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## Planning With UTMA Accounts and Other Transfers to Minors

*The Uniform Transfers to Minors Act is a simple and cost-effective way to facilitate transfers to minors that qualify for the gift tax annual exclusion, but it has some limitations. This first part of a two-part article examines the structure and tax treatment of UTMA accounts.*

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The Uniform Transfers to Minors Act (“UTMA”)<sup>1</sup> and Uniform Gifts to Minors Act (“UGMA”) are convenient and useful arrangements for accumulating wealth on behalf of a minor, but many donors feel that age 18 or 21 is too young for the beneficiary to receive the custodial property outright upon the termination of the custodianship, especially if the property has appreciated substantially in value. This first part of a two-part article analyzes the statutory framework and taxation of UTMA accounts. Part 2 of the article will explore options for limiting a beneficiary’s access to existing UTMA accounts upon reaching the age of majority, and will suggest alternative planning strategies for transfers to minors.

As a general matter, minors cannot contract for any substantial transfer of property and cannot accept a receipt for the transfer of property. There are three common ways that a donor may make a transfer to a minor which qualifies for the gift tax annual exclusion (currently \$12,000).<sup>2</sup> First, the donor may transfer the property to a court-appointed guardian. The guardian must account to the court for most expenditures of assets on behalf of the minor and must distribute the property to the minor when the minor reaches the age of majority. Second, the donor may transfer the property to a trust that meets the requirements of Section 2503(c) (discussed later and in Part 2). Third, the donor may transfer property to a custodian pursuant to the provisions of the UTMA. Of these alternatives, guardianship is the most expensive and time-consuming, and UTMA is the easiest and least expensive to implement and administer, as a general rule.

### Structure of UTMA

***Custodian’s powers under the UTMA.*** A transferor may create an UTMA account for the benefit of a minor by giving property (“custodial property”) to an adult individual, or to a bank, trust company or other entity authorized to act as a trustee, as custodian, by designating that

individual or entity as custodian in the appropriate beneficiary designation (as in the case of an insurance policy), or by executing an instrument describing the property and having the custodian sign a written acknowledgment of receipt.<sup>3</sup> A “custodian” is a person so identified by the transferor of the property.<sup>4</sup> A transferor may be an individual (who need not be an adult), trust, estate or other legal entity.<sup>5</sup>

A transfer may be made from a trust to an UTMA account for the benefit of a trust beneficiary, even, in certain circumstances, if the transfer is not expressly authorized by the terms of the governing instrument.<sup>6</sup> Once the transfer is complete, legal title to the property vests indefeasibly in the Beneficiary.<sup>7</sup> The custodian has broad discretion to apply the custodial property for the benefit of the Beneficiary, without regard to any other person's duty to support the Beneficiary.<sup>8</sup> In addition, the minor (if he or she has attained age 14) or an interested person may petition the court to order the custodian to pay to the minor or expend for the minor's benefit so much of the custodial property as the court considers advisable.<sup>9</sup>

Custodial property includes “any interest in property transferred to a custodian” and “the income from and proceeds of that interest in property.”<sup>10</sup> This definition includes “every conceivable legal or equitable interest in property of any kind, including real estate and tangible or intangible personal property,” and encompasses limited partnership interests.<sup>11</sup> A custodian is specifically authorized to retain custodial property received from a donor.<sup>12</sup>

A custodian must take control of the custodial property and “collect, hold, manage, invest, and reinvest” the property.<sup>13</sup> A custodian has the same powers over custodial property as an unmarried adult owner has over his or her own property, even though the Beneficiary—not the custodian—is the legal owner of the property.<sup>14</sup> The custodian's authority is intended to include the power “to borrow, whether at interest or interest free, the power to invest in common trust funds, and the power to enter contracts that extend beyond the termination of the custodianship.”<sup>15</sup> Under the New York UTMA, for example, the custodian also is specifically authorized to delegate investment and management functions in the manner of a trustee.<sup>16</sup> The UTMA is specifically designed to protect a Beneficiary's assets and to encourage non-professionals to serve as custodians.<sup>17</sup>

Generally, the custodian must transfer the custodial property to the Beneficiary when the Beneficiary reaches age 21 (or to the Beneficiary's estate upon the Beneficiary's earlier death), but some states (such as California, Nevada and Alaska) allow the donor to specify a later age of distribution (e.g., age 25) at the time the UTMA account is created.<sup>18</sup> Some states, including New York, permit the donor to designate either age 18 or age 21 as the age of payout.<sup>19</sup> If a choice is available, it is generally recommended that the donor choose age 21 (or older, if permitted)<sup>20</sup> as the payout date, because the minor may be able to manage the property more prudently at that age than he or she would at age 18.

