

Memorandum 91-51

Subject: Study L-400 - Deposit of Money of Minor or Incompetent Person
in Special Needs Trust

Exhibit 1 is a letter from attorney Edmond R. Davis of Brobeck, Phleger and Harrison in Los Angeles. He is concerned that the new Probate Code may eliminate former authority in Sections 3602 and 3611 for settlement proceeds of a minor or incompetent person to be put in a special needs trust and managed by an institutional trustee. A special needs trust is used for proceeds of a personal injury settlement where the injured person has permanent disability. Prensky & Ross, *Public Benefit Planning for the Elderly and Disabled*, in Sixteenth Annual USC Probate and Trust Conference at 40, 56-57 (U.S.C. Law Center, Oct. 26, 1990). The trust permits professional management and keeps the proceeds from disqualifying the beneficiary for social security benefits and Medi-Cal. Special needs trusts seem useful, and the staff thinks the law should permit them. The question is how to do it.

Mr. Davis says special needs trusts were used under old language of Sections 3602 and 3611, which permitted the court approving the settlement to order the proceeds to be deposited in a "trust company authorized to transact a trust business in this state," subject to withdrawal only on court authorization. The "trust company" language was not continued in the new Probate Code. See Prob. Code §§ 2453, 3412, 3413, 3500, 3602, 3611, 9700.

Former Statutory Authority for Special Needs Trusts Unclear

It is not clear that the former "trust company" language authorized special needs trusts. The former language permitting the court to order that the proceeds be "deposited" in a trust company, subject to withdrawal only on court authorization, appears to authorize a court-controlled deposit account, but does not seem to be sufficient authority for the court to name the trust company or some other person as trustee.

What are the trust terms? The article by Prensky and Ross *supra* has sample provisions for a special needs trust for a child (apparently whether the child is a minor or an adult). But this contemplates

voluntary creation of a trust by the parents of the injured person as an estate planning tool, not creation of a trust by the court. What authority is there for a parent to write trust terms for a child receiving settlement proceeds? The proceeds are the property of the recipient, not the property of the parents. Does the court approve the terms of the trust? What authority is there for the court to do so?

Special Needs Trust for Minor Unnecessary

There seems to be no need for special needs trust for a minor, because the court approving settlement may order that the proceeds be paid to a custodian under the California Uniform Transfers to Minors Act. Prob. Code §§ 3602, 3611. The Uniform Act has carefully drafted provisions on administration and disbursement of custodial funds.

Special Needs Trust for Incompetent Adult

The problem of a special needs trust for an incompetent adult is more difficult. Who proposes the terms of the trust to the court? Must the court review or draft a trust in each case? Isn't there a potential conflict of interest between the incompetent person and his or her relatives who propose the trust?

There appears to be a need for a statute with provisions for administration and disbursement of settlement proceeds for an incompetent adult if a court-supervised conservatorship is to be avoided. California does not now have such a statute. But the Uniform Custodial Trust Act (approved in 1987 by the National Conference of Commissioners on Uniform State Laws) would provide authority for an adult comparable to that provided for minors by the Uniform Transfers to Minors Act. The Uniform Custodial Trust Act is attached as Exhibit 2. The Prefatory Note to the Act observes:

The provisions of this Act are based on trust analogies to concepts developed and used in establishing custodianships for minors under the Uniform Transfers to Minors Act [The Act will] be available for accomplishing distribution of funds by judgment debtors and others to incapacitated persons for whom a conservator has not been appointed.

The Act would provide a comprehensive scheme for special needs trusts for settlement proceeds of an adult incompetent parallel to existing authority in the Probate Code for custodianships for minors for such proceeds.

In 1989, the Uniform Custodial Trust Act was introduced in a bill by Assemblyman Byron Sher. The bill was opposed by the Executive Committee of the Estate Planning, Trust and Probate Law Section of the State Bar. The State Bar analysis is attached as Exhibit 3. According to the State Bar, "there is no demonstrated need for such an unprotected and unsupervised testamentary device when one considers the available alternatives, such as formal trusts, conservatorships, durable powers of attorney for estate management and joint tenancy."

The staff recommends adoption of the Uniform Custodial Trust Act. If necessary to satisfy objections of the State Bar, we would limit application of the Act to money and property paid pursuant to a court-approved settlement or judgment for an incompetent adult under Probate Code Sections 3600-3612. If the Commission thinks this would be a desirable approach, the staff will prepare a *Tentative Recommendation* for a future meeting.

Respectfully submitted,

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BROBECK, PHLEGER & HARRISON

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June 13, 1991

WRITER'S DIRECT DIAL NUMBER (213) 745-3378

Hon. Arthur K. Marshall
The California Plaza
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Re: Special Needs Trusts

Dear Art:

I appreciated the opportunity to talk to you about special needs trusts. They are being used with greater frequency to aid in the settlement of personal injury cases where severe permanent handicaps exist. As I mentioned to you, it is typical that a bank or trust company is the trustee of the trust, and there is also an advisory committee, usually composed of family members and friends, who determine how the funds are to be disbursed for the benefit of the injured party. The institutional trustee has the sole management and possession of the trust estate.

As we discussed, in addition to the management, investment and protection of the trust estate by the institutional trustee, one of the purposes of the special needs trust is that the assets in the trust not be considered "available" resources to disqualify the beneficiary from public entitlement

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benefits, such as Medi-Cal. These trusts are recognized in the Social Security Administration Regulations as not being an available resource. The trusts are discretionary, spendthrift trusts.

Now, to the problem. As a member of the Law Revision Commission, we are hopeful that you can be of assistance to us in reversing what we believe to be an inadvertent amendment to certain probate code sections, which amendment might affect the creation of special needs trusts in connection with settlement of personal injury claims. Perhaps a little background would be helpful. The settlement situations where special needs trusts have been used are typically ones where no formal guardianship or conservatorship has been established. Rather, guardians ad litem have been appointed for the minor or incompetent person. This is authorized under Code of Civil Procedure Sections 372, 373, and 373.5. Code of Civil Procedure Section 372 provides in part that any money or other property to be paid or delivered in connection with a judgment or settlement of a claim involving a minor or incompetent person "shall be paid and delivered as provided in Probate Code Sections 3600 et seq." Code of Civil Procedure Section 373.5 has a similar requirement.

Probate Code Sections 3610-3612 contain the relevant provisions for the disposition of money where there is no formal guardianship or conservatorship. The important provision

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currently in effect is Probate Code Section 3611(b) which authorizes money to be deposited "in a bank in this state or in a trust company authorized to transact a trust business in this state." Interestingly, Probate Code Section 3602, which deals with situations where there is a formal guardianship or conservatorship, also authorizes the court to order that the money coming to the injured party "not become a part of the guardianship or conservatorship estate and instead be deposited in a bank in this state or in a trust company authorized to transact a trust business in this state." (Probate Code Section 3602(c)(1)).

The troublesome new language is in Assembly Bill 759, introduced by Assemblyperson Friedman on February 21, 1989. We have now received the information from the Legislative Intent Service giving the background on AB 759. As originally introduced, there was no change to either Probate Code Section 3602(c)(1) or Probate Code Section 3611(b). However, at the first amendment on May 30, 1989, both those sections were modified deleting the language set forth above and adding, in lieu thereof, "an insured account in a financial institution in this state." That new language stayed in the bill through the Legislative process and, as you know, was adopted and will be operative July 1, 1991.

