’s limitation on the custodian’s liability to third parties, the UTMA imposes a stricter fiduciary standard on the custodian than does the UGMA. The UTMA changes the standard from that of a prudent person “who is seeking a reasonable income and the preservation of his capital” to a prudent person “dealing with the property of another.” A higher standard of care is imposed on the professional or expert custodian. These changes most likely were enacted to retain uniformity in statutory fiduciary standards of care by adopting the standard that North Carolina imposes on trustees. The new provision does not incorporate the prior immunity of the noncompensated custodian from liability for any acts which did not result “from his bad faith, intentional wrongdoing or gross negligence or from his failure to maintain the standard of prudence in investing the custodial property.” States such as Illinois and California which have retained this immunity in their adoption of similar fiduciary care provisions explain that they have done so “because [the immunity] is likely to reflect the desires of the donor who makes a gift unconditionally.”

85. See UNIF. TRANSFERS TO MINORS ACT § 17 comment, 8A U.L.A. 177 (Supp. 1983).
86. See id. While the minor’s ability to make an effective disclaimer is not expressly limited by statute, the law presumes the minor’s acceptance of a beneficial gift during minority, 38 AM. JUR. 2d GIFTS § 96 (1968), and vests the minor’s fiduciary with only a limited power to disclaim a gift on behalf of the minor. See N.C. GEN. STAT. § 35A-1251(5) (1987) (guardian may abandon or relinquish all rights in property on behalf of the minor when that property is of no benefit or value to the minor). See also I.R.C. § 2518(b) (1986) (donee does not have to disclaim a gift for tax purposes until the donee attains age 21).
87. See UNIF. TRANSFERS TO MINORS ACT § 17 comment, 8A U.L.A. 177 (Supp. 1983).
88. N.C. GEN. STAT. § 33A-17(b) (1987). For written contracts, the custodian must identify the custodianship within the contract. Id. This provision may have the effect of limiting existing common-law sources of custodial liability. See CAL. PROB. CODE § 3917 comment (West Supp. 1988); Hall v. Jameson, 151 Cal. 606, 91 P. 518 (1907) (trustee personally liable on contract unless contract stipulates otherwise).
89. N.C. GEN. STAT. § 33A-17(c) (1987).
92. Id. Massachusetts does not place a higher standard of care on the professional or expert custodian. See MASS. GEN. LAWS ANN. ch. 201A, § 12 (West Supp. 1987). This is presumably because the Massachusetts probate code makes no distinction between the fiduciary responsibility of expert and nonexpert trustees. See id. ch. 203.
93. N.C. GEN. STAT. § 36A-2 (1987). The UTMA, however, permits the custodian to retain property placed in the custodianship without incurring liability to the minor. Id. § 33A-12(b). Cf. id. § 36A-2(b) (trustee authorized to retain original trust property only if retention satisfies fiduciary standard of care).
95. ILL. ANN. STAT. ch. 110 1/2, para. 266 (Smith-Hurd Supp. 1987). Illinois also retains the UGMA’s less stringent standard of fiduciary care. See id. para. 363.
transfer to a custodian who serves without compensation."\textsuperscript{97} Despite limitations on liability to third parties, the North Carolina statute's higher standard of care and lack of immunity for negligent acts of the custodian may dissuade the nonprofessional individual from serving as custodian.

Many of the revisions enacted in the UTMA were motivated by a desire to enhance the income and wealth-shifting advantages of the custodianship.\textsuperscript{98} This motivation is evidenced most notably by revisions to the former UGMA provision governing distribution of custodial funds.\textsuperscript{99} Under the UGMA the custodian was authorized to disburse to the minor or on the minor's behalf as much of the custodial property as deemed necessary "for the minor's support, maintenance or education."\textsuperscript{100} The Internal Revenue Service took the position that income paid from the custodial account pursuant to this direction, when used to satisfy the parent's legal obligation of support of the minor, were taxable to the parents at their applicable rate.\textsuperscript{101} The favorable income tax shifting incentives associated with the use of a custodianship were thus destroyed if the property was expended other than for luxury items for the minor. The UTMA replaces the prior "support" directive of the UGMA with the direction that the custodial property be used "for the use and benefit of the minor . . . without regard to (i) the duty or ability of the custodian personally or of any other person to support the minor, or (ii) any other income or property of the minor which may be applicable or available for that purpose."\textsuperscript{102} In addition, the UTMA provides that a disbursement to or for the benefit of the minor "is in addition to, not in substitution for, and does not affect any obligation of a person to support the minor."\textsuperscript{103} This new language was adopted in an attempt to ensure that income paid from a custodianship, since those payments are not contingent on the parent's ability to support the minor, cannot be deemed to affect or to be in satisfaction of the parental support obligation. All income disbursed from the custodial account, even if used for the minor's "support," would therefore be subject to tax at the minor's rate.\textsuperscript{104}