***Custodian's fiduciary duties under the UTMA.*** A custodian is a fiduciary and is subject to fiduciary duties.<sup>21</sup> The UTMA requires that the custodian “observe the standard of care that would be observed by a prudent person dealing with property of another.”<sup>22</sup> Under this standard, the custodian must act with a greater degree of care than would an individual dealing with his or her own property.<sup>23</sup> In addition, a custodian with special skills (e.g., a trust company) is held to an even higher standard of care, commensurate with those special skills.<sup>24</sup>

The prudent-person standard requires the custodian to “preserve the property of the minor;” that is, the custodian must not place the custodial property at risk.<sup>25</sup> For example, a custodian may not engage in speculative investments, such as investing in “penny” stocks.<sup>26</sup> Further, the custodian may not place restraints on the property which “significantly diminish” the liquidation value of the Beneficiary's investment.<sup>27</sup>

The UTMA fiduciary standard is similar to the standard applied to a trustee, but it is unclear whether a donor would be able to modify that standard, as the creator of a trust sometimes may.<sup>28</sup> The grantor of a trust may, in the instrument of transfer, restrict or expand the trustee's ability to act; for example, the grantor may authorize the trustee to invest in a wider range of securities than permitted by statute.<sup>29</sup> Also, a grantor generally may waive the prudent-person rule in the instrument of transfer although the grantor may not, at least in certain jurisdictions, waive liability for gross negligence or willful misconduct.<sup>30</sup> Thus, a grantor may specifically authorize a trustee to undertake certain acts and may absolve the trustee from liability for certain acts, even if those acts would have been outside the scope of the trustee's power under state law in the absence of an authorization under the trust instrument. No published authority seems to indicate clearly whether the donor of an UTMA account might be able to modify the scope of the custodian's fiduciary duties in a similar manner.

***Liability of custodian under the UTMA.*** If the custodian breaches the duty of care, there are multiple remedies available. First, the custodian may be liable to the Beneficiary in an accounting proceeding.<sup>31</sup> In fact, the custodian may be required to account at any time; the UTMA does not predicate an accounting proceeding on the custodian's breach of fiduciary duty.<sup>32</sup> Nor does the UTMA require that the investment have resulted in a reduction of the value of the custodial property in order to justify an accounting.<sup>33</sup> In addition, the Beneficiary (or the Beneficiary's representative) may petition the court at any time for removal of the custodian for cause and for appointment of a successor custodian, or for the posting of a bond by the custodian.<sup>34</sup>

A Beneficiary who has reached age 14 (or otherwise the Beneficiary's representative) may petition the court (1) for an accounting by the custodian or the custodian's legal representative, or (2) for an allocation of claims or damages between the custodian personally and the custodial property.<sup>35</sup> In an accounting proceeding, the court determines whether the custodian properly maintained the account, and, if not, adjusts the account accordingly.<sup>36</sup> The court has broad discretion to fashion a remedy for breach of the duty of care. For example, the court may require the custodian to repay any losses caused by the breach, to compensate the Beneficiary for lost investment opportunities, and to pay damages.<sup>37</sup> If the custodian acted in bad faith, the court may surcharge and remove the custodian.<sup>38</sup> These remedies are not mutually exclusive, and the court will select the remedy it determines to be most appropriate.<sup>39</sup>

The UTMA does not contain a separate statute of limitations, because custodianships may be created without the minor's knowledge, and because the minor might not become aware of any breach of duty until after reaching the age of majority.<sup>40</sup> The minor likely cannot hold the custodian liable for a breach of fiduciary duty if the beneficiary accepts the benefits of the investment upon reaching the age of majority. In the trust context, a beneficiary of competent age and understanding cannot hold the trustee liable for breach of duty—whether or not the investment depreciates—if the beneficiary subsequently affirms the transaction either by express approval or by receiving the benefits of the transaction.<sup>41</sup>

## **Income, gift, and estate tax treatment of UTMA accounts**

Property transferred to an UTMA account is vested indefeasibly in the Beneficiary. Therefore, the Beneficiary is subject to income tax on the assets held in the UTMA account under Section 1(c).<sup>42</sup> If the Beneficiary is under age 18, the Beneficiary's income may be aggregated with his or her parents' income and the excess over a certain threshold (\$1,700 in 2007) is taxed at his or her parents' highest marginal rate under Section 1(g).<sup>43</sup>

There are two general exceptions to this rule. First, any income on the UTMA assets that is used to satisfy the legal obligation of *any person* (including, but not limited to, the custodian) to support the Beneficiary is taxable to such person to the extent of the property so used.<sup>44</sup> The effect of this exception is to treat the custodian or another person as a beneficiary of a trust and

the UTMA account as a trust<sup>45</sup> under such circumstances, even though, as a matter of the UTMA statute, the custodial property has vested absolutely in the Beneficiary. Second, in limited circumstances, courts have held that income on the UTMA assets should be taxed to the donor—regardless of whether that income was used to satisfy a legal obligation of support—if the transfer to the UTMA account was, in effect, an attempted anticipatory assignment of income by the donor to the Beneficiary.<sup>46</sup>