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a financial institution in this state, or in a trust company authorized to transact a trust business in this state, or in a single-premium deferred annuity, subject to withdrawal only upon authorization of the court."

Probate Code Section 3611(b) should be amended to read as follows:

"(b) [T]hat the remaining balance of any money paid or to be paid be deposited in an insured account in a financial institution in this state, or in a trust company authorized to transact a trust business in this state, or in a single-premium deferred annuity, subject to withdrawal only upon the authorization of the court, and that the remaining balance of any other property delivered or to be delivered be held on such conditions as the court determines to be in the best interest of the minor or incompetent person."

We understand that you, as a member of the Law Revision Commission, will take up the matter of reversing this inadvertent change at the next meeting of the Law Revision Commission. We thank you for your interest and support.

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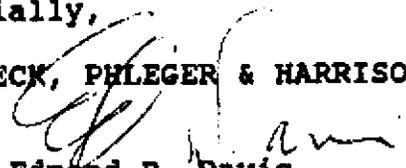
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Please let me know if you have any questions or if we
can be of further assistance.

Cordially,

BROBECK, PHLEGER & HARRISON

By


Edmond R. Davis

ERD:hme5220

UNIFORM CUSTODIAL TRUST ACT

Drafted by the

**NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS**

and by it

**APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES**

At its

**ANNUAL CONFERENCE
MEETING IN ITS NINETY-SIXTH YEAR
IN NEWPORT BEACH, CALIFORNIA
JULY 31 - AUGUST 7, 1987**

With Prefatory Note and Comments

UNIFORM CUSTODIAL TRUST ACT

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UNIFORM CUSTODIAL TRUST ACT

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UNIFORM CUSTODIAL TRUST ACT

PREFATORY NOTE

This Uniform Act provides for the creation of a statutory custodial trust for adults to be governed by the provisions of the Act whenever property is delivered to another "as custodial trustee under the (Enacting state) Uniform Custodial Trust Act." The provisions of this Act are based on trust analogies to concepts developed and used in establishing custodianships for minors under the Uniform Transfers to Minors Act (UTMA). The Custodial Trust Act is designed to provide a statutory standby inter vivos trust for individuals who typically are not very affluent or sophisticated, and possibly represented by attorneys engaged in general rather than specialized estate practice. The most frequent use of this trust would be in response to the commonly occurring need of elderly individuals to provide for the future management of assets in the event of incapacity. The statute will also be available for accomplishing distribution of funds by judgment debtors and others to incapacitated persons for whom a conservator has not been appointed. Since this Act allows any person, competent to transfer property, to create custodial trusts for the benefit of themselves or others, with the beneficial interest in custodial trust property in the beneficiary and not in the custodial trustee, its potential for use is extensive. Although the most frequent use probably will be by elderly persons, it is also available for a parent to establish a custodial trust for an adult child who may be incapacitated; for adult persons in the military, or those leaving the country temporarily, to place their property with another for management without relinquishing beneficial ownership of their property; or for young people who have received property under the Uniform Transfers to Minors Act to continue a custodial trust as adults in order to obtain the benefit and convenience of management services performed by the custodial trustee.

This Act follows the approach taken by the Uniform Transfers to Minors Act and allows any kind of property, real or personal, tangible or intangible, to be made the subject of a transfer to a custodial trustee for the benefit of a beneficiary. However, the most typical transaction envisioned would involve a person who would transfer intangible property, such as securities or bank accounts, to a custodial trustee but with retention by the transferor of direction over the property. Later, this direction could be relinquished,

or it could be lost upon incapacity. The objective of the statute is to provide a simple trust that is uncomplicated in its creation, administration, and termination. The potential for tax problems is minimized by permitting the beneficiary in most instances to retain control while the beneficiary has capacity to manage the assets effectively. The statute contains an asset specific transfer provision that it is believed will be simple to use and will gain the acceptance of the securities and financial industry. A simple transfer document, examples of which are set forth in the Act, and a receipt from the custodian, also in the Act, would provide for identification of beneficiaries or distributees upon death of the beneficiary. Protection is extended to third parties dealing with the custodian. Although the Act is patterned on the Uniform Transfers to Minors Act and meshes into the Uniform Probate Code, it is appropriate for enactment as well in states which have not adopted either UTMA or the UPC.

An adult beneficiary, who is not incapacitated, may: (1) terminate the custodial trust on demand (Section 2(e)); (2) receive so much of the income or custodial property as he or she may request from time to time (Section 9(a)); and (3) give the custodial trustee binding instructions for investment or management (Section 7(b)). In the absence of direction by the beneficiary, who is not incapacitated, the custodial trustee manages the property subject to the standard of care that would be observed by a prudent person dealing with the property of another and is not limited by other statutory restrictions on investments by fiduciaries. (Section 7).

A principal feature of the Custodial Trust under this Act is designed to protect the beneficiary and his or her dependents against the perils of the beneficiary's possible future incapacity without the necessity of a conservatorship. Under Section 10, the incapacity of the beneficiary does not terminate (1) the custodial trust, (2) the designation of a successor custodial trustee, (3) any power or authority of the custodial trustee, or (4) the immunities of third persons relying on actions of the custodial trustee. The custodial trustee continues to manage the property as a discretionary trust under the prudent person standard for the benefit of the incapacitated beneficiary.

Means of monitoring and enforcing the custodial trust include provisions requiring the custodial trustee to keep the beneficiary informed, requiring

accounting by the custodial trustee (Section 15), providing for removal of the custodial trustee (Section 13), and the distribution of the assets on termination of the custodial trust (Section 17). The custodial trustee is protected in Section 16 by the statutes of limitation on proceedings against the custodial trustee.

Transactions with the custodial trustee should be executed readily and quickly by third parties because their rights and protections are determined by the Act and a third party acting in good faith has no need to determine the custodial trustee's authority to bind the beneficiary with respect to property and investment matters. (Section 11). The Act generally limits the claims of third parties to recourse against the custodial property, with the beneficiary insulated against personal liability unless he or she is personally at fault and the custodial trustee is similarly insulated unless the custodial trustee is personally at fault or failed to disclose the custodial capacity when entering into a contract (Section 12).

As a consequence of the mobility of our population, particularly the mature persons who are most likely to utilize this Act, uniformity of the laws governing custodial trusts is highly desirable, and the Act is designed to avoid conflict of laws problems. A custodial trust created under this Act remains subject to this Act despite a subsequent change in the residence of the transferor, the beneficiary, or the custodial trustee or the removal of the custodial trust property from the state of original location. (Section 19).

UNIFORM CUSTODIAL TRUST ACT

SECTION 1. DEFINITIONS.

As used in this [Act]:

(1) "Adult" means an individual who is at least 18 years of age.

(2) "Beneficiary" means an individual for whom property has been transferred to or held under a declaration of trust by a custodial trustee for the individual's use and benefit under this [Act].

(3) "Conservator" means a person appointed or qualified by a court to manage the estate of an individual or a person legally authorized to perform substantially the same functions.

(4) "Court" means the [_____] court of this State.

(5) "Custodial trust property" means an interest in property transferred to or held under a declaration of trust by a custodial trustee under this [Act] and the income from and proceeds of that interest.

(6) "Custodial trustee" means a person designated as trustee of a custodial trust under this [Act] or a substitute or successor to the person designated.

