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ESTATE TAX APPLICATION TO THE GIFTS TO MINORS ACTS

The model "Act Concerning Gifts of Securities to Minors"¹ resulted from "a real need for a simple method to allow a parent to make a gift of securities to a child."² The Model Act was an attempt to remove the complications and uncertainties of outright ownership by the minor without the formalities, expense, or restrictions of guardianships and inter vivos trusts. The Model Act has largely been replaced by the similar Uniform Gifts to Minors Act,³ which Indiana adopted in 1957.⁴

Under the Indiana Act an adult may give securities or money to himself, another adult, or a trust company as custodian for the minor donee by following the prescriptions of the act.⁵ The gift vests indefeasible legal title in the minor and does not give the minor's guardian any power except as provided by the act.⁶ The donor in making the gift adopts all of the provisions of the act and thereby grants all the powers and immunities of the act to the custodian and third persons with whom he deals.⁷ The custodian is granted broad powers to invest the custodial property and has almost complete discretion in paying it to the minor or expending it for his benefit.⁸

1. This Model Act was drafted and sponsored by the New York Stock Exchange and the Association of Stock Exchange Firms in 1955. It appears in 3 MARTINDALE-HUBBLE, (1957).

2. Remarks of G. Keith Funston, President, New York Stock Exchange, before the Nat'l. Ass'n. of Securities Administrators, in New York City, Sept. 29, 1954, in Newman, *The Uniform Gifts to Minors Act in New York and Other Jurisdictions—Tax Consequences, Possible Abuses, and Recommendations*, 49 CORNELL L. Q. 12 (1963).

3. Fourteen states and the District of Columbia adopted the model "Act Concerning Gifts of Securities to Minors" from 1955 to 1957. All but Alaska and Georgia have replaced it with the Uniform Act or major provisions of it. The Uniform Act was approved by the National Conference of Commissioners on Uniform State Laws and the American Bar Association in 1956. In 1965 the National Conference of Commissioners and the American Bar Association approved the Revised Uniform Gifts to Minors Act which has been adopted in New York. The purposes of the revision were to broaden the type of depositories for gifts under the act, to allow insurance and endowment policies to be given under the act, and to facilitate the designation of successor custodians. There was no attempt in the revision to alter the tax consequences of custodianship.

4. IND. ANN. STAT. § 31-801 to -810 (Burns Supp. 1966).

5. Registered securities are given by registering them in the name of the custodian with words, substantially as prescribed in the Act, indicating that he holds as custodian and for whom. Unregistered securities are given by delivering them to the custodian, who cannot be the donor, and executing an instrument, substantially in the prescribed form and signed by both the donor and custodian, stating the nature of the transaction and the name of the donee. Money is given by depositing it with a bank or broker in the name of the custodian as in a gift of registered securities. IND. ANN. STAT. § 31-802 (Burns Supp. 1966).

6. IND. ANN. STAT. § 31-803(a) (Burns Supp. 1966).

7. IND. ANN. STAT. § 31-803(b) (Burns Supp. 1966).

8. IND. ANN. STAT. § 31-804 (Burns Supp. 1966) :

(a) The custodian shall collect, hold, manage, invest and reinvest the

The Internal Revenue Service has ruled that custodial property is includable in the gross estate of a donor-custodian who dies while acting as custodian.⁹ This position is based on *Lober v. United States*,¹⁰ which held trust property includable in the gross estate of a donor-trustee under section 2038(a)(1)¹¹ because he retained power to affect the time of enjoyment of the property. The beneficiary of each trust was to receive all the property when he reached age twenty-five but the donor-trustee could in his discretion pay all or part of the property over to the beneficiary prior to this time. Under the Uniform Gifts to Minors Act the custodian has a similar discretionary power to pay over the custodial property prior to the donee attaining age twenty one.¹²

THE CHRYSLER CASE

The only case to date considering the estate tax application to custodianship is *Estate of Jack F. Chrysler*,¹³ in which a New York decedent attempted to give securities and money to his two children. Prior to adoption of custodianship in New York, the decedent owned

custodial property.