Transfers to UTMA accounts are completed gifts for gift tax purposes.<sup>47</sup> However, unlike gifts to guardians, which qualify for the annual exclusion as present interests under Section 2503(b)(1), transfers to UTMA accounts qualify for the gift tax annual exclusion under Section 2503(c) and the generation-skipping non-taxable gift exclusion under Section 2642(c), by analogy to Section 2503(c).<sup>48</sup> No taxable gift occurs when the custodianship terminates or when a custodian resigns in favor of a successor.<sup>49</sup>

Some states permit an UTMA custodianship to last beyond age 21, such as age 25. However, because the IRS has ruled that the transfer to a custodial account qualifies for the gift tax annual exclusion under Section 2503(c), which requires that the trust property be distributed to the Beneficiary by age 21, providing for the UTMA custodianship to last beyond that age would seem to foreclose any transfer to it from qualifying for the gift tax annual exclusion.

Even though legal title to custodial property vests in the minor upon transfer, the property nonetheless will be includable in the gross estate of the donor either under Section 2035(a), if the donor makes a transfer of the property to the UTMA account as described in that section within three years of death, or under Section 2038(a)(1), if the donor is also the custodian and dies while serving in that capacity, because the custodian has the power to terminate the custodial arrangement at any time and, therefore, may withhold enjoyment of the income from the property,<sup>50</sup> or if the donor relinquishes the power within three years of death. The entire value of the custodial property *also* may be subject to inclusion in the donor's gross estate under Section 2036(a)(1) if he or she has an obligation to support the Beneficiary, because the donor-parent retained the power to use the income of the account to fulfill his or her support obligation.<sup>51</sup>

Given the IRS's multiple theories for inclusion in the estate of the donor for federal estate tax purposes, the donor should not serve as the custodian of the property in almost all cases. The donor's spouse probably may serve as custodian, even if he or she "splits" the gift to the UTMA account with the donor spouse for gift tax purposes under Section 2513, because the IRS has ruled that neither Section 2035 nor Section 2038 applies to gift-splitting situations, so the custodial property should not be included in the non-donor spouse's gross estate for federal estate tax purposes if he or she dies during the custodianship.<sup>52</sup> However, spouses should not create identical UTMA accounts for minor children and name each other as custodians, because the "reciprocal trust" doctrine may apply in those situations,<sup>53</sup> causing the custodian spouse to be treated as the transferor for federal estate tax purposes of the UTMA account over which that spouse is custodian and thereby triggering gross estate inclusion.

## Inconsistencies in taxation of UTMA accounts

***Income tax treatment vs. estate and gift tax treatment of UTMA accounts.*** Applying the gift tax annual exclusion to transfers to UTMA accounts by analogy to Section 2503(c) seems inconsistent with the income tax treatment of UTMA accounts. For income tax purposes, an UTMA account is treated like a guardianship arrangement. Income on UTMA assets is taxed to the Beneficiary (except to the extent that such income has been used to discharge a legal obligation of another) because the Beneficiary holds legal title to the assets, unlike a trust, where the trustee holds legal title to the assets. For gift and estate tax purposes, however, the UTMA account is treated like a trust under the terms of which the Beneficiary's access to the funds is

restricted until a later date, so that the Beneficiary's interest is considered a future interest because it is "limited to commence in use, possession or enjoyment at some future date or time."<sup>54</sup>

If the rationale for taxing the income of the UTMA account to the Beneficiary is that the property has vested in the Beneficiary, then the same rationale would seem to apply for gift tax and estate tax purposes: transfers to an UTMA account should qualify for the gift tax annual exclusion because the property *may* be used immediately by the custodian for the Beneficiary's benefit and, therefore, the transfer is a gift of a present interest, whether or not the property actually *is* used for the Beneficiary's benefit.<sup>55</sup> Similarly, property contributed to an UTMA account should not be included in the donor's estate, at least under Section 2038(a)(1), for the same reason. Yet this theory has been explicitly rejected by the courts on the ground that vesting is *not* the same as present possession or enjoyment.<sup>56</sup>

Indeed, in an UTMA account, either the Beneficiary (if over age 14) or an interested person may petition at any time for the application of funds for the Beneficiary's benefit, which is not the case in a Section 2503(c) trust. In other words, a Crummey-type power of withdrawal should not be necessary to make a transfer to an UTMA account a present interest, because the Beneficiary holds legal title to the assets; it is necessary only for a trust, where someone other than the Beneficiary has legal title to the assets. The Section 2503(c) requirements that the trust property pass to the beneficiary at age 21 and must be payable to the beneficiary's estate if he or she dies before that age are already inherent in the UTMA statute, because the trust property already belongs to the Beneficiary.

