Spending the Children’s Money: A Critical Look at Custodial Accounts

by
Joanne Ross Wilder†

I. Introduction

Custodial accounts established for the parties’ children during the marriage can constitute significant assets. But whose money is this and how can it be used? Some parents view the custodial accounts as a convenient way to make up a shortfall in the income available to meet support payments and property settlement obligations. Because the unilateral expenditure of children’s funds is almost guaranteed to generate a new series of disputes between the parties, it can be helpful for the lawyer to discuss the children’s money with the client and what can – and cannot – be done with it.

II. The Uniform Transfers to Minors Act and the Uniform Gifts to Minors Act

The Uniform Transfers to Minors Act (UTMA)¹ and its predecessor, the Uniform Gifts to Minors Act, (UGMA),² were intended to provide a convenient procedure for making inter vivos gifts of money or securities to children without the complex and expensive requirements of establishing and maintaining trusts. The statutory procedure makes it possible to easily transfer money and stock to children, and is particularly appropriate for relatively small amounts. Every state has enacted a version of the Act providing for transfers to minors.³ The fact that, in most states, the custodian can be the donor as well as a parent


¹ UNIF. TRANSFERS TO MINORS ACT, 8C U.L.A. 1 (2001).
² UNIF. GIFTS TO MINORS ACT, 8A U.L.A. 376 (1993).
³ Bradley E.S. Fogel, Billion Dollar Babies: Annual Exclusion Gifts to Minors, 12 PROB. & PROP. 6 (Oct. 1998); Jani Maurer, Uniform Transfers to
contributes to the confusion over what the custodian can actually do with the minor’s funds.

The original Uniform Act was proposed by the New York Stock Exchange to encourage gifts of securities to minors by providing a simple procedure for such transfers and affording protection for both the minor owner and third parties dealing with the gifted assets. An account established pursuant to the Uniform Act differs from a trust in that the assets in the account actually belong to the child rather than to a trust.\(^4\) The Act contemplates that a transfer is a completed gift, and the donor consequently retains no rights with respect to the transferred assets. However, the adult custodian retains the power to spend the minor’s money, subject to some statutory restrictions.

A. Requirements

A completed gift involves three elements: Donative intent, delivery, and acceptance. The Act streamlines the gifting process and provides that actual delivery and acceptance are not necessary to complete the gift if the statutory procedures are followed.\(^5\) Once donative intent is established, the gift is complete and the donor’s subsequent change of mind does not undo the gift. Similarly, a change in circumstances does not negate the gift. A transfer of funds to a custodial account may be dispositive as to all three elements; under the Act delivery and acceptance are constructive and, in some jurisdictions, donative intent is established by the transfer itself.\(^6\) In other jurisdictions it is possible to defeat the presumption of donative intent by demonstrating fraud or mistake, or that donative intent was otherwise lacking. For example, the California Court of Appeals set aside a transfer of securities consistent with the statutory requirements because the mother had not consented to the gift of securities by the father to the child.\(^7\) In Matter of Hopkins\(^8\) the court held that,

---

4. See id.
6. Id.
8. Id.
since the mother’s consent was essential to the transfer, donative intent did not exist in the case of the father’s unilateral transfer.

The motivation of the donor to, for example, avoid taxes, does not preclude a finding of donative intent. In other words, where the transfer was intended and in compliance with the statutory requirements, the motivation for the transfer is irrelevant. In *Sternlicht v. Sternlicht*, the court rejected the father’s claim that he had “parked” money in his daughter’s account merely to save taxes and that he never intended a gift of the funds, holding that father had confused “motive” with “intent.” Similarly, ignorance of the legal consequences of the transfer does not serve to void a compliant, intentional transfer. The bright line test is not without pitfalls, however. As the concurring opinion in *Sternlicht* notes, if the presumption of donative intent cannot be rebutted, an intentional transfer by mistake, for example, a transfer into the wrong account, can result in an unintentional but irrevocable gift.

Some courts have held that an account established in compliance with the Act is not conclusive as to the issue of donative intent, but rather creates a rebuttable presumption, with the party challenging the gift having the burden of overcoming the presumption by clear and convincing evidence.

In certain circumstances, usually involving wrong-doing, courts have found that if the parties treated the funds as their own rather than as belonging to the child, donative intent is not present and there is no completed transfer to the custodial account. For example, in *State v. Keith*, a case involving a forfeiture pursuant to a corrupt activities lien under RICO, the court held that the defendant mother had no donative intent and the custodial funds were therefore subject to forfeiture. There was also evidence in *Keith* that the transfer was not in compliance

---

9 876 A.2d 904 (Pa. 2005).
11 876 A.2d at 913 (Cappy, C.J., concurring).
12 Id.
14 610 N.E.2d 1017 (Ohio Ct. App. 1991)
with the statute and that the mother failed to prove that the funds were derived from a source other than corrupt activities.

In In re Marriage of Jacobs, the husband, an accountant, manipulated the parties’ money allegedly to save taxes and misrepresented the tax consequences as well as the ownership of the transfers to the wife. The court found no donative intent on the part of the wife and held that the funds were therefore community property and not custodial assets.