(7) "Guardian" means a person appointed or qualified by a court as a guardian of an individual,

including a limited guardian, but not a person who is only a guardian ad litem.

(8) "Incapacitated" means lacking the ability to manage property and business affairs effectively by reason of mental illness, mental deficiency, physical illness or disability, chronic use of drugs, chronic intoxication, confinement, detention by a foreign power, disappearance, minority, or other disabling cause.

(9) "Legal representative" means a personal representative or conservator.

(10) "Member of the beneficiary's family" means a beneficiary's spouse, descendant, stepchild, parent, stepparent, grandparent, brother, sister, uncle, or aunt, whether of the whole or half blood or by adoption.

(11) "Person" means an individual, corporation, business trust, estate, trust, partnership, joint venture, association, or any other legal or commercial entity.

(12) "Personal representative" means an executor, administrator, or special administrator of a decedent's estate, a person legally authorized to perform substantially the same functions, or a successor to any of them.

(13) "State" means a state, territory, or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico.

(14) "Transferor" means a person who creates a custodial trust by transfer or declaration.

(15) "Trust company" means a financial institution, corporation, or other legal entity, authorized to exercise general trust powers.

COMMENT

(1) "Adult" is a person 18 years of age for the purpose of custodial trusts. The result of this is that a person 18 years of age will be eligible to be a custodial trustee under this Act, although he or she may not be eligible under UTMA since minor custodianships under UTMA may run to age 21 and the minor could in some cases be older than the custodian. As the Comments under Section 1 of UTMA explain, the age of 21 was retained under that Act because the Internal Revenue Code continues to permit a "minority trust" under Section 2053(c), to continue in effect until age 21 and because it was believed that most transferors creating trusts or custodianships for minors would prefer to retain the property under management for the benefit of the young person as long as possible. The difference has little or no practical consequence and serves the purpose of each Act.

(3) "Conservator" is defined broadly to permit identification of a person functioning as a conservator.

(4) "Court" means _____ court. Here the likelihood is that most states would utilize the same court, e.g., the probate court, that deals with conservators and estates.

(5 and 6) The terms, "custodial trust property" and "custodial trustee," are used throughout to identify clearly the statutory trust property and trustee under this Act. The statutory trust concept is used throughout the Act.

(7) A definition of guardian has been included and is based on the Uniform Probate Code Section 5-103(6).

(8) A definition of incapacitated has been included, for the purpose of this Act, because incapacity of the beneficiary converts the trust from a revocable trust to a discretionary trust. The definition is taken from the Uniform Probate Code Section 5-401(c) relating to the person who is unable to manage property. Compare Uniform Probate Code Section 5-103(7). Note that Section 10(a)(ii) permits a transferor to direct that the trust shall be administered as one for an incapacitated person. Section 10 deals specifically with the determination of incapacity.

(10) The beneficiary's family is broadly defined to identify persons who may have standing to seek judicial intervention or accounting (Sections 13 and 15).

(11) The definition of a person is taken from the Uniform Probate Code Section 1-201(29).

(12) Personal representative is broadly defined and the definition reflects that in the Uniform Probate Code Section 1-201(30).

SECTION 2. CUSTODIAL TRUST; GENERAL.

(a) A person may create a custodial trust of property by a written transfer of the property to another person, evidenced by registration or by other instrument of transfer, executed in any lawful manner, naming as beneficiary, an individual who may be the transferor, in which the transferee is designated, in substance, as custodial trustee under the [Enacting state] Uniform Custodial Trust Act.

(b) A person may create a custodial trust of property by a written declaration, evidenced by registration of the property or by other instrument of declaration executed in any lawful manner, describing the property and naming as beneficiary an individual other than the declarant, in which the declarant as titleholder is designated, in substance, as custodial trustee under the [Enacting state] Uniform Custodial Trust Act. A registration or other declaration of trust for the sole benefit of the declarant is not a custodial trust under this [Act].

(c) Title to custodial trust property is in the custodial trustee and the beneficial interest is in the beneficiary.

(d) Except as provided in subsection (e), a transferor may not terminate a custodial trust.

(e) The beneficiary, if not incapacitated, or the conservator of an incapacitated beneficiary, may terminate a custodial trust by delivering to the custodial trustee a writing signed by the beneficiary or conservator declaring the termination. If not previously terminated, the custodial trust terminates on the death of the beneficiary.

(f) Any person may augment existing custodial trust property by the addition of other property pursuant to this [Act].

(g) The transferor may designate, or authorize the designation of, a successor custodial trustee in the trust instrument.

(h) This [Act] does not displace or restrict other means of creating trusts. A trust whose terms do not conform to this [Act] may be enforceable according to its terms under other law.

COMMENT

Section 2 is the principal provision authorizing the creation of a custodial trust and utilizes the concept of incorporation by reference when the transferee or titleholder of property is designated as custodial trustee under the Act. Section 2 sets forth the general effect of such a transfer. Section 18 provides forms which satisfy the requirements of this section and identifies customary methods of transferring assets to create a custodial trust.

Section 2(a) provides that a trust may be created by transfer to another for the benefit of the transferor or another. This is expected to be the most common way in which a custodial trust would be created. However, a custodial trust may also be created by declaration of trust by the owner of property to hold it for the benefit of another as is provided in Section 2(b). A declaration in trust by the owner of property for the sole benefit of the owner is not contemplated by this Act because such an attempt may be considered ineffective as a trust due to the total identity of the trustee and beneficiary. However, the doctrine of merger would not preclude an effective transfer under this Act for the benefit of the transferor and one or more other beneficiaries. See Section 6.

A custodial trust could be created by the exercise of a valid power of attorney or power of appointment given by the owner of property as one of the transfers "consistent with law."

These alternatives permit the major uses of the custodial trust to be accomplished expeditiously. For example, an older person, wishing to be relieved of management of property may transfer property to another for benefit of the transferor or of the transferor's spouse or child. The declaration may be used to

establish a trust of which the owner is trustee to continue management of the property for benefit of another, such as a spouse or child. The trust may include a provision for distribution of assets remaining at the beneficiary's death directly to a named distributee.

This Act does not preclude the creation of trusts under other existing law, statutory or nonstatutory, but is designed to facilitate the creation of simple trusts incorporating the provisions of this Act. The written transfer or declaration "consistent with law" requires that the formalities of the transfer of particular property necessary under other law will be observed, e.g., if land is involved, the requirements of a proper deed and recording must be satisfied.

Section 2(c) provides for the retention of the beneficial interest in the custodial trust property in the beneficiary and, of course, not in the custodial trustee. The extensive control and benefit in the beneficiary who is not incapacitated maintains the simplicity of the trust and avoids tax complexity. The custodial trustee is given the title to the property and authority to act with regard to the property only as is authorized by the statute. The custodial trustee's powers are enumerated in Section 8.

Section 2(e) gives the adult beneficiary, who is not incapacitated, the power to terminate the custodial trust at any time during his or her lifetime. This power of termination exists in any beneficiary who is not incapacitated whether the beneficiary was or was not the transferor. A beneficiary may be determined to be incapacitated or the transferor may designate that the trust is to be administered as a trust for an incapacitated beneficiary under Section 10, in which event the beneficiary does not have the power to terminate. However, the designation of incapacity by the transferor can be modified by the trustee or the court by reason of changed circumstances pursuant to Section 10. The Act precludes termination by exercise of a durable power of attorney if the beneficiary is incompetent (Section 7(f)). If the donor prefers not to permit the beneficiary the power to terminate or to designate the beneficiary as incapacitated under Section 10, an individually drafted trust outside the scope of this Act would seem appropriate.