(b) The custodian shall pay over to the minor for expenditure by him, or expend for the minor's benefit, so much of or all the custodial property as the custodian deems advisable for the support, maintenance, education and benefit of the minor in the manner, at the time or times, and to the extent that the custodian in his discretion deems suitable and proper, with or without court order, with or without regard to the duty of himself or of any other person to support the minor or his ability to do so, and with or without regard to any other income or property of the minor which may be applicable or available for any such purpose.

(c) The court, on the petition of a parent or guardian of the minor or of the minor, if he has attained the age of fourteen years, may order the custodian to pay over to the minor for expenditure by him or to expend so much of or all the custodial property as is necessary for the minor's support, maintenance or education.

9. Rev. Rul. 357, 1959-2 CUM. BULL. 212. This ruling applied a similar ruling on the Model Act, Rev. Rul. 366, 1957-2 CUM. BULL. 618 to the Uniform Act.

Rev. Rul. 357 also applied other prior rulings on the Model Act to the Uniform Act. Rev. Rul. 86, 1956-1 CUM. BULL. 449 provided that custodianship gifts qualified for the per donee exclusion under INT. REV. CODE OF 1954, § 2503(c). Rev. Rul. 484, 1956-2 CUM. BULL. 23 said that custodial income used to support the donee would be taxed to the person obligated to furnish such support. All other custodial income will be taxed to the donee. The income tax ruling has been subjected to criticism and has not yet been litigated.

10. 346 U.S. 335 (1953).

11. INT. REV. CODE OF 1954, § 2038(a)(1) :

The value of the gross estate shall include the value of all property . . . [t]o the extent of any interest therein of which the decedent has at any time made a transfer . . . , by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.

12. IND. ANN. STAT. § 31-804(b) (Burns Supp. 1966).

13. 44 T.C. 55 (1965), *rev'd*, 361 F.2d 508 (2d Cir. 1966).

outright certain securities which he later registered partly to himself and his wife jointly and partly to himself and his daughter jointly. He recorded these transfers in a ledger and reported them as gifts for the federal gift tax. He made similar transfers for his son recording them in a different ledger. A joint checking account in the name of the decedent and his wife was created for each child; the decedent made deposits to these accounts which he recorded in the ledgers and reported as gifts.

The securities for each child were kept in separate safety deposit boxes and the income reported as the children's. The decedent deposited the proceeds from sales of the securities in the checking accounts and purchased securities, which were jointly registered and placed in safety deposit boxes, with funds from the checking accounts. The decedent did not commingle the property held for one child with either that held for the other child or his own.

After New York adopted the Model Act,¹⁴ the decedent transferred some of the jointly held securities to himself as custodian for each child. He made additional deposits in the checking accounts but neither transferred any of his own securities to custodianship nor purchased securities for custodianship directly with his own funds. The decedent handled the securities which he held as custodian in the same manner as those jointly held.

The Tax Court determined that the decedent made no delivery of the jointly registered securities or of the checking account funds sufficient to complete the gifts.¹⁵ Therefore, he retained a beneficial interest and their entire value was includable in his gross estate under section 2040.¹⁶

The securities which the decedent held as custodian were held to be includable under section 2038¹⁷ because as custodian the decedent had power to pay over the securities to his children at any time before they reached age twenty one.¹⁸ This was viewed by the court as the same type of power which the decedent retained in *Lober* and the result is in accord with the Internal Revenue Service position on the imposition of the estate tax on custodial property held by a donor-custodian.¹⁹

14. Law of March 2, 1956, ch. 35, [1956] N.Y. Laws 77 (repealed 1959).

15. Estate of Jack F. Chrysler, 44 T.C. 55, 67 (1965), *rev'd*, 361 F.2d 508 (2d Cir. 1966).

16. INT. REV. CODE of 1954, § 2040 provides for inclusion of the value of property held by a decedent in joint tenancy to the extent of the proportion of consideration which he furnished for its acquisition.