It is not clear whether the new language of the UTMA will result in the taxation of all disbursed custodial income to the minor.\textsuperscript{105} The language is derived from Treasury Regulation Section 1.662(a)-4,\textsuperscript{106} which provides that payments made in full or partial discharge or satisfaction of a person's legal

\textsuperscript{97} Id. § 3912(b)(1) comment.
\textsuperscript{103} Id. § 33A-14(c).
\textsuperscript{105} It is equally unclear whether the UTMA should achieve this result. One commentator notes that without an express provision granting a cause of action to the minor against an obligor who defaults on an obligation of support (an alternative rejected by the UTMA's drafters), the UTMA may "require, in essence, that the minor support himself during his minority with what is . . . his own property." Allison, supra note 41, at 363 n.194.
\textsuperscript{106} See Treas. Reg. § 1.662(a)-4 (1956).
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obligation is includable in the gross income of that person. This regulation further defines a "legal obligation" as including a duty

to support another person if, and only if, the obligation is not affected by the adequacy of the dependent's own resources . . . [A] parent has a "legal obligation" . . . to support his minor child if under local law property or income from property owned by the child cannot be used for his support so long as his parent is able to support him. 107

Under North Carolina law, the primary obligation for a child's support rests with the parent. 108 The minor is entitled to a right of reimbursement from the parent or other individual legally obligated to support the minor if custodial funds are used for the support of the minor in lieu of the parent's or obligor's funds. 109 Thus, under North Carolina law, income paid from the custodial account in discharge of a parent's obligation to support the minor, since that obligation does not depend on the ability of the minor to support himself from his own property, will be includable in the gross income of the parent. The parent in turn may argue that since such payments give rise to a right of reimbursement in the minor, the payments are not made in "discharge" or "satisfaction" of the parental obligation. Therefore, the payments are not taxable to the parent. In an internal memorandum, the General Counsel to the Internal Revenue Service observed the merits of this argument but nonetheless expressed doubts as to its success in light of prior tax court decisions which "seemed to have assumed that [the UGMA] gives the parent authority to discharge a legal obligation." 110 The legislation at issue in those decisions, however, did not contain the caveat in the UTMA that payment from the account "does not affect any obligation of a person to support the minor." 111 It is questionable whether this language will be sufficient to override the tax court's assumption that support payments "discharge" or "satisfy" a legal obligation for income tax purposes. 112