It seems strange that the rationale for qualifying contributions to a Section 2503(c) trust, where the *trustee* holds legal title to the assets, is the present-interest exception, whereas contributions to UTMA, where the *Beneficiary* holds legal title, qualify by analogy to a trust. Further, if gifts to an UTMA account qualify for the gift tax annual exclusion because the property immediately vests in the Beneficiary, then the gift tax annual exclusion also should be available for gifts to UTMA accounts that permit the donor to restrict access until an age beyond 21—but that does not appear to be the case.<sup>57</sup>

If Section 2503(c) is the rationale for applying the gift tax annual exclusion to UTMA accounts, then it may be possible for transfers to such UTMA accounts to qualify for the gift tax annual exclusion if the Beneficiary is granted the right to withdraw the assets at age 21 for a brief period of time (such as 60 or 90 days), but the property remains in the UTMA account beyond age 21 if the Beneficiary does not withdraw it, because the IRS has ruled that such an arrangement is acceptable for Section 2503(c) trusts.<sup>58</sup>

In sum, the major difference between UTMA accounts and Section 2503(c) trusts is the distinction between title and possession. In a custodial account, the Beneficiary has title, but not possession, whereas in a trust, the Beneficiary has *neither* title nor possession. One might argue that transfers to UTMA accounts should be treated, for both income and gift/estate tax purposes, as guardianships rather than as trusts, because of the possibility that, at some point in the future, the beneficiary could obtain immediate possession of the property (whether by petition by the Beneficiary or another interested person or whether by attaining the age of majority). It does not seem that the reason for the incapacity—whether mental incapacity or minority status—should matter.

This is an important difference between Section 2503(c) trusts and custodianships, and highlights the rationale for treating UTMA accounts for *both* income tax purposes and gift/estate tax purposes more like guardianships and not like trusts. Under that rationale, transfers to UTMA accounts would qualify for the gift tax annual exclusion under the present-interest exception, not

the Section 2503(c) exception. Instead, the current differential income and gift/estate tax treatment of UTMA accounts shows that the UTMA is viewed as a trust/guardianship hybrid.

***Effect of use of custodial property to discharge support obligation or other creditors' claims.*** A common question that has arisen under the UTMA, especially in the context of UTMA accounts created or maintained pursuant to a divorce settlement, is whether a custodian who is a parent of the Beneficiary may apply the property to discharge his or her obligation to support the Beneficiary. The UTMA does not contain a blanket prohibition on use of the custodial funds to support the Beneficiary; it merely states that the existence of the custodial funds does not *affect* the parent's support obligation.<sup>59</sup>

Courts have held, as a matter of state UTMA law, that a parent-custodian may not apply the property to discharge his or her support obligation, at least while the parent has sufficient funds of his or her own to support the minor.<sup>60</sup> If a parent does not have sufficient funds to discharge his or her support obligation, the UTMA funds probably may be used to support the minor, at least if permitted by a court.<sup>61</sup> If the court does not authorize the use of such funds, the parent's use of custodial assets to support the beneficiary will be considered a breach of fiduciary duty.<sup>62</sup>

Whether or not the use of custodial assets to discharge a support obligation is authorized by a court, the mere power to use the custodial property to discharge the custodian's support obligation causes the custodial property to be includable in the parent-custodian's gross estate under Section 2036(a)(1); it does not matter whether or not that power is actually exercised.<sup>63</sup> Thus, there is a distinction between (1) the estate tax implications of the UTMA account, which turn on the mere possibility that the donor may use custodial property to discharge a legal obligation of support, and (2) the state-law fiduciary implications, which turn on whether the custodian *actually* does so. Yet, if the custodian who is the donor can use custodial assets to discharge his or her legal obligation of support (e.g., to satisfy the claims of the donor's creditors), it may be more accurate to include the custodial property in the custodian's estate not under Section 2036(a)(1), but under Section 2041 on the ground that he or she has a general power of appointment over the custodial property.

Courts have held in several cases that custodial assets may be used to satisfy claims of the custodians' creditors—for example, in cases involving tax liens against the parent-custodian, in which the government argued that the funds in the custodial accounts were actually transferred to help the parent avoid tax liability and were commingled with the parent's assets, and the parent-custodian contended that the government had wrongfully attempted to levy the custodial assets.<sup>64</sup> The courts tend to follow two separate lines of reasoning in these creditors' claims cases.

Some courts have held that the mere fact that the custodial assets were commingled with the custodian's personal assets and/or used to pay the custodian's debts means that no custodianship was created in the first place, because the donor did not have the requisite donative intent in creating the UTMA account.<sup>65</sup> In these cases, the custodial property will be includable in the custodian's gross estate under Section 2033, and there is no need to reach the question whether Section 2036 or 2038 is applicable.