Upon termination of a custodial trust, the custodial trust property must be distributed as provided in Section 17.

A transfer under this Act is irrevocable except to the extent the beneficiary may terminate it. Hence, a transfer to a trustee for benefit of a person other than the transferor is not revocable by the transferor. If a power of revocation were retained by the transferor, that would be a trust outside the scope of this Act and enforceable under general law pursuant to subsection 2(h).

This Act does not provide for protection of the custodial trust assets from the claims of creditors of the beneficiary, whether those are general or governmental creditors. Other laws of the state remain unaffected. In this regard, unusual problems of handicapped persons and the coordination of resources and state or federal services call for special provision and planning outside the scope of this Act.

SECTION 3. CUSTODIAL TRUSTEE FOR FUTURE PAYMENT OR TRANSFER.

(a) A person having the right to designate the recipient of property payable or transferable upon a future event may create a custodial trust upon the occurrence of the future event by designating in writing the recipient, followed in substance by: "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act."

(b) Persons may be designated as substitute or successor custodial trustees to whom the property must be paid or transferred in the order named if the first designated custodial trustee is unable or unwilling to serve.

(c) A designation under this section may be made in a will, a trust, a deed, a multiple-party account, an insurance policy, an instrument exercising a power of appointment, or a writing designating a beneficiary of contractual rights. Otherwise, to be effective, the designation must be registered with or delivered to the fiduciary, payor, issuer, or obligor of the future right.

COMMENT

This section permits a future custodial trustee to be designated to receive property for the beneficiary of a custodial trust to be effective upon the occurrence of a future event or transfer. To accommodate changes in circumstances during the passage of time, one or more successors or substitute custodial trustees can also be designated. The designation of the future custodial trustee and the beneficiary can be made in an instrument which is revocable or irrevocable depending upon the nature of the transaction or transfer. Any person designated as a future custodial trustee may decline to serve before the transfer occurs or may resign under Section 13 after the transfer.

The source of this section is Section 3 of UTMA.

The enacting state's rule against perpetuities may limit or affect the creation of a custodial trust upon the occurrence of a future event, but because the use of a custodial trust usually contemplates dispositions for the benefit of living persons, perpetuity problems should rarely arise.

SECTION 4. FORM AND EFFECT OF RECEIPT AND ACCEPTANCE BY CUSTODIAL TRUSTEE, JURISDICTION.

(a) Obligations of a custodial trustee, including the obligation to follow directions of the beneficiary, arise under this [Act] upon the custodial

trustee's acceptance, express or implied, of the custodial trust property.

(b) The custodial trustee's acceptance may be evidenced by a writing stating in substance:

CUSTODIAL TRUSTEE'S RECEIPT AND ACCEPTANCE

I, _____ (name of custodial trustee) acknowledge receipt of the custodial trust property described below or in the attached instrument and accept the custodial trust as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act. I undertake to administer and distribute the custodial trust property pursuant to the [Enacting state] Uniform Custodial Trust Act. My obligations as custodial trustee are subject to the directions of the beneficiary unless the beneficiary is designated as, is, or becomes incapacitated. The custodial trust property consists of _____.

Dated: _____

(Signature of Custodial Trustee)

(c) Upon accepting custodial trust property, a person designated as custodial trustee under this [Act] is subject to personal jurisdiction of the court with respect to any matter relating to the custodial trust.

COMMENT

Although a custodial trust is created by a transfer that satisfies Section 2 of the Act, the responsibility and obligations upon the trustee do not arise until the trustee has accepted the transfer. This detailed section is included to call the attention of the parties to the effective receipt and acceptance by the custodial trustee. Once a custodial trustee accepts the transfer of the custodial trust property, the custodial trustee assumes the obligation of a custodial trustee under this Act. The acceptance can be expressed or implied, but it is recommended that the written acceptance provided for in Section 4(b) be utilized. By the acceptance the custodial trustee submits to the personal jurisdiction of the courts of the enacting state for the purpose of the custodial trust, despite subsequent relocation of the parties or of the custodial trust property. The principal sources of these provisions are Sections 8 and 9 of UTMA and the analogous provisions under the Uniform Probate Code, Sections 3-602, 5-208, 5-307, 7-103.

SECTION 5. TRANSFER TO CUSTODIAL TRUSTEE BY FIDUCIARY OR OBLIGOR; FACILITY OF PAYMENT.

(a) Unless otherwise directed by an instrument designating a custodial trustee pursuant to Section 3, a person, including a fiduciary other than a custodial trustee, who holds property of or owes a debt to an incapacitated individual not having a conservator may make a transfer to an adult member of the beneficiary's family or to a trust company as custodial trustee for the use and benefit of the incapacitated individual. If the value of the property or the debt exceeds [\$20,000], the transfer is not effective unless authorized by the court.

(b) A written acknowledgment of delivery, signed by a custodial trustee, is a sufficient receipt and discharge for property transferred to the custodial trustee pursuant to this section.

COMMENT

This section is in the nature of a facility-of-payment provision that permits persons owing money to an incapacitated individual to discharge a fixed obligation by a payment to a custodial trustee under this Act. The section does not authorize the custodial trustee to settle claims for disputed amounts but only to acknowledge an effective receipt of property paid or delivered. It is based primarily on Sections 6 and 7 of UTMA and includes the protections of Section 8 of UTMA as well. It permits a custodial trust to be established as a substitute for a conservatorship to receive payments due an incapacitated individual. Also, see Section 11, which protects transferors and other third parties dealing with the custodial trustee.

SECTION 6. MULTIPLE BENEFICIARIES; SEPARATE CUSTODIAL TRUSTS; SURVIVORSHIP.

(a) Beneficial interests in a custodial trust created for multiple beneficiaries are deemed to be separate custodial trusts of equal undivided interests for each beneficiary. Except in a transfer or declaration for use and benefit of husband and wife, for whom survivorship is presumed, a right of survivorship does not exist unless the instrument creating the custodial trust specifically provides for survivorship [or survivorship is required as to community or marital property].

(b) Custodial trust property held under this [Act] by the same custodial trustee for the use and benefit of the same beneficiary may be administered as a single custodial trust.

(c) A custodial trustee of custodial trust property held for more than one beneficiary shall separately account to each beneficiary pursuant to Sections 7 and 15 for the administration of the custodial trust.

COMMENT

This Act, unlike UTMA, does not preclude a custodial trust for more than one beneficiary. Adult persons creating custodial trusts are likely to set up custodial trusts in various forms, e.g., parents may wish to set up a custodial trust for their children or for themselves, then for a spouse, etc. However, the interests of each beneficiary are separate and the custodial trustee is obligated under subsection (c) to account separately to each beneficiary for administration of the beneficiary's interest in the custodial trust.

Subsection (b) allows a custodial trustee who is administering multiple custodial trusts for the same beneficiary to administer the custodial trusts as a single custodial trust. For example, if multiple trusts are created for an incapacitated beneficiary, the custodial trustee can administer them as a single custodial trust.

SECTION 7. GENERAL DUTIES OF CUSTODIAL TRUSTEE.