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107. Id.
108. Lee v. Coffield, 245 N.C. 570, 573, 96 S.E.2d 726, 728 (1957) (parent cannot get reimbursement for support expenditures from children's funds); Maryland Casualty Co. v. Lawing, 225 N.C. 103, 107, 33 S.E.2d 609, 612 (1947) (disbursements made by parent guardian from children's funds for their support is allowable only when parent is without sufficient means to provide for support).
111. N.C. GEN. STAT. § 33A-14(c) (1987).
112. One commentator has asserted that a similar disclaimer in the California custodianship statute, CAL. PROB. CODE § 3914(c) (West Supp. 1988), will preclude treatment of expenditures from the custodianship as satisfaction of the parents' support obligation. Wald, Inter Vivos Transfers, 18TH ANNUAL ESTATE PLANNING INSTITUTE, 393, 441 (1987). Another commentator, discussing the Uniform Gifts To Minors Act, has noted the patent ambiguity of treating the payment from a custodianship as a discharge of the parental obligation when custodial property otherwise is treated as being indefeasibly vested in the minor. Mahoney, supra note 10, at 517-20. To foreclose interpretation of a custodial payment as a discharge of the parental obligation, that author recommends the action taken by the drafters of the UTMA—namely, eliminating the power of the custodian to make payments which affect the parental duty and modifying the distribution provision to
Even if the new language governing distributions from the custodial account does not effectively allow income paid for the minor’s support to be taxed to the minor, the custodianship remains a beneficial income shifting device.\textsuperscript{113} Under North Carolina law, the support obligation of the parent does not extend beyond the child’s attainment of majority at age eighteen.\textsuperscript{114} The custodian therefore may expend custodial funds for the minor’s college education without having those funds taxed to the parent.\textsuperscript{115} A contrary result arises, however, if tuition or other payments constitute a discharge of a parental contractual obligation.\textsuperscript{116} This shift in tax liability appears largely limited to the discharge of an express contractual obligation, but courts have at times found an implied parental contractual obligation arising out of a course of dealing. For example, a parent who has regularly paid for his child’s tuition may be held liable to the payee for failing to continue doing so.\textsuperscript{117} Absent such a finding, the donor who creates a custodial account with funds for the minor’s post-secondary education may realize substantial income shifting benefits.

The statutory revisions of the UTMA give rise to important new planning considerations for the creation of custodianships. Two primary considerations are whether the donor should use a custodianship instead of a trust or guardianship and, if the custodianship is used, who should be appointed custodian. The revisions effected by the UTMA enhance the benefits of the custodianship as a trust and guardianship substitute. In some instances, however, a trust may still afford greater flexibility for income tax and estate planning.\textsuperscript{118} Under a trust, a grantor may provide for a sprinkling of income to several beneficiaries in accord-

direct payments for the “benefit” rather than the “support” of the minor. \textit{Id; see also} Thenney, \textit{Using the Custodian Statute As A Planning Device}, 16 N.Y.U. INST. FED. TAX, 937, 952 (1958) (FINDING REVENUE RULING 56-484, \textit{supra} note 110, erroneous in its holding that use of minor’s property for support constitutes “discharge” of parental liability).

\textsuperscript{113} All income accumulated in the custodianship or used for nonsupport payments is taxed to the minor. The Tax Reform Act of 1986 reduced but did not eliminate the income shifting advantages of gifts to minors. The Act provides that a child under age 14 with unearned income in excess of $1,000 will be taxed on that excess at the parent’s marginal rate, assuming the parent’s rate is greater than the child’s. I.R.C. § 1(h) (1986). Any child with unearned income is not eligible to claim a personal exemption if he is claimed as an exemption by his parents. I.R.C. § 151(d)(2) (1986); see Wald, \textit{supra} note 112, at 420-33 (examples and planning considerations of “kiddie tax” of 1986 Tax Reform Act); S. KESS, \textit{supra} note 8, at ¶ 135(1) (discussing income shifting advantages of transfers of property to custodianship remaining after the 1986 Tax Reform Act).

\textsuperscript{114} Appelbe v. Appelbe, 75 N.C. App. 197, 198, 330 S.E.2d 57, 58 (1985). Exceptions occur in the event the child is mentally or physically handicapped, N.C. GEN. STAT. § 50-13 (1984), or has not completed his secondary schooling. \textit{Id.} § 50-13.4(c).

\textsuperscript{115} Recent family law and tax decisions in other jurisdictions may be evidence of a growing tendency to increase the scope of the parental support obligation, and to thereby circumscribe the tax benefits of intrafamily income shifting devices such as the custodianship. See generally Note, \textit{The Federal Income Tax Consequences of the Legal Obligation of Parents to Support Children}, 47 OHIO ST. L.J. 753 (1986) (reviewing recent trends in determining the scope of the parental support obligation).

\textsuperscript{116} See I.R.C. § 61(a)(12) (“gross income” includes income from discharge of indebtedness); \textit{id.} § 677(a) (trust income taxable to grantor if distributable to grantor).

\textsuperscript{117} Morrill v. United States, 228 F. Supp. 734 (1964); see \textit{Note, supra} note 115, at 761-62.