On the other hand, some courts have held that the custodianship is valid even where the custodial funds were used to pay the custodian's debts because the donor had the requisite donative intent in creating the UTMA account, but the custodial assets may be used to satisfy the claims of the custodian's creditors because the custodian treated the assets as his or her own property.<sup>66</sup> In those cases, Section 2036 may apply, even though the custodial property "belongs" to the minor as a matter of state law, because the custodial assets were, or could be, used to satisfy the claims of the custodian's creditors.<sup>67</sup>

At least two New York courts, though, have held that where the UTMA account was properly created and the donor had the requisite donative intent, the funds are not subject to the claims of the custodian's creditors in any event.<sup>68</sup> In that case, it seems that Section 2036 would not apply to the custodial assets. In sum, the case law governing whether and when custodial assets may be used to satisfy the claims of the custodian's creditors is inconsistent and does not lead to a clear result under Section 2036.

With respect to a custodian who was not the donor, one might argue that custodial funds should not be subject to inclusion under Section 2041 if there is no evidence that the funds actually were used to discharge the custodian's obligations.<sup>69</sup> The reach of Section 2041 is broader than that of Section 2036(a)(1), because it would extend to situations in which the custodian does not have a legal obligation of support but there is the mere possibility that custodial assets might be used to satisfy the claims of the custodian's creditors.

The IRS should issue guidance under Section 2041 to clarify that the mere power to use custodial assets to satisfy the claims of the custodian's creditors is not a general power of appointment and, therefore, does not cause inclusion under that section. In the absence of such guidance, states should consider modifying their respective UTMA statutes to codify the result in *Estate of McLaughlin*<sup>70</sup> and prohibit custodians from using custodial assets to satisfy the claims of a custodian's creditors. The following language might be considered for adoption:

Notwithstanding any provision of [state law dealing with UTMA] to the contrary, custodial assets may not be used, directly or indirectly, to satisfy the claims of a custodian's creditors. A custodian shall be liable to the minor beneficiary in accordance with the foregoing provisions of the UTMA if the custodian uses any portion of the custodial assets to satisfy the claims of the custodian's creditors. Any attempted transfer of custodial property to a creditor of the custodian, except in accordance with the foregoing provision, shall be null, void and of no effect.

Part 2 of this article, which will appear in the next issue of Estate Planning, will examine planning options for existing UTMA accounts (including transferring UTMA property to a family limited partnership, to a trust, or to a Section 529 plan), and alternatives to UTMA accounts.

## PRACTICE NOTES

Some states permit an UTMA custodianship to last beyond age 21, such as age 25. However, because the IRS has ruled that the transfer to a custodial account qualifies for the gift tax annual exclusion under Section 2503(c), which requires that the trust property be distributed to the Beneficiary by age 21, providing for the UTMA custodianship to last beyond that age would seem to foreclose any transfer to it from qualifying for the gift tax annual exclusion.<sup>1</sup>

The UTMA is the successor to the Uniform Gifts to Minors Act ("UGMA"). As of this writing, all states except Vermont have adopted the UTMA. Most states have replaced the UGMA with the UTMA, because (in general) the UTMA enables the custodian to hold property until the minor reaches age 21 (or older, in some states), covers a broader range of property, and permits the custodian to apply the property more liberally for the minor's benefit than does the UGMA. Custodians should consult local counsel for a detailed analysis of a particular state's provisions. References in this article to the UTMA include both the UGMA and the UTMA.<sup>2</sup>

<sup>3</sup> IRC Section 2503(b).

<sup>4</sup> Uniform Transfers to Minors Act ("UTMA") §9, 8C U.L.A. 36 (2001).

[5](#) UTMA §1(7), 8C U.L.A. 14.

[6](#) UTMA §§1(12) and 16, 8C U.L.A. 14.

[7](#) UTMA §6, 8C U.L.A. 28.

UTMA §11(b), 8C U.L.A. 46; see also Rev. Rul. 56-86, 1956-1 CB 449. The term “Beneficiary,” as used herein, refers to the person for whom the account was established and whether that person still is a minor or has now reached the age of majority.

[8](#) UTMA §14(c), 8C U.L.A. 56.

[9](#) UTMA §14(b), 8C U.L.A. 56.

[10](#) UTMA §1(6), 8C U.L.A. 14.

[11](#) UTMA §1 cmt., 8C U.L.A. 15; see also UTMA §9 cmt., 8C U.L.A. 39 (describing UTMA section 9(b)(7), concerning creation of custodial property, as including partnership interests). The UGMA specifically included “interests as a limited partner of a limited partnership” in the definition of custodial property. See, e.g., N.Y. Estates, Powers and Trusts Law (“EPTL”) §7-4.1(e)(3) (repealed). The UTMA is intended to cover a broader scope of property than the UGMA. UTMA §1 cmt., 8C U.L.A. 15.

[12](#) UTMA §12(b), 8C U.L.A. 49.

[13](#) UTMA §12(a), 8C U.L.A. 49.

[14](#) UTMA §13(a), 8C U.L.A. 54.