(a) If appropriate, a custodial trustee shall register or record the instrument vesting title to custodial trust property.

(b) If the beneficiary is not incapacitated, a custodial trustee shall follow the directions of the

if it is registered, or held in an account in the name of the custodial trustee, designated in substance: "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act."

(e) A custodial trustee shall keep records of all transactions with respect to custodial trust property, including information necessary for the preparation of tax returns, and shall make the records and information available at reasonable times to the beneficiary or legal representative of the beneficiary.

(f) The exercise of a durable power of attorney for an incapacitated beneficiary is not effective to terminate or direct the administration or distribution of a custodial trust.

COMMENT

Subsection (b) restates and confirms the control by the beneficiary who is not incapacitated. However, the trustee has a reasonable obligation to act when the beneficiary has not directed him. Under Sections 9 and 10, when a beneficiary becomes incapacitated, the custodial trust becomes a discretionary trust and the trustee is subject to the control of the statute and not the beneficiary's direction. The custodial trustee is subject to the usual trustee's standard as taken from Section 7-302 of the Uniform Probate Code. The statute also imposes a slightly higher standard on professional fiduciaries acting under the statute. Otherwise, much of this section is taken from Section 12 of UTMA. Whenever recordable assets, such as land, are in the custodial trust, the trustee would be expected to record title to the asset. The section is entitled "general duties" because there are additional specific duties identified in other sections such as Section 9.

SECTION 8. GENERAL POWERS OF CUSTODIAL TRUSTEE.

(a) A custodial trustee, acting in a fiduciary capacity, has all the rights and powers over custodial trust property which an unmarried adult owner has over individually owned property, but a custodial trustee may exercise those rights and powers in a fiduciary capacity only.

(b) This section does not relieve a custodial trustee from liability for a violation of Section 7.

COMMENT

This section is taken from Section 13 of UTMA. It grants the trustee very broad powers over the property, subject, however, to the Prudent Person Rule and to the obligations set out in the Act. An alternative approach to subsection (a) that might be taken by an enacting state is to refer to the existing statutes granting powers to a trustee, such as the Uniform Trustee's Powers Act. For example: [(a) A custodial trustee has the powers of a trustee under the Uniform Trustee's Powers Act.]

SECTION 9. USE OF CUSTODIAL TRUST PROPERTY.

(a) A custodial trustee shall pay to the beneficiary or expend for the beneficiary's use and benefit so much or all of the custodial trust property as the beneficiary while not incapacitated may direct from time to time.

(b) If the beneficiary is incapacitated, the custodial trustee shall expend so much or all of the custodial trust property as the custodial trustee considers advisable for the use and benefit of the beneficiary and individuals who were supported by the

beneficiary when the beneficiary became incapacitated, or who are legally entitled to support by the beneficiary. Expenditures may be made in the manner, when, and to the extent that the custodial trustee determines suitable and proper, without court order and without regard to other support, income, or property of the beneficiary.

(c) A custodial trustee may establish checking, savings, or other similar accounts of reasonable amounts under which either the custodial trustee or the beneficiary may withdraw funds from, or draw checks against, the accounts. Funds withdrawn from, or checks written against, the account by the beneficiary are distributions of custodial trust property by the custodial trustee to the beneficiary.

COMMENT

This section provides that the custodial trustee is obligated to follow the directions of the beneficiary who is not incapacitated in paying over or expending custodial trust property. If the beneficiary is incapacitated, this section imposes duties on the custodial trustee to apply funds for the beneficiary similar to those imposed on custodians for minors under Section 14 of UTMA. In addition, however, subsection (b) authorizes a custodial trustee to pay over or expend custodial trust property for the use and benefit of the incapacitated beneficiary's dependents who were supported by the beneficiary at the time the beneficiary became incapacitated or for whom there is a legal obligation to support.

The use-and-benefits standard for the expenditure of custodial property is intended to avoid any implication that the custodial trust property can be used only for the required support of the incapacitated beneficiary.

Subsection (c) allows a custodial trustee to maintain a bank account, of an amount reasonable under the circumstances, with the beneficiary whereby both the beneficiary and the custodial trustee may write checks on the account. This may be used as one method of making money available for the beneficiary's personal needs. Many incapacitated persons, unable to manage business affairs, are still competent to pay personal expenses. This type of arrangement would be important to them. A custodial trustee should maintain, of course, a separate bank account for use in managing the custodial trust property and investments.

An alternative approach might be taken to this section that refers to the distributive powers of a conservator under the laws of the enacting state, in the event that state should prefer that incorporation by reference. For example: [The custodial trustee has the distributive powers of a conservator under the Uniform Probate Code.]

SECTION 10. DETERMINATION OF INCAPACITY; EFFECT.

(a) The custodial trustee shall administer the custodial trust as for an incapacitated beneficiary if

- (i) the custodial trust was created under Section 5,
- (ii) the transferor has so directed in the instrument creating the custodial trust, or
- (iii) the custodial trustee has determined that the beneficiary is incapacitated.

(b) A custodial trustee may determine that the beneficiary is incapacitated in reliance upon

- (i) previous direction or authority given by the beneficiary while not incapacitated, including direction or authority pursuant to a durable power of attorney,
- (ii) the certificate of the beneficiary's physician, or
- (iii) other persuasive evidence.

(c) If a custodial trustee for an incapacitated beneficiary reasonably concludes that the beneficiary's incapacity has ceased, or that circumstances concerning the beneficiary's ability to manage property and business affairs have changed since the creation of a custodial trust directing administration as for an incapacitated beneficiary, the custodial trustee may administer the trust as for a beneficiary who is not incapacitated.

(d) On petition of the beneficiary, the custodial trustee, or other person interested in the custodial trust property or the welfare of the beneficiary, the court shall determine whether the beneficiary is incapacitated.

(e) Absent determination of incapacity of the beneficiary under subsection (b) or (d), a custodial trustee who has reason to believe that the beneficiary is incapacitated shall administer the custodial trust in accordance with the provisions of this [Act] applicable to an incapacitated beneficiary.

(f) Incapacity of a beneficiary does not terminate (i) the custodial trust, (ii) any designation of a successor custodial trustee, (iii) rights or powers of the custodial trustee, or (iv) any immunities of third persons acting on instructions of the custodial trustee.

COMMENT

This is one of the more important sections of the Act under which the custodial trustee may determine that the beneficiary is incapacitated so the trust will change from one subject to the control of the beneficiary to a discretionary trust for the beneficiary. Subsection (b) allows the custodial trustee to determine that the beneficiary is incapacitated provided the determination is based upon the certificate of the beneficiary's physician, the prior direction or authority of the beneficiary, or other reasonable evidence. That authority could be evidenced, for example, by a durable power of attorney executed by the beneficiary prior to becoming incapacitated even though that power of attorney is not otherwise effective to control management or termination of the custodial trust. Such a durable power of attorney could be given to a child, spouse, friend, or other trusted individual. In addition, specific authority is provided in subsection (d) for the beneficiary, the custodial trustee, or other interested person to seek a declaration from the court as to the capacity of the beneficiary for the purposes of this Act. This is important to the custodial trustee, as his duties and responsibilities change on the event of the beneficiary's incapacity.