17. INT. REV. CODE of 1954, § 2038(a) (1).

18. Law of March 2, 1956, ch. 35, § 266(2) (a), [1956] N.Y. Laws (repealed 1959). This is the section corresponding to the UNIFORM GIFTS TO MINORS ACT § 4 and IND. ANN. STAT. § 31-804 (Burns Supp. 1966). The Internal Revenue Service's position is that the custodial powers under the Uniform Act are the same as those under the Model Act for tax purposes. Rev. Rul. 357, 1959-2 CUM. BULL. 212.

19. Rev. Rul. 357, 1959-2 CUM. BULL. 212; Rev. Rul. 366, 1957-2 CUM. BULL. 618.

In addition, the Tax Court found that under the absolute discretion granted to custodians to expend custodial property for the donee's benefit, the decedent could have used it to discharge his legal obligations to support his children. This made the custodial property includable in the gross estate under section 2036(a)(1).²⁰

The appellate court reversed²¹ and held that the transfers into joint tenancy, considered with the decedent's record-keeping and treatment of the property, were completed gifts.²² Therefore, the decedent's joint interest was nominal and the property was not includable under sections 2033 or 2040 which are concerned only with beneficial interests.

The court interpreted New York law as not allowing a grantor-parent-trustee, at least in the absence of a support provision in the trust instrument, to apply the trust property to the discharge of his legal obligation to support the donee.²³ Without this power there could be no inclusion of the jointly held property under section 2036(a)(1).

The decedent's transfers into joint tenancy and handling of the property were viewed by the court as indicating his intent that the property given to each child be preserved until the child's majority. Thus the property was not includable under section 2038 because the decedent could not affect the time of a donee's enjoyment by paying it over before the donee attained majority.

The appellate court reasoned that the decedent could have no greater powers over the custodial securities than he had over the funds used to purchase them.²⁴ Since all the custodial securities were purchased with funds from the joint tenancies, the decedent could neither use the custodial securities to satisfy his legal obligations to support his children nor pay the securities over to the children before they reached age twenty-one. Therefore, the custodial securities were held not to be includable in the decedent's gross estate. This decision was based on a determination that the decedent did not have the powers granted to a custodian under the act; therefore, it left unchanged the Tax Court determination that custodial powers cause property to be includable in the gross estate of a donor-custodian.

20. INT. REV. CODE OF 1954, § 2036(a) :

The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—(1) the possession or enjoyment of, or the right to the income from, the property. . . .

21. Estate of Chrysler v. Commissioner, 361 F.2d 508 (2d Cir. 1966).

22. *Id.* at 510.

23. *Id.*

24. 361 F.2d 508, 511.

The appellate court's decision seems to imply that the custodial powers are not sufficient to cause inclusion. While the court considered the decedent's treatment of the property as indicative of his intent, they did not indicate that the transfers to custodianship were relevant for purposes of determining that intent. Instead these transfers were viewed as being controlled by the decedent's prior treatment of the property. If the decedent had used the property for his own benefit, it seems unlikely that the court would have viewed such action as a violation of the intent previously implied. Therefore, if the court had viewed the custodial powers as sufficient to cause inclusion, it would probably have held that the transfers to custodianship indicated the decedent's intent to retain these powers. The court's failure so to view the transfers to custodianship could be due to a belief that custodial powers are not sufficient to cause inclusion.

However, the court specifically said that the question of whether or not custodial powers are sufficient to cause inclusion was not reached.²⁵ While the appellate court decision may justify some doubts as to the validity of the Tax Court decision on the inclusion of custodial property, it does not overturn the Tax Court decision on the inclusion of custodial property in the gross estate of a donor-custodian who retains the custodial powers.