[15](#) UTMA §13 cmt., 8C U.L.A. 55.

[16](#) N.Y. EPTL §7-6.12(b).

[17](#) UTMA §17 cmt., 8C U.L.A. 62.

[18](#) UTMA §20, 8C U.L.A. 72; see also Cal. Prob. Code §3920.5(d), Nev. Rev. Stat. §167.034(3)-(4), Alaska Stat. 13.46.195(e).

[19](#) N.Y. EPTL §7-6.21.

[20](#) Nevertheless, as discussed later, extending the age of distribution beyond 21 years may preclude the transfer to the UTMA account from qualifying for the gift tax annual exclusion.

[21](#) UTMA §12 cmt., 8C U.L.A. 50; see also *In re Levy*, 97 Misc 2d 582, 412 NYS2d 285 (1978), *Mangiante v. Niemiec*, 843 A2d 656 (2004); *Grover v. Grover*, 1995 Mass. App. Div. 122 (1995).

[22](#) UTMA §12(b), 8C U.L.A. 49.

[23](#) The standard of care set out in the UTMA is stricter than that provided in the UGMA, which required that the custodian deal with the custodial property as a prudent person would with his or her *own* property. UTMA §12 cmt., 8C U.L.A. 50.

[24](#) *Id.*

[25](#) *Buder v. Sartore*, 774 P2d 1383 (Colo., 1989). There is very little case law dealing with the UTMA, because it has been in existence for less than 20 years, and because the simplicity of the

statutory scheme and the ease of administration generate very little litigation. Many of the cases discussed here were decided under the UGMA. Because the standard of care prescribed by the UTMA is higher than the standard of care prescribed by the UGMA (see *supra* note 23), the UGMA cases may be viewed as effectively describing the custodian's minimum duty of care.

[26](#)  
Buder, 774 P.2d at 1388.

[27](#)

Fogelin v. Nordblom, 521 NE2d 1007 (Mass., 1988) (holding that custodian's consent to amendment to voting trust agreement, which reduced by 75% the value of the custodial property—preferred stock held by the voting trust—constituted breach of fiduciary duty). Although *Buder*, *Fogelin*, *Mangiante*, and *Grover* all held that the custodian had breached the custodian's fiduciary duty in dealing with the custodial property, the cases stated different grounds for the breach. *Buder* suggests that investing custodial property in risky securities is a breach of the duty to invest the assets prudently, while *Fogelin* and *Mangiante* indicate that entering into an agreement which limits the value of the custodial property or using the custodial property to discharge the custodian's support obligation may constitute self-dealing. *Grover*, on the other hand, indicates that failure to turn over the custodial property to the former minor upon reaching the age for distribution is a breach of both the duty of prudence and the obligation to keep custodial property separate in a manner sufficient to identify it clearly as the minor's property. In other words, as with a trustee, a custodian's actions may constitute multiple breaches of fiduciary duty, depending on the facts and circumstances. Thus, as discussed more fully in Part 2 of this article, it is possible that contributing custodial property to a partnership might be *both* a breach of the duty to invest custodial assets prudently (because such a contribution might reduce the value of the custodial property) *and* self-dealing (if the custodian is also a partner in the partnership and benefits from the contribution of custodial assets to the partnership). *Cf.* Fogelin, 521 N.E.2d at 1012 (the fact that the custodian also reduced the value of his own shares by entering into the amendment to the voting trust agreement does not justify the custodian's exercise of discretion in a manner that reduced the value of the custodial property).

[28](#)

See, e.g., Alaska Stat. §13.36.192.

[29](#)

3 *Scott on Trusts* §222 (Scott and Fratcher eds., 4th ed. 1988).

[30](#)

*Id.*

[31](#)

UTMA §19, 8C U.L.A. 70.

[32](#)

UTMA §19 cmt., 8C U.L.A. 71.

[33](#)

UTMA §19, 8C U.L.A. 70.

[34](#)

UTMA §18(f), 8C U.L.A. 64.

[35](#)

UTMA §19(a).

[36](#)

Buder, 774 P.2d at 1390.

[37](#)

*Id.*

[38](#)

Sutliff v. Sutliff, 528 A2d 1318 528 A2d 1318 (1987).

[39](#)

Buder, 774 P.2d at 1390.