This section is not a proceeding for the appointment of a conservator, and it is not contemplated that such a declaration would lead to court appointment of a conservator or guardian unless other factors would warrant such appointment. The existence of a comprehensive and well-managed custodial trust would be one factor that would tend to avoid the necessity for the appointment of a conservator or guardian of the estate.

This section also does not provide a proceeding to attack the legal competence of a transferor in setting up a trust under Section 2. Rather, Section 10 relates to a management matter in a validly established custodial trust.

Subsection (f) provides that the incapacity of the beneficiary does not terminate the custodial trust. If the beneficiary becomes incapacitated, the authority of the custodial trustee continues and the custodial trustee must follow the statutory provisions of the Act relating to managing custodial trusts for incapacitated individuals.

SECTION 11. EXEMPTION OF THIRD PERSON FROM LIABILITY.

A third person in good faith and without a court order may act on instructions of, or otherwise deal with, a person purporting to make a transfer as, or purporting to act in the capacity of, a custodial trustee. In the absence of knowledge to the contrary, the third person is not responsible for determining:

- (1) the validity of the purported custodial trustee's designation;
- (2) the propriety of, or the authority under this [Act] for, any action of the purported custodial trustee;
- (3) the validity or propriety of an instrument executed or instruction given pursuant to this [Act] either by the person purporting to make a transfer or declaration or by the purported custodial trustee; or
- (4) the propriety of the application of property vested in the purported custodial trustee.

COMMENT

This section is based upon Section 16 of the UTMA and protects third persons who deal in good faith with the custodial trustee.

SECTION 12. LIABILITY TO THIRD PERSON.

- (a) A claim based on a contract entered into by a custodial trustee acting in a fiduciary capacity, an obligation arising from the ownership or control of

custodial trust property, or a tort committed in the course of administering the custodial trust, may be asserted by a third person against the custodial trust property by proceeding against the custodial trustee in a fiduciary capacity, whether or not the custodial trustee or the beneficiary is personally liable.

(b) A custodial trustee is not personally liable to a third person:

(1) on a contract properly entered into in a fiduciary capacity unless the custodial trustee fails to reveal that capacity or to identify the custodial trust in the contract; or

(2) for an obligation arising from control of custodial trust property or for a tort committed in the course of the administration of the custodial trust unless the custodial trustee is personally at fault.

(c) A beneficiary is not personally liable to a third person for an obligation arising from beneficial ownership of custodial trust property or for a tort committed in the course of administration of the custodial trust unless the beneficiary is personally in possession of the custodial trust property giving rise to the liability or is personally at fault.

(d) Subsections (b) and (c) do not preclude actions or proceedings to establish liability of the custodial trustee or beneficiary to the extent the

person sued is protected as the insured by liability insurance.

COMMENT

This section is patterned after Section 17 of the UTMA and that section in turn was based upon Sections 5-428 and 7-306 of the Uniform Probate Code limiting the liability of conservators and trustees. See also Restatement of Trusts, 2d. Sections 265 and 277. The effect of this section is to limit the claims of third parties to recourse against custodial trust property as both the custodial trustee and the beneficiary are protected from personal liability absent personal fault on their part. This section does not alter the obligations between the custodial trustee and the beneficiary arising out of the administration of the estate and the accounting for that administration.

There may be cases in which a custodial trustee or beneficiary may have a right to possession of custodial trust property and may insure against liability arising out of possession or control of the property as a named insured, e.g., under homeowner's or automobile liability insurance. In such a case, the beneficiary should be permitted as a party defendant under subsection (d) but only to the extent of the protection of the liability insurance.

SECTION 13. DECLINATION, RESIGNATION, INCAPACITY, DEATH, OR REMOVAL OF CUSTODIAL TRUSTEE, DESIGNATION OF SUCCESSOR CUSTODIAL TRUSTEE.

(a) Before accepting the custodial trust property, a person designated as custodial trustee may decline to serve by notifying the person who made the designation, the transferor, or the transferor's legal representative. If an event giving rise to a transfer has not occurred, the substitute custodial trustee designated under Section 3 becomes the custodial trustee, or, if a substitute custodial trustee has not

been designated, the person who made the designation may designate a substitute custodial trustee pursuant to Section 3. In other cases, the transferor or the transferor's legal representative may designate a substitute custodial trustee.

(b) A custodial trustee who has accepted the custodial trust property may resign by (i) delivering written notice to a successor custodial trustee, if any, the beneficiary and, if the beneficiary is incapacitated, to the beneficiary's conservator, if any, and (ii) transferring or registering, or recording an appropriate instrument relating to, the custodial trust property, in the name of, and delivering the records to, the successor custodial trustee identified under subsection (c).

(c) If a custodial trustee or successor custodial trustee is ineligible, resigns, dies, or becomes incapacitated, the successor designated under Section 2(g) or 3 becomes custodial trustee. If there is no effective provision for a successor, the beneficiary, if not incapacitated, may designate a successor custodial trustee. If the beneficiary is incapacitated, or fails to act within 90 days after the ineligibility, resignation, death, or incapacity of the custodial trustee, the beneficiary's conservator becomes successor custodial trustee. If the beneficiary does not have a conservator or the

conservator fails to act, the resigning custodial trustee may designate a successor custodial trustee.

(d) If a successor custodial trustee is not designated pursuant to subsection (c), the transferor, the legal representative of the transferor or of the custodial trustee, an adult member of the beneficiary's family, the guardian of the beneficiary, a person interested in the custodial trust property, or a person interested in the welfare of the beneficiary, may petition the court to designate a successor custodial trustee.

(e) A custodial trustee who declines to serve or resigns, or the legal representative of a deceased or incapacitated custodial trustee, as soon as practicable, shall put the custodial trust property and records in the possession and control of the successor custodial trustee. The successor custodial trustee may enforce the obligation to deliver custodial trust property and records and becomes responsible for each item as received.

(f) A beneficiary, the beneficiary's conservator, an adult member of the beneficiary's family, a guardian of the person of the beneficiary, a person interested in the custodial trust property, or a person interested in the welfare of the beneficiary, may petition the court to remove the custodial trustee for cause and designate a successor custodial trustee,

to require the custodial trustee to furnish a bond or other security for the faithful performance of fiduciary duties, or for other appropriate relief.

COMMENT

This section follows many of the provisions of Section 18 of UTMA with some substantive changes. It is designed to accommodate in a single section the circumstances in which a custodial trustee would be replaced by another custodial trustee. Under subsection (b), if the beneficiary is incapacitated, a custodial trustee who resigns must give written notice to both the beneficiary and the beneficiary's conservator if one exists. Under subsection (c), a beneficiary who is not incapacitated may designate, without limitation, a successor custodial trustee. If, however, the beneficiary fails to act or is incapacitated, the procedure to be followed is very similar to that found in UTMA except that the nonincapacitated beneficiary has 90 days to act and if the beneficiary has no conservator or if the conservator declines to act, the custodial trustee may eventually designate a successor custodial trustee.

Under subsection (f), the beneficiary, whether or not incapacitated, can petition the court to remove the custodial trustee for cause and to designate a successor trustee, or the court may require the custodial trustee to give bond or other appropriate relief.

This section, unlike Section 18 of UTMA, does not give the custodial trustee the general power to designate a successor custodial trustee but rather limits that power to the situation in which the procedure for designating successor custodial trustees by others has been exhausted.

SECTION 14. EXPENSES, COMPENSATION, AND BOND OF CUSTODIAL TRUSTEE.