PRESENT ESTATE TAX STATUS OF CUSTODIANSHIP

The position taken in the revenue rulings and by the Tax Court's *Chrysler* decision is that the broad discretionary power of a custodian to pay over to or expend for the benefit of the donee any or all of the custodial property²⁶ is the type of power specified in section 2038. Under this position custodial property is includable in the gross estate of any donor who retains the custodial powers.

The Tax Court decision in *Chrysler* determined, without regard to any legal obligations to support the donee,²⁷ that the custodian's power to expend the property to support the donee was a power to enjoy the property as specified by section 2036(a)(1). This expands the prior Internal Revenue Service position so that custodial property is includable in the gross estate of a donor who is obligated to support the donee under section 2036(a)(1) as well as under section 2038.

Although section 2036(a)(2)²⁸ has not been relied on by the

25. *Id.*

26. *E.g.*, IND. ANN. STAT. §31-804(b) (Burns Supp. 1966).

27. *Id.*

28. INT. REV. CODE OF 1954, § 2036:

(a) General Rule. —The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at

Internal Revenue Service either in its rulings or in *Chrysler*, there are two arguments under that section for inclusion of the property in the estates of all donors who retain the custodial powers. First, the property is includable because the donor retains the power to determine who will enjoy the property. By expending the property for support of the donee, the donor relieves the person obligated to support the donee of this obligation thereby giving this person the enjoyment of the property. By preserving the property for the donee's majority or expending it for non-support items, the donor can give the enjoyment to the donee. A donor who retains the custodial powers can give the enjoyment of the property to the donee or to the person obligated to support the donee, whether or not this person is the donor himself. The property is includable under this argument whether or not the donor-custodian is obligated to support the donee.

The second argument for inclusion under section 2036(a)(2) is based on the decision in *Struthers v. Kelm*²⁹ that the test for inclusion under this section is the same as that applied in *Lober* for inclusion under section 2038(a). Under this interpretation, property is includable in the decedent's gross estate under section 2036(a)(2) if he retains power to affect the time of enjoyment even where the donee or his estate will receive the property regardless of the decedent's exercise of this power. While this test seems to expand the grounds for inclusion under section 2036(a)(2) beyond a retention of the power to determine the person who will enjoy the property,³⁰ it has been supported by subsequent cases.³¹ However, the weight of these cases is reduced because section 2038 was also relied upon. In some of these, the statement that power to affect time of enjoyment is sufficient for inclusion must be considered dicta because the donee or his estate would not necessarily have received the property.³²

any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or income therefrom.

29. 218 F.2d 810 (8th Cir. 1955).

30. Gray & Covey, *State Street—A Case Study of Sections 2036(a)(2) and 2038*, 15 TAX L. REV. 75, 79 & n.22 (1959).

31. United States v. O'Malley, 383 U.S. 627 (1966) (dictum); Joy v. United States, FED. EST. & GIFT TAX REP. (67-2 U.S. Tax Cas.) ¶12,482 (E.D. Mich. 1967); Estate of John J. Round, 40 T.C. 970 (1963), *aff'd. without discussion*, 332 F.2d 590 (1st Cir. 1964).

32. Joy v. United States, FED. EST. & GIFT TAX REP. (67-2 U.S. Tax Cas.) ¶ 12,482 (E.D. Mich. 1967); Estate of John J. Round, 40 T.C. 970 (1963), *aff'd.*, 332 F.2d 590 (1st Cir. 1964).

Section 2036 also covers property over which the decedent retained a power for a period not ascertainable without reference to his death. Where the decedent has a power on a condition, the property that may be subject to the power will be included under section 2036 if the condition could occur at the decedent's death while only the property actually subject to the power at the decedent's death is included under section 2038. This distinction is of little importance to custodianship because the custodial powers apply to the entire interest transferred and are not on a condition. However, section 2036 may be very important in an attempt to alter the custodial powers to avoid inclusion.