[40](#)

*Id.*

[41](#)

3 *Scott on Trusts, supra* note 29, at §218.  
[42](#)

The Beneficiary's parent may elect to report and include the Beneficiary's unearned income (subject to certain limitations) on the parent's tax return and pay the tax attributable to that income. Section 1(g)(7). There is no published authority that indicates that the parent is making a gift to the Beneficiary by taking advantage of the election under Section 1(g)(7). Analogizing to the grantor trust rules under Section 671 -Section 678, it could be argued that the parent does not make a gift by choosing to report, include and pay the income tax attributable to the child's unearned income under Section 1(g)(7). Under Rev. Rul. 2004-64, 2004-2 CB 7, it is certain that the parent who creates a grantor trust does not make a gift to the beneficiary of the trust by reporting the income, deductions and credits of the trust on his or her own return and paying the income tax attributable to the trust's income, even if the parent intentionally structures the trust as a grantor trust (which decision could be viewed as an election, although it is not an "after-the-fact" election like the election under Section 1(g)(7)). Conversations with a member of the professional staff of the Joint Committee on Taxation indicated that Congress intended that a parent would not be treated as making a gift to his or her minor child by making the election under Section 1(g)(7), although there does not appear to be any such statement in the legislative history.  
[43](#)

For tax years after 5/25/07, the Small Business and Work Opportunity Tax Act of 2007 (Pub. L. No. 110-28, 5/25/07) extends this so-called kiddie tax to children who have attained age 18, and to children who are over age 18 but under age 24 if they are full-time students and their earned income does not exceed half the amount of their support. Section 1(g)(2)(A).  
[44](#)

Rev. Rul. 56-86, 1956-1 CB 449; Rev. Rul. 59-357, 1959-2 CB 212; see also Rev. Rul. 56-484, 1956-2 CB 23.  
[45](#)

*Cf.* Reg. 1.643(c)-1(a) and Reg. 1.662(a)-4.  
[46](#)

See, e.g., Peterson Irrevocable Trust #2, TC Memo 1986-267, PH TCM ¶186267, 51 CCH TCM 1300 (involving a transfer of stock by a parent to a custodial account shortly before the company was sold); see also Estate of Applestein, 80 TC 331 (1983); Anastasio, 67 TC 814 (1977), *aff'd* 41 AFTR2d 78-328 (CA-2, 1977).  
[47](#)

This is so even if the transferor is the custodian. Reg. 25.2511-2(d).  
[48](#)

Rev. Rul. 59-357, *supra* note 44.  
[49](#)

*Id.*  
[50](#)

Rev. Rul. 57-366, 1957-2 CB 618; see also Rev. Rul. 59-357, *supra* note 44, Rev. Rul. 70-348, 1970-2 CB 193, Stuit, 28 AFTR 2d 71-6289, 452 F2d 190, 71-2 USTC ¶12815 (CA-7, 1971), *aff'g* 54 TC 580 (1970), Eichstedt, 30 AFTR 2d 72-5912, 354 F Supp 484, 72-2 USTC ¶12891 (DC Cal., 1972).  
[51](#)

Rev. Rul. 59-357, *supra* note 44; Estate of Prudowsky, 55 TC 890 (1971), *aff'd* 30 AFTR 2d 72-5856, 465 F2d 62, 72-2 USTC ¶12870 (CA-7, 1972).  
[52](#)

Rev. Rul. 74-556, 1974-2 CB 300. See generally Zeydel, "Gift-Splitting: A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules," 106 J. Tax'n 5 (June 2007).  
[53](#)

Exchange Bank & Trust Co. of Florida, 51 AFTR 2d 83-1317, 694 F2d 1261, 82-2 USTC ¶13505 (CA-FC, 1982).  
[54](#)

Reg. 25.2503-3(a).  
[55](#)

In fact, the existence of a Crummey power of withdrawal qualifies a transfer in trust for the gift tax annual exclusion as a present interest for that exact reason: the fact that the powerholder (or, if the powerholder is a minor, his or her parent or guardian) *may* withdraw the property, whether or not the right is actually exercised. Crummey, 22 AFTR 2d 6023, 397 F.2d 82, 68-2 USTC ¶12541 (CA-9, 1968).

[56](#)

See Stuit, 452 F.2d at 192 (rejecting the petitioners' argument that the term "present interest" for gift tax purposes has the same meaning as "enjoyment" for estate tax purposes, and stating that "both terms 'enjoyment' and 'enjoy' are not terms of art but connote substantial present economic benefit rather than technical vesting of titles or estates."); Eichstedt, 354 F. Supp. at 487-88 ("Section 2038 extends to property subject to a decedent's power to affect 'the time or manner of enjoyment of property or its income' . . . even though the beneficiary may previously have had 'vested' rights in the property.") (citations omitted).

[57](#)

Rev. Rul. 73-287, 1973-2 CB 321 ("The provisions of section 2503(c) of the Code set forth the maximum restrictions that may be attached to gifts to minors and still have such gifts considered as present interests for purposes of the annual exclusion allowable under section 2503(b) of the Code.").

[58](#)

Rev. Rul. 74-43, 1974-1 CB 285. In any event, the Section 2503(c) exception probably does not apply to UTMA accounts created in states where a donor is permitted to restrict access to the custodial property beyond age 21 and does so. The practical effect of this rule is that transfers to UTMA accounts which restrict access to the custodial property after age 21 probably are tax-efficient only for testamentary transfers to UTMA accounts, not inter vivos transfers.