\textsuperscript{118} See \textit{Note, supra} note 35, at 1194-96 (discussing limitations of custodianship relative to trusts); Mahoney, \textit{supra} note 10, at 510-11 (discussing relative merits of guardianships, trusts, and custodianships). \textit{But see supra} notes 11-14 and accompanying text (discussing tax and non-tax limitations to the use of trust).
ance with their relative needs and tax liabilities, and for a directed disposition of the assets after the minor's death. Custodial funds, by contrast, can be distributed to only one minor, and must be paid to the minor's estate at death. The drafters of the UTMA were required to retain these limitations to ensure the continued eligibility of the annual gift tax exclusion for transfers to the custodianship. The lack of a spendthrift provision under the UTMA also may render the custodianship deficient as a trust substitute. Custodial property is subject to all personal debts of the minor, as well as to all liability arising out of ownership of the property. Unlike the UTMA's prohibition against multiple beneficiaries, the lack of a spendthrift provision is not mandated by gift tax considerations. It is therefore questionable why North Carolina chose not to incorporate such a provision in the UTMA, especially in light of the heightened risk of liability created by UTMA's broader scope of permissible custodial property. Because of the lack of spendthrift protection and the income and estate planning limitations in a custodianship, some donors still may be advised to use a trust or guardianship.

The selection of the custodian should be influenced by qualitative as well as potential tax considerations. The UTMA imposes limits on the custodian's liability to third parties, but creates a stricter standard of care with respect to the management of the custodial property. Transferors therefore may be advised to nominate a custodian with some financial and administrative expertise if the custodianship will hold complex financial or business investments. The potential for greater bookkeeping complexities under the UTMA also may invite the selection of a sophisticated custodian. If the custodial account must be consolidated with accounts created prior to October 1, 1987, the custodian will be responsible for keeping records of the property and income attributable to

119. Internal Revenue Code § 2503(c) provides that a gift in trust for a minor qualifies as a gift of present interest eligible for the annual federal gift tax exclusion under I.R.C. § 2503(b) if the property and income therefrom may be expended by or for the minor. The trustee must pay the minor, or the minor's estate if the minor is deceased, all unexpended amounts at age 21. These provisions apply equally to transfers to custodianships. See Rev. Rul. 59-357, 1959-2, C.B. 212.

120. See N.C. GEN. STAT. § 33A-17 (1987) (liability to third parties limited to recourse against custodial assets).

121. The drafters of the uniform act rejected the inclusion of a spendthrift clause on the ground that its qualification on the minor's interest in property was inconsistent with the theory of the Act to convey property indefeasibly to the minor. UNIF. TRANSFERS TO MINORS ACT § 11 comment, 8A U.L.A. 171 (Supp. 1983). This "inconsistency" would not disqualify transfers to a custodianship from eligibility for the gift tax exclusion. See I.R.C. § 2503(c); Rev. Rul. 54-344, 1954-2 C.B. 319; Bittker, supra note 20, at 454-55.

122. The Alabama custodianship statute contains a spendthrift provision. ALA. CODE § 35-5A-12 (1986) ("Neither the minor nor the minor's legal representative can transfer by assignment or otherwise custodial property. . . . [A] transfer to a custodian pursuant to this chapter does not authorize the custodian to settle or release a claim of the minor."). The drafters of the uniform act encourage the custodian to insure properly and adequately the custodial property against these heightened risks, and to consider the use of a trust with a spendthrift provision if the custodianship's assets are subject to uninsurable risks or are insufficient to enable the custodian to purchase insurance. See UNIF. TRANSFERS TO MINORS ACT prefatory note, 8A U.L.A. 154 (Supp. 1983).

123. See supra notes 84-89 and accompanying text.

124. See supra notes 90-94 and accompanying text.

125. The UTMA mandates consolidation of all custodial accounts managed by the same custodian for the same minor. See supra notes 74-75 and accompanying text.
each account so that final distributions of the property are made at the appropriate statutory age of majority. Property transferred to a preexisting custodianship created pursuant to the UTMA also may be subject to different dates of termination,126 which gives rise to similar record-keeping responsibilities.