Except as otherwise provided in the instrument creating the custodial trust, in an agreement with the beneficiary, or by court order, a custodial trustee:

(1) is entitled to reimbursement from custodial trust property for reasonable expenses incurred in the performance of fiduciary services;

(2) has a noncumulative election, to be made no later than six months after the end of each calendar year, to charge a reasonable compensation for fiduciary services performed during that year; and

(3) need not furnish a bond or other security for the faithful performance of fiduciary duties.

COMMENT

This section follows the pattern of Section 15 of the UTMA except it does subject the arrangements for payment of expenses, compensation, and bond to provisions in the custodial trust instrument or agreement of the beneficiary or court order.

As in UTMA, the provisions with regard to compensation are designed to avoid imputed compensation to the custodian who waives compensation and also to avoid the accumulation of claims for compensation until the termination of the custodial trust. Although the ability to control these matters by the trust instrument or agreement of the beneficiary seems to be implied, as was assumed in UTMA, it is here expressly stated because of the possibility of informal arrangements with persons as trustees.

SECTION 15. REPORTING AND ACCOUNTING BY CUSTODIAL TRUSTEE; DETERMINATION OF LIABILITY OF CUSTODIAL TRUSTEE.

(a) Upon the acceptance of custodial trust property, the custodial trustee shall provide a written statement describing the custodial trust property and shall thereafter provide a written statement of the administration of the custodial trust property (i) once

each year, (ii) upon request at reasonable times by the beneficiary or the beneficiary's legal representative, (iii) upon resignation or removal of the custodial trustee, and (iv) upon termination of the custodial trust. The statements must be provided to the beneficiary or to the beneficiary's legal representative, if any. Upon termination of the beneficiary's interest, the custodial trustee shall furnish a current statement to the person to whom the custodial trust property is to be delivered.

(b) A beneficiary, the beneficiary's legal representative, an adult member of the beneficiary's family, a person interested in the custodial trust property, or a person interested in the welfare of the beneficiary may petition the court for an accounting by the custodial trustee or the custodial trustee's legal representative.

(c) A successor custodial trustee may petition the court for an accounting by a predecessor custodial trustee.

(d) In an action or proceeding under this [Act] or in any other proceeding, the court may require or permit the custodial trustee or the custodial trustee's legal representative to account. The custodial trustee or the custodial trustee's legal representative may petition the court for approval of final accounts.

(e) If a custodial trustee is removed, the court shall require an accounting and order delivery of the custodial trust property and records to the successor custodial trustee and the execution of all instruments required for transfer of the custodial trust property.

(f) On petition of the custodial trustee or any person who could petition for an accounting, the court, after notice to interested persons, may issue instructions to the custodial trustee or review the propriety of the acts of a custodial trustee or the reasonableness of compensation determined by the custodial trustee for the services of the custodial trustee or others.

COMMENT

This section requires that the custodial trustee inform the beneficiary of the initiation of the trust and provide reasonably current reports of the administration of the custodial trust to the beneficiary or the beneficiary's legal representative. Even though some custodial trustees may act informally, it seems appropriate that both the trustee and the beneficiary be expected to exchange complete information concerning the administration of the trust at least once each year. In some cases, more frequent exchanges of information between the custodial trustee and beneficiary would be expected, e.g., when they use a bank account to which both have access. This is particularly true with regard to necessary information for tax reporting by the parties involved. This section assumes the usual minimum components of an account, i.e., assets and values at the beginning of the accounting period, receipts, and disbursements during the accounting period and assets and their values on hand or available for distribution at the close of the accounting period.

Subsection (a) identifies the necessary reports and accountings for the parties, and subsection (b) identifies a broad group of persons who may petition

the court for an accounting by the custodial trustee or the custodial trustee's legal representative. Much of the section is drawn from Section 19 of the UTMA modified to fit the custodial trust. Subsection (f) recognizes the inherent power of the court to instruct trustees and review their actions. This paragraph is patterned after Uniform Probate Code Section 7-205.

SECTION 16. LIMITATIONS OF ACTION AGAINST CUSTODIAL TRUSTEE.

(a) Except as provided in subsection (c), unless previously barred by adjudication, consent, or limitation, a claim for relief against a custodial trustee for accounting or breach of duty is barred as to a beneficiary, a person to whom custodial trust property is to be paid or delivered, or the legal representative of an incapacitated or deceased beneficiary or payee:

(1) who has received a final account or statement fully disclosing the matter unless an action or proceeding to assert the claim is commenced within two years after receipt of the final account or statement; or

(2) who has not received a final account or statement fully disclosing the matter unless an action or proceeding to assert the claim is commenced within three years after the termination of the custodial trust.

(b) Except as provided in subsection (c), a claim for relief to recover from a custodial trustee

for fraud, misrepresentation, or concealment related to the final settlement of the custodial trust or concealment of the existence of the custodial trust, is barred unless an action or proceeding to assert the claim is commenced within five years after the termination of the custodial trust.

(c) A claim for relief is not barred by this section if the claimant:

(1) is a minor, until the earlier of two years after the claimant becomes an adult or dies;

(2) is an incapacitated adult, until the earliest of two years after (i) the appointment of a conservator, (ii) the removal of the incapacity, or (iii) the death of the claimant; or

(3) was an adult, now deceased, who was not incapacitated, until two years after the claimant's death.

COMMENT

In an effort to provide as comprehensive a statute as possible to inform the parties of substantially all of their obligations and rights, statutes of limitation are provided in this section. The limitations provided in this section are derived from the Uniform Probate Code, Sections 1-106 and 7-307, and from the Missouri Custodial Act.

The nature of the limitations imposed by the section are illustrated by the situation in which a custodial trustee is removed, resigns, or dies. If the former custodial trustee accounts as required under Section 13 on removal or resignation, or the deceased custodial trustee's personal representative accounts, the two-year limitation of subsection (a)(1) applies. Should the former custodial trustee or the personal representative fail to account, then, subsection (a)(2)

would apply to limit the time in which a proceeding to assert the claim could be commenced. This time would begin to run on the date the trust terminated. Of course, if the claim is one for fraud or concealment, the longer time limitation of subsection (b) would apply. In any event, should the beneficiary become incapacitated or die before the applicable time limitation had expired, the tolling provision of subsection (c) could postpone the time bar until two years after removal of the disability or death.

SECTION 17. DISTRIBUTION ON TERMINATION.

(a) Upon termination of a custodial trust, the custodial trustee shall transfer the unexpended custodial trust property:

(1) to the beneficiary, if not incapacitated or deceased;

(2) to the conservator or other recipient designated by the court for an incapacitated beneficiary; or

(3) upon the beneficiary's death, in the following order:

(i) as last directed in a writing signed by the deceased beneficiary while not incapacitated and received by the custodial trustee during the life of the deceased beneficiary;

(ii) to the survivor of multiple beneficiaries if survivorship is provided for pursuant to Section 6;

(iii) as designated in the instrument creating the custodial trust; or

(iv) to the estate of the deceased beneficiary.

(b) If, when the custodial trust would otherwise terminate, the distributee is incapacitated, the custodial trust continues for the use and benefit of the distributee as beneficiary until the incapacity is removed or the custodial trust is otherwise terminated.

(c) Death of a beneficiary does not terminate the power of the custodial trustee to discharge obligations of the custodial trustee or beneficiary incurred before the termination of the custodial trust.