[59](#)

UTMA §14(c), 8C U.L.A. 56.

[60](#)

Sutliff v. Sutliff, *supra* note 38 (holding that custodian's use of UGMA funds in addition to, but not as a substitute for, his court-ordered support obligation to his minor children is a breach of the agent's duty of loyalty to act only for the benefit of the principal); see also Cohen v. Cohen, 608 A. 2d 57 (N.J., 1992); Roberts v. Roberts, 908 A.2d 1274 (N.J. Super., 2006).

[61](#)

Sutliff, 528 A.2d at 1324 ("Where the parent lacks the means to fully meet his children's needs, the court may specify the excess sum needed and order the custodian to pay it as a minimum. Otherwise, additional payment should be left to the custodian's good faith discretion."). In fact, the IRS's own Revenue Rulings clearly seem to contemplate the use of custodial property to support the minor, or else there would be no need for a Ruling on the estate tax consequences of the use of custodial property for that purpose. See Rev. Rul. 59-357, *supra* note 44.

[62](#)

See, e.g., Mangiante, 843 A.2d at 660; Newman v. Newman, 123 Cal App 3d 618, 176 Cal Rptr 723 (1981); Wilson v. Wilson, 154 P3d 1136 (Kan. App., 2007). But see Cohen, 608 A.2d at 60 (holding that parent's use of custodial funds to reimburse herself for expenditures which were her legal obligation was improper but not a breach of the fiduciary duty of prudence).

[63](#)

See Prudowsky, 55 TC at 895. ("Petitioner's argument that under Wisconsin law decedent would have been restrained from employing the custodial assets in satisfaction of his legal obligation of support is unacceptable.... It is decedent's ability to employ the funds for support should he so desire that is critical, not whether he ever actually does so or intends to.").

[64](#)

See, e.g., Marshall, 72 AFTR 2d 93-5011, 831 F Supp 988 (DC N.Y., 1993); Dubisky, 1994 U.S. Dist. LEXIS 13745 (DC Ill., 1994), *aff'd* 76 AFTR 2d 95-5824, 62 F3d 182, 95-2 USTC ¶150580 (CA-7, 1995), *cert. den.*

[65](#)

See, e.g., Dubisky, 1994 U.S. Dist. LEXIS at \*4; Hall, 71 AFTR 2d 93-360, 92-2 USTC ¶150600 (DC Ga., 1992); Crocker Citizens Nat'l Bank, 36 AFTR 2d 75-6522, 75-2 USTC ¶13106 (DC Cal., 1975); see also In re Marriage of Jacobs, 128 Cal App 3d 273, 180 Cal Rptr 234 (Cal. App. 4th

Dist., 1982); *State v. Keith*, 610 NE2d 1017 (Ohio App., 1991).  
[66](#)

See, e.g., *Marshall*, 831 F. Supp. at 1003; *cf.* *Paolozzi*, 23 TC 182 (1954), *acq.*  
[67](#)

See *Marshall*, 831 F. Supp. at 1003-04 (“The rationale for permitting a levy on these funds is that when a custodian converts protected funds for personal use such funds are no longer used for the ‘benefit’ of the minor. . . . [W]hen a custodian’s use of such funds appears to be more than merely negligent, creditors may, depending on the circumstances, have a right to levy on such funds which would otherwise not be ‘attachable.’”)  
[68](#)

See *Matter of Estate of McLaughlin*, 126 Misc 2d 817, 483 NYS2d 943 (Surr. Ct. Nassau Co., 1985) (involving decedent’s executor’s attempt to recover custodial property in payment of estate’s debts); *Friedman v. Mayerhoff*, 156 Misc 2d 295, 592 NYS2d 909, 1992 WL 409873 (N.Y. City Civ. Ct., 1992) (involving landlord’s attempt to garnish custodial accounts in payment of parents’ rent obligations). *Estate of McLaughlin* seems to stand for the proposition that even if the custodian’s estate is insolvent, the custodial property cannot be used to satisfy debts of the decedent-custodian’s estate even though the custodial property is includable in his or her estate under Section 2038(a)(1). In such a case, there would be estate tax inclusion without any way for the decedent’s executor to recover custodial property for the payment of estate taxes attributable to such property (unlike in other situations where the transferee of the decedent’s property is subject to transferee liability for estate taxes). It also is unclear in such a case whether the IRS, rather than the decedent’s executor, could attach the custodial property in satisfaction of an estate tax lien against the decedent’s estate (as *Marshall* seems to indicate would be possible). If so, the property is arguably subject to the claims of the decedent’s creditors and, therefore, also subject to estate tax inclusion under Section 2041.  
[69](#)

*Cf.* Reg. 20.2041-1(a).  
[70](#)

126 Misc 2d 817, 483 NYS2d 943 (Surr. Ct. Nassau Co., 1985).