A transferor may be constrained by the UTMA from naming herself as custodian. The UTMA invalidates the transfer of "bearer" securities, the assignment of annuity or life insurance contracts, and the endorsement of titled personality by a transferor to herself as custodian.127 The property must be placed in the possession and control of a third party to establish the requisite donative intent and consummation of these types of transfers.128

Estate tax implications also may dictate the selection of the custodian. The value of the custodial account will be includable in the estate of the donor if the donor serves as custodian and dies prior to the minor's attaining the age of majority.129 The parent-custodian who names his spouse as custodian to avoid this result may subject the spouse to estate tax liability if the spouse-custodian dies while serving in that capacity. The custodial account may be includable in the spouse-custodian's estate if that spouse has an obligation to support the minor, under the theory that the decedent retained a right to have the custodial prop-

126. See supra note 78.
129. Inclusion in the donor's taxable estate is founded on § 2038 of the 1954 Internal Revenue Code, which taxes transfers in which the decedent transferor has retained the right to "alter, amend, revoke or terminate." This provision applies to the estates of donor-custodians. Treas. Reg. § 20.2038-1(a) (1962); Rev. Rul. 57-366, 1957-2 C.B. 618; Rev. Rul. 59-357, 1959-2, C.B. 212; Rev. Rul. 70-348, 1970-2 C.B. 193, Estate of Prudowsky v. Commissioner, 55 T.C. 890 (1971), aff'd per curiam, 465 F.2d 62 (7th Cir. 1972). See generally Mahoney, supra note 10, at 520-26 (discussing estate tax consequences of transfers under Uniform Gifts to Minors Acts). If the donor-custodian is also the minor's parent, inclusion in the donor's estate is mandated in addition by Internal Revenue Code § 2036(a)(1), which provides for inclusion of all transfers in which "the possession or enjoyment of, or the right to the income from, the property is retained by the donor." The parent's right to use the custodial funds for the support of the child constitutes a retained right of enjoyment of the funds, even if the property is not in fact used to satisfy a support obligation. Estate of Chrysler v. Comm'r, 44 T.C. 55 (1965), rev'd on other grounds, 361 F.2d 508 (2d Cir. 1966). See generally, Mahoney, supra note 10, at 526-30 (estate tax consequences to parent-custodian custodian). North Carolina's imposition of inheritance taxes follows the federal scheme. See N.C. GEN. STAT. § 105-2(3) (1973); Korschun v. Clayton, 13 N.C. App. 273, 185 S.E.2d 417 (1971); Note, supra note 35, at 1185-93.

In an effort to avoid inclusion in the donor-custodian's estate, the California custodianship statute allows the custodian to make an irrevocable election not to expend custodial funds until termination, except by order of the court upon a showing that the expenditure is necessary for the support, maintenance, or education of the minor. CAL. PROB. CODE § 3914(d) & comment (West Supp. 1988). Such an election presumably will preclude treating the custodian as having retained any right to terminate the custodianship by early distribution of the funds.

To limit estate taxation of non-donor custodians, the UTMA provides that the custodian may exercise powers and incidences of ownership only in her capacity as custodian. N.C. GEN. STAT. § 33A-13 (1987). This provision is designed to prevent interpretation that a custodian retained the right to exercise powers of ownership of policies insuring her life and held in the custodianship. See UNIF. TRANSFERS TO MINORS ACT § 13 comment, 8A U.L.A. 173 (Supp. 1983); I.R.C. § 2042 (1986) (property in which decedent has retained powers and incidences of ownership exercisable for her own benefit is includable in decedent's estate). But cf. Terriberry v. United States, 517 F.2d 259 (5th Cir. 1975) (value of insurance policy on trustee's life includable in trustee's estate despite trust provision prohibiting trustee's exercise of incidence of ownership of policy); Rose v. United States, 511 F.2d 259 (5th Cir. 1975) (trustee with right to convert policy insuring his life held in trust for children retained sufficient incidence of ownership to require inclusion of policy value in his estate).
TRUSTS AND ESTATES

If the tax courts are persuaded by the argument that the UTMA's distribution language precludes discharge of a parental support obligation, this basis for estate tax liability may be eliminated.131