B. Limitations on Expenditures

Parents are not generally permitted to meet their own support obligations from the children’s funds. In In re Marriage of Ludwig the court held that the custodial account established to meet the daughter’s educational expenses should be retained intact because the parents could afford to meet these expenses from their own resources. The Missouri Court of Appeals in Gulmen v. Gulmen, questioned the mother’s use of funds in her child’s account to secure the release of her car from execution pursuant to a support judgment against her and remanded for an accounting. In Sutliff v. Sutliff, the Pennsylvania Superior Court held that the father breached his duty as custodian when he used his children’s funds to pay court-ordered child support. That same court, in the later case of Perlberger v. Perlberger, remanded for a determination of whether a mother expended her own resources before depleting the children’s accounts for such things as mortgage payments on the parties’ vacation home and whether certain other of mother’s expenditures on behalf of the children were unreasonably extravagant.

Although one of the purposes of the Act is to protect the custodian from the claims of mismanagement to which a trustee is exposed, the custodian does not have unlimited discretion with respect to expenditures. The Act permits the custodian to make

18 913 S.W.2d 852 (Mo. Ct. App. 1995).
expenditures for the benefit of the child who owns the account.\textsuperscript{21} Since child support is viewed to be a primary obligation of the parents, courts have uniformly held that using the child’s funds to meet the parent’s support obligation benefits the parent, not the child, and is therefore an improper use of custodial funds.\textsuperscript{22} This rationale applies even where the parental support obligation has not been reduced to a court order because parents are expected to provide for their children’s needs consistent with their means. It is only when the parent is lacking sufficient financial resources to meet the child’s needs that custodial funds may be utilized.\textsuperscript{23} Most state versions of the Uniform Act provide that a parent custodian may be reimbursed for out-of-pocket expenses but may not receive compensation. The custodian is generally not liable for claims of mismanagement absent bad faith, gross negligence, or failure to use due care in making investments. The custodian must keep records, but unlike a trustee, is not required to file periodic accounts. Third parties, such as banks, brokers, and transfer agents, are generally exempt from liability.

A minor owner of custodial funds or the non-custodian parent may petition for an accounting, removal of the custodian for cause, or for a distribution. The custodian must deliver the funds to the owner when he or she reaches the age of 21 years. The custodian may be required to account to the owner and to reimburse the account for funds improperly spent during the owner’s minority.\textsuperscript{24}

What expenses may the custodian pay from the minor’s account? Generally, expenditures that are consistent with the children’s pre-separation standard of living are appropriately paid from the children’s funds if the parents’ resources are inadequate to maintain the standard and the custodial funds are available. Although arguably, many expenditures for the parents benefit the children, courts have found that withdrawals for a parent’s therapy or legal fees are too attenuated in terms of a benefit to the child to qualify as a reasonable expenditure.\textsuperscript{25} It is safe to conclude that the benefit to the child must be a direct one and

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{21}] Id.
\item[\textsuperscript{23}] In re Marriage of Rosenfeld, 668 N.W.2d 840 (Iowa 2003).
\item[\textsuperscript{24}] See Erdmann v. Erdmann, 226 N.W.2d 439 (Wis. 1975).
\item[\textsuperscript{25}] See Perlberger, 626 A.2d 1186.
\end{enumerate}
\end{footnotesize}
not based upon a trickle-down theory that what is good for the parent is good for the child.

Particularly in states that do not afford a cause of action for post-high school educational support, the importance of maintaining the custodial funds intact for the child should be addressed and even agreed-upon expenditures from the accounts avoided if possible.

III. Tuition Account Programs

An alternative to custodial accounts for parents who want to retain control over the savings set aside for their children’s education is an account in a qualified tuition account program (“TAP”) pursuant to Section 529 of the Internal Revenue Code. The purpose of these accounts is to set aside money specifically for the higher education of minor children. TAP accounts are different from custodial accounts because the funds remain the property of the donor rather than the beneficiary. Beneficiaries are not limited to the children of the donors, but include grandchildren, stepchildren, siblings, and even the spouse. Tuition account plans provide favorable tax consequences but do not allow the donor unlimited options to withdraw the funds. Nonqualified distributions are subject to penalties.

Another difference between TAP accounts and custodial accounts is that the former are limited to funds earmarked for higher education while custodial accounts can serve as a vehicle for transferring assets to minors that can accumulate and may be used by the beneficiary upon achieving majority for any purpose.

IV. Conclusion

Parties should carefully consider the consequences of establishing certain types of funds for minor beneficiaries because there are, of course, always tradeoffs. In the case of custodial accounts, the ease and economy of making transfers to the minor is offset by the lack of control over these funds even during the

26 26 U.S.C.A. § 529. See generally Craig D. Bell & Maureen C. Ackerly, A Primer: Section 529 Plans, Coverdell Education Savings Accounts (Education IRAs), and Other Tax-Smart Ways to Save for College, 2004 ARMY LAW, 28 (Apr. 2004).
beneficiary’s minority. Potential donors should also consider whether it is prudent to deliver a substantial sum of money to a twenty-one year old. When the funds involved are significant, the donor should consider whether a trust is a more appropriate vehicle for the transfer.