AVOIDING INCLUSION BY MAKING ANOTHER CUSTODIAN

In most situations the fact that the property is includable in the gross estate of a donor-custodian presents no serious problem. Under the present Internal Revenue Service position,³³ by simply appointing another to act as custodian, the donor can avoid possible inclusion.

The rationale of the Internal Revenue Service position is that, where he appoints another custodian, the donor retains neither the right to enjoy the property nor the power to affect its enjoyment. The donor is not deemed to have retained the right to enjoy property where he creates a trust and gives the trustee discretionary power to expend the trust property to support the donor's dependents, so long as the donor is not and cannot make himself trustee.³⁴

In *McCullough v. Granger*,³⁵ property in an irrevocable trust was not includable in the gross estate of the settlor where he gave the trustees—his wife and older son—discretionary power to expend the property for support of the beneficiary, the settlor's younger son. The Commissioner contended that the property should be included in the decedent's gross estate under section 2036(a)(1) because the trustees would exercise their discretion as the decedent directed. Therefore, the Commissioner argued, the decedent, in effect, retained the power to expend the property for his own benefit. In holding for the taxpayer, the district court said that it did not know how the trustees would have responded to a request by the decedent as to the expenditure of the property and that an assumption that they would comply with it was

33. Rev. Rul. 357, 1959-2 CUM. BULL. 214.

34. *Colonial-American Nat'l. Bank v. United States*, 243 F.2d 312 (4th Cir. 1957); *Commissioner v. Douglass' Estate*, 143 F.2d 961 (3d Cir. 1944); *McCullough v. Granger*, 128 F. Supp. 611 (W.D. Pa. 1955); *Estate of Jack F. Chrysler*, 44 T.C. 55 (1965). The first issue in the Tax Court involved a trust created by the donor with another as trustee. This trust was not associated with the second and third issues which involved the custodial property.

35. 129 F. Supp. 611 (W.D. Pa. 1955).

not realistic.³⁶

The court's emphasis on its inability to predict the trustees' response to a settlor's request³⁷ suggests that, if there were an indication that the trustees would follow the decedent-settlor's requests, the property would have been included in the decedent's gross estate. This is consistent with holdings that property is includable in the gross estate of a donor who directly retains the right to income by separate agreements, even though the agreements are unenforceable under state law³⁸ and that, where the income from property has been given to the donor, an agreement between the settlor and trustee has been inferred.³⁹ In all of these cases, the donor received all or most of the income. But where a donor received only about twenty-five per cent of the income, the property was not included.⁴⁰ While it is true that these cases dealt with benefits going directly to the donor, since the discharge of a legal obligation to support dependents is enjoyment,⁴¹ it would seem that the same reasoning should apply to property held by a custodian purportedly given discretion but actually subject to a separate agreement to apply the property to discharge the donor's obligation to support the donee.

AVOIDING INCLUSION IN THE GROSS ESTATE OF A DONOR-CUSTODIAN UNDER THE PRESENT ACT

Since the donor can appoint as custodian any adult or a trust company,⁴² the appointment of another as custodian is a satisfactory method of avoiding inclusion for most donors. But there may be situations in which the donor desires to retain the custodial powers. He may feel that a trust company or person not closely related to the donee would not be sufficiently familiar with the donee's needs. Such factors as financial irresponsibility, marital difficulties, or bad relations with the donor may make the donee's other close relatives undesirable custodians. Even where the donor believes another to be qualified to exercise the custodial powers in the donee's best interest, the donor may believe himself to be better qualified to manage the particular type of securities or other property given.

36. *Id.* at 615.

37. *Id.*

38. *Estate of McNichol v. Commissioner*, 265 F.2d 667 (3d Cir.), *cert. denied*, 361 U.S. 829 (1959); *Greene v. United States*, 237 F.2d 848 (7th Cir. 1956).

39. *Estate of Skinner v. United States*, 316 F.2d 517 (3d Cir. 1963).