In its eagerness to instate the custodianship as a trust and guardianship substitute, the general assembly has lost sight of the original purpose of custodianship statutes—to facilitate the giving of small gifts to minors.132 Family members or the minor's guardian traditionally were regarded as suitable managers of the funds until the minor reached majority.133 By contrast, the UTMA is tailored to the desires of transferors with substantial wealth and diversified property holdings who wish to minimize income and estate taxes and who are willing and financially able to employ a professional custodian.134 The mandatory consolidation of custodial accounts,135 the imposition of a higher standard of fiduciary care,136 and the removal of immunity for noncompensated custodians,137 for example, insure expert and efficient management. At the same time, these provisions may effectively discourage the services of the volunteer, nonprofessional custodian, and thereby discourage use of a custodianship by transferors who cannot afford professional custodial services. Less wealthy transferors who are dissuaded from using a custodianship consequently are deprived of UTMA benefits—such as the potential for all payments from a custodial account to be taxed to the minor,138 the limitations on a custodian's liability to third parties,139 and the extended duration of custodial accounts140—which they otherwise may have enjoyed. The general assembly should follow the example of those states141

130. In this instance, estate tax liability may be predicated on Internal Revenue Code § 2041, which provides for the inclusion of property subject to a power of appointment in favor of the decedent. Treas. Reg. § 1.2041-1(g). But see Mahoney, supra note 10, at 529-30 (noting that I.R.S. has never asserted § 2041 as a basis for estate tax liability of non-donor parent-custodians). In assessing estate tax liability, courts may treat reciprocal transfers from spouses to each other as custodians for a child as if the transferor had retained the property himself as custodian. See Exchange Bank & Trust Co. of Florida v. United States, 694 F.2d 1261 (Fed. Cir. 1982).

131. See supra notes 103-12 and accompanying text; Mahoney, supra note 10, at 535-36 (predicting modifications to estate tax liability effected by revision of Uniform Gifts to Minors Act to preclude treatment of support payments as discharge of parental obligation).

132. See supra note 17 and accompanying text.

133. See supra note 18 and accompanying text.

134. While the drafters of the uniform act have offered the rationale of greater accessibility to the lay custodian for some of the uniform act's modifications, see supra note 83, the uniform act largely presupposes the use of a professional, compensated custodian. See UNIF. TRANSFERS TO MINORS ACT § 15 comment, 8A U.L.A. 175 (Supp. 1983).

135. See supra notes 74-75 and accompanying text.

136. See supra notes 90-93 and accompanying text.

137. See supra note 94 and accompanying text.

138. If the UTMA's language successfully prevents treatment of custodial payments as a discharge of a parental obligation, all parental grantors who are subject to greater tax liability than the minor benefit from the shifting of income to a custodianship. See supra notes 98-112 and accompanying text. A contrary result, which taxes some custodial payments to the grantor, favors the wealthy transferor who does not need to rely on custodial funds for support payments. See Hess, The Federal Taxation of Nongeneral Powers of Appointment, 52 Tenn. L. Rev. 395, 456 (1985) (discussing economic disparity in taxation of support payments from trusts).

139. See supra notes 84-89 and accompanying text.

140. See supra note 55 and accompanying text.

141. See supra notes 95-97 and accompanying text.
which have preserved the immunity for noncompensated custodians and re-
tained the UGMA's less stringent standard of care, to promote use of a custodi-
anship as a trust substitute for all otherwise appropriate transfers to minors
regardless of the size of the transfer or the wealth of the donor.

The UTMA is flawed in addition by its lack of spendthrift protection for
the minor.142 The UTMA actually creates the need for such protection by al-
lowing and encouraging large transfers of risk-producing property to a custodi-
anship.143 A spendthrift provision should be incorporated in the UTMA if the
custodianship is, as it is touted to be, an effective trust substitute.

The manner of giving may well be worth more than the gift when one con-
siders the tax and administrative implications of alternative gift vehicles. The
UTMA attempts, and nearly succeeds in establishing the custodianship as an
attractive trust and guardianship substitute for large, diversified transfers to mi-
nors. As an unfortunate consequence, the UTMA no longer fully accommodates
the small, family-managed gifts for which custodianship statutes were originally
created.

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142. See supra notes 120-22 and accompanying text.
143. See supra notes 58-60, 84-85 and accompanying text.