40. *In re Uhl's Estate*, 241 F.2d 867 (7th Cir. 1957).

41. *Commissioner v. Dwight's Estate*, 205 F.2d 298 (2d Cir.), *cert. denied*, 346 U.S. 871 (1953); *Helvering v. Mercantile Bank & Trust Co.*, 111 F.2d 224 (8th Cir.), *cert. denied*, 310 U.S. 654 (1940); *First Nat'l. Bank v. United States*, 211 F. Supp. 403 (M.D. Ala. 1962); *National Bank of Commerce v. Henslee*, 179 F. Supp. 346 (M.D. Tenn. 1959); *Estate of William H. Lee*, 33 T.C. 1064 (1960).

42. IND. ANN. STAT. § 31-802 (Burns Supp. 1966).

Where the donor believes that he is the best custodian, he is forced into a choice between appointing a less qualified custodian or risking inclusion of the property in his gross estate. While the policy of inclusion because of a power to affect only the time of enjoyment has been questioned, the courts have adhered to the *Lober* decision as to section 2038 and the *Struthers* decision as to section 2036(a) (2).

However, even if the *Lober* and *Struthers* decisions were overcome, custodial property would still be includable under section 2036(a) (2). The donor-custodian's power to use the property to discharge his own or another's legal obligation to support the donee allows him to determine who enjoys the property. Where he is obligated to support the donee, inclusion also results under section 2036(a) (1). When all the possible grounds for inclusion are considered, it can only be concluded that the retention of the custodial powers imposes the risk of inclusion of the property in the donor-custodian's gross estate.

While it may be possible for a donor to make himself custodian without causing the property to be included in his gross estate, this requires that he divest himself of the custodial powers of distribution. This largely eliminates the reason for wanting to be custodian but allows the donor to retain power to manage the property. Other possible methods for avoiding adverse tax consequences create other problems: first, their use is not certain to avoid inclusion; second, they involve formalities which reduce the simplicity of custodianship; and, third, they create uncertainties in the administration of the custodianship.

The appellate court decision in *Chrysler* indicates that a donor may make himself custodian, without retaining the powers over the property which make it includable in his gross estate, by going through a two-step process. First, without retaining discretion to expend or distribute, the donor gives the property to himself as trustee to hold until the child's majority at which time he must distribute all of the property. Second, the donor-trustee transfers the property to himself as custodian. By this second transfer the donor does not give himself the distributive powers of a custodian, either because he does not have the powers to give or because exercise of them would be a violation of the trust, or both.⁴⁹

There are, however, problems with this procedure which the appellate court did not have to face in making its decision in *Chrysler*. In interpreting such a transfer, a state court would be likely to hold that the second transfer was a violation of the donor's duties as trustee under the

43. The court said, "the decedent lacked the authority to assert them [custodial powers] over property of the fruits of property previously held by the children free of comparable restriction." The exact theory upon which this lack of authority was based is not clear. 361 F.2d 508, 511.

first transfer. An alternative interpretation would require that the donor be viewed as holding his trust powers as custodian.

Under either interpretation nothing is gained by the transfer to custodianship. Since the property is not includable in the donor's gross estate while it is held under the trust, it is not the transfer to custodianship that prevents inclusion. Nor does it give the donor powers which he did not have under the trust because he is still subject to the limitations placed on him as trustee. While the donor may hold the property as custodian in form, in substance, he still holds it as trustee. Furthermore, the court's statement that there was no simple method of making a gift to his children at the time Chrysler created the informal trusts⁴⁴ may indicate that the court would take a less favorable view of a similar transfer now that custodianship is available.

A donor might be able to create a situation similar to *Chrysler* by giving property to himself as custodian and then executing an instrument renouncing powers (1) to apply the property to discharge his legal obligation to support the donee and (2) to distribute or expend the property prior to the donee's majority, when he must distribute all the property.

There is a question whether or not such a renunciation would be effective to remove the powers and whether or not the transfer would be effective with such a renunciation.⁴⁵ If both the transfer and the renunciation are valid, then the donor holds the property as custodian without the distributive powers of a custodian. But since the donor must execute a separate instrument to create this situation, the simplicity of creating the custodianship is reduced. The donor could execute a formal trust creating the same situation without the risk of its being held invalid.

ALTERING THE ACT TO AVOID INCLUSION IN THE GROSS ESTATE OF A DONOR-CUSTODIAN

In response to the Tax Court decision in *Chrysler*, the California Legislature acted to eliminate this problem in their custodianship statute.⁴⁶ A provision was added which enables a donor-custodian to exe-

44. 361 F.2d 508, 210 (2d Cir. 1966).

45. REPORT OF THE SUBCOMMITTEE ON ASPECTS OF UNIFORM GIFTS TO MINORS ACT, ABA REAL PROPERTY, PROBATE, AND TRUST SECTION (Proceedings in N.Y., N.Y. Aug. 10-12, 1964).

46. CAL. CIV. CODE § 1158.5 (West Supp. 1966) :

In lieu of the powers and duties described in subdivision (b) of Section 1158, a donor who is also the custodian may elect to govern his custodial powers and duties under this section. If such election is made, the custodian shall not pay over to the minor for expenditure by him, nor expend for the minor's benefit, any part of the custodial property for any purpose prior to the time specified in subdivision (d) of Section 1158, except by order of the court upon a showing that such expenditure is necessary for the support, maintenance or education of

cute, at his option, an instrument by which he renounces the custodial powers to distribute the property before the donee reaches his majority. After executing this instrument, the donor-custodian can only distribute by court order upon a showing that such expenditure is necessary for the support, maintenance, or education of the donee.

The execution of such an instrument should prevent inclusion of the property because the donor does not retain discretionary power to pay over or expend the property. Authorization of the custodian to apply for a court order should not make the property includable because it only allows the custodian to request the court to exercise power over the property. The ruling⁴⁷ that custodial property is not includable in the gross estate of a donor who is not the custodian supports this view because it is possible for a donor, who is not the custodian, to ask the proper court to order the custodian to expend the property. A donor who is the donee's parent or guardian has this "power" because the present act gives the donee's parent or guardian right to apply for such an order.⁴⁸ The option gives a donor who is unwilling to appoint another custodian the choice of retaining the broad powers of distribution with the risk that the property will be included in his gross estate or of avoiding possible inclusion by limiting his powers to distribute much as a guardian's powers are limited.

An option could be drafted to eliminate the need for the custodian to obtain a court order. Such an option would not allow the donor-custodian any more discretion in making expenditures and would allow him to expend the property only when he deems it necessary for the support, maintenance, or education of the donee; it would prohibit all other distributions prior to the donee reaching his majority. Such limitation on the donor's powers would prevent inclusion due to the rule developed from *Jennings v. Smith*.⁴⁹

In *Jennings* the donor-trustee retained power to distribute the property if the beneficiary suffered prolonged illness or financial reverses. The court held that this power did not cause inclusion under either sections 2036(a)(2) or 2038 because the donor had no discretion in

the minor. When the powers and duties of the custodian are governed by this section, the donor-custodian shall file with the clerk of the court a declaration in substantially the following form:

Declaration under the California Uniform Gifts to Minors Act I, _____ as custodian for _____ under the California Uniform Gifts to Minors Act, hereby irrevocably elect to be governed under Section 1158.5 of the Civil Code in my custodial capacity over the following described property _____. I declare under penalty of perjury that the foregoing is true and correct.

47. Rev. Rul. 357, 1959-2 CUM. BULL. 214.

48. IND. ANN. STAT. § 31-804(c) (Burns Supp. 1966).

49. 161 F.2d 74 (2d Cir. 1947).

determining whether or not to distribute the property. In so holding the court said that the limiting event or condition had to be sufficiently definite to be determined by a court of equity. Otherwise there would be no means of enforcing the limitation on the donor.

The rule⁵⁰ has been interpreted by the Tax Court to apply to a retained power to expend trust property for the support, maintenance, and education of the beneficiary when considered necessary by the trustees.⁵¹ A limitation of expenditures to those necessary to provide comfortable care, maintenance, and support of a life beneficiary was held sufficient to prevent inclusion.⁵² Inclusion under section 2036 (a) (2) is avoided because these limitations are interpreted as requiring distributions when the conditions occur.

An optional provision limiting distributions by the donor-custodian to those necessary for the support, maintenance, and education of the donee and requiring distributions when necessary for these purposes should avoid inclusion. In addition the donor-custodian would actually have a limited range of discretion in determining what distributions are necessary.

The use of an optional provision limiting the donor-custodian's power to distribute the property may raise problems as to the per donee gift tax exclusion. The California provision which requires a court order for the donor-custodian to expend the property is so similar to guardianship that the per donee exclusion would probably be allowed. An optional provision not requiring a court order for expenditure would probably be challenged since it can be distinguished from guardianship. If the transfer of legal title to the donee is sufficient to qualify for the per donee exclusion, then there is no problem. However, if the custodianship is treated as a trust, such an option would prevent the exclusion, because section 2503 (c)⁵³ is interpreted as requiring that the trustee's discretion be substantially unlimited.⁵⁴

50. *DeLancey v. United States*, 264 F.2d 904 (W.D. Ark. 1967); *Estate of Frederick M. Kasch*, 30 T.C. 102 (1958); *Estate of Robert W. Wier*, 17 T.C. 409 (1951); and recognizing the rule but not finding a sufficient condition: *United States v. O'Malley*, 383 U.S. 627 (1966).

51. *Estate of Robert W. Wier*, 17 T.C. 409 (1951).

52. *DeLancey v. United States*, 264 F.2d 904 (W.D. Ark. 1967).

53. INT. REV. CODE OF 1954, § 2503(c):

No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest . . . if the property and the income therefrom—(1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and (2) will to the extent not so expended—(A) pass to the donee on his attaining the age of 21 years, and (B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c).

54. Treas. Reg. § 25.2503-4(b) (1) (1961) provides that a gift qualifies for the

CONCLUSION

Custodianship provides a convenient, inexpensive method of making gifts to minors. The powers of the custodian provide for flexibility both in managing the property and in distributing it and a custodial gift qualifies for the per donee gift tax inclusion. If the donor is not the custodian, the property is includable only in the donee's estate.

The appellate court's willingness to find a completed gift in *Chrysler* could be interpreted as indicating that this court might hold that custodial powers are not sufficient to cause inclusion. However, such a decision would require a restriction of *Lober*. Even if this is done, the property would still be includable, unless the court can either interpret the act as not giving the custodian power to discharge the obligation of one other than the donee or interpret this power as not allowing the custodian to choose who will enjoy the property. The Internal Revenue Service has made it clear that it believes the property is includable. Thus if a donor-custodian dies while custodian, his estate will certainly be faced with litigation if it attempts to avoid inclusion. This, combined with the small chance for success in the suit, makes it impractical for a donor to make himself custodian unless he is willing to risk inclusion of the property in his gross estate.

The methods for avoiding inclusion in the gross estate of a donor-custodian under the present act are too uncertain and impractical to be useful. The approach taken by California offers a method for a donor to appoint himself custodian without risk of the property being included in his estate. While it may not be necessary to require a court order to limit sufficiently the donor-custodian's powers, this requirement does avoid the problem of trying to discern what courts will consider a sufficiently definite standard for application for the *Jennings* rule. It also reduces the likelihood that the per donee gift tax exclusion will be disallowed.

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exclusion where the expenditure during the donee's minority is left to the trustee's discretion "provided there are no substantial restrictions under the terms of the trust instrument on the exercise of such discretion. . . ."