COMMENT

This section controls distribution of the custodial trust property when the custodial trust is terminated under Section 2(e). It is designed to provide for efficient and certain distribution without judicial proceedings. Subsection (a)(3) is an important provision for avoiding complications on distribution and provides that distribution may be controlled first, by the direction of the deceased beneficiary or second, by the custodial trust instrument (see Sections 2, 6 and 18) and, only if no effective prior designation for the payment or distribution of the property on the death of the beneficiary has been made, shall it pass through the beneficiary's estate.

The direction to the custodial trustee by the beneficiary, who is not incapacitated, for distribution on termination of the custodial trust may be in any written form clearly identifying the distributee. For example, the following direction would be adequate under the statute:

I, _____ (name of beneficiary) hereby direct _____ (name of trustee) as custodial trustee, to transfer and pay the unexpended balance of the custodial trust property of which I am beneficiary to _____ as distributee on the termination of the trust at my death. In the event of the prior death of _____ above named as distributee, I

designate _____ as distributee of the
custodial trust property.

Receipt Acknowledged

Signed

(signature)
Custodial Trustee

(signature)
Beneficiary

Date _____

Date _____

**SECTION 18. METHODS AND FORMS FOR CREATING
CUSTODIAL TRUSTS.**

(a) If a transaction, including a declaration with respect to or a transfer of specific property, otherwise satisfies applicable law, the criteria of Section 2 are satisfied by:

(1) the execution and either delivery to the custodial trustee or recording of an instrument in substantially the following form:

TRANSFER UNDER THE [ENACTING STATE]

UNIFORM CUSTODIAL TRUST ACT

I, _____ (name of transferor or name and representative capacity if a fiduciary), transfer to _____ (name of trustee other than transferor), as custodial trustee for _____ (name of beneficiary) as beneficiary and _____ as distributee on termination of the trust in absence of direction by the beneficiary under the [Enacting state] Uniform Custodial Trust Act, the following:

(insert a description of the custodial trust property legally sufficient to identify and transfer each item of property).

Dated: _____

(Signature); or

(2) the execution and the recording or giving notice of its execution to the beneficiary of an instrument in substantially the following form:

DECLARATION OF TRUST UNDER THE [ENACTING STATE]

UNIFORM CUSTODIAL TRUST ACT

I, _____ (name of owner of property), declare that henceforth I hold as custodial trustee for _____ (name of beneficiary other than transferor) as beneficiary and _____ as distributee on termination of the trust in absence of direction by the beneficiary under the [Enacting state] Uniform Custodial Trust Act, the following: (Insert a description of the custodial trust property legally sufficient to identify and transfer each item of property).

Dated: _____

(Signature)

(b) Customary methods of transferring or evidencing ownership of property may be used to create a custodial trust, including any of the following:

(1) registration of a security in the name of a trust company, an adult other than the transferor, or the transferor if the beneficiary is other than the transferor, designated in substance "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act";

(2) delivery of a certificated security, or a document necessary for the transfer of an uncertificated security, together with any necessary endorsement, to an adult other than the transferor or to a trust company as custodial trustee, accompanied by an instrument in substantially the form prescribed in subsection (a)(1);

(3) payment of money or transfer of a security held in the name of a broker or a financial institution or its nominee to a broker or financial institution for credit to an account in the name of a trust company, an adult other than the transferor, or the transferor if the beneficiary is other than the transferor, designated in substance: "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act";

(4) registration of ownership of a life or endowment insurance policy or annuity contract with the issuer in the name of a trust company, an adult other than the transferor, or the transferor if the beneficiary is other than the transferor, designated in

substance: "as custodial trustee for _____
(name of beneficiary) under the [Enacting state]
Uniform Custodial Trust Act";

(5) delivery of a written assignment to an
adult other than the transferor or to a trust company
whose name in the assignment is designated in substance
by the words: "as custodial trustee for
_____ (name of beneficiary) under the
[Enacting state] Uniform Custodial Trust Act";

(6) irrevocable exercise of a power of
appointment, pursuant to its terms, in favor of a trust
company, an adult other than the donee of the power, or
the donee who holds the power if the beneficiary is
other than the donee, whose name in the appointment is
designated in substance: "as custodial trustee for
_____ (name of beneficiary) under the
[Enacting state] Uniform Custodial Trust Act";

(7) delivery of a written notification or
assignment of a right to future payment under a
contract to an obligor which transfers the right under
the contract to a trust company, an adult other than
the transferor, or the transferor if the beneficiary is
other than the transferor, whose name in the
notification or assignment is designated in substance:
"as custodial trustee for _____ (name of
beneficiary) under the [Enacting state] Uniform
Custodial Trust Act";

(8) execution, delivery, and recordation of a conveyance of an interest in real property in the name of a trust company, an adult other than the transferor, or the transferor if the beneficiary is other than the transferor, designated in substance: "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act";

(9) issuance of a certificate of title by an agency of a state or of the United States which evidences title to tangible personal property:

(i) issued in the name of a trust company, an adult other than the transferor, or the transferor if the beneficiary is other than the transferor, designated in substance: "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act"; or

(ii) delivered to a trust company or an adult other than the transferor or endorsed by the transferor to that person, designated in substance: "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act"; or

(10) execution and delivery of an instrument of gift to a trust company or an adult other than the transferor, designated in substance: "as custodial trustee for _____ (name of beneficiary) under the [Enacting state] Uniform Custodial Trust Act."

COMMENT

This section largely follows Section 9 of UTMA. It provides instructional detail for forms and methods of transferring assets that satisfy the requirements of the statute. Although many of the customary methods of transferring assets are identified, these methods are not intended to be exclusive since any type of property that can be transferred by any legal means is intended to be within the scope of the statute, provided the requirements of Section 2 are met. The method of transfer or conveyance appropriate to the asset should be used, e.g., if land is involved, a deed or conveyance that satisfies the local requirements would be appropriate. In the effort to make the statute as self-contained and as fully explanatory as possible, these provisions for implementation are included in the statute rather than being appended or inserted in the Comments.

SECTION 19. APPLICABLE LAW.

(a) This [Act] applies to a transfer or declaration creating a custodial trust that refers to this [Act] if, at the time of the transfer or declaration, the transferor, beneficiary, or custodial trustee is a resident of or has its principal place of business in this State or custodial trust property is located in this State. The custodial trust remains subject to this [Act] despite a later change in residence or principal place of business of the transferor, beneficiary, or custodial trustee, or removal of the custodial trust property from this State.

(b) A transfer made pursuant to an act of another state substantially similar to this [Act] is

governed by the law of that state and may be enforced in this State.

COMMENT

This section is designed to avoid confusion in the event a party or assets are removed from the state.

SECTION 20. UNIFORMITY OF APPLICATION AND CONSTRUCTION.

This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among states enacting it.

SECTION 21. SHORT TITLE.

This [Act] may be cited as the "[Name of Enacting State] Uniform Custodial Trust Act."

SECTION 22. SEVERABILITY.

If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 23. EFFECTIVE DATE.

This [Act] takes effect _____.

**ESTATE PLANNING, TRUST AND
PROBATE LAW SECTION
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REPLY TO:

TO : Jackson R. Gualco, Esquire
James V. Quillinan
Suite 900

FROM : James V. Quillinan, Vice Chair
444 Castro Street
Mountain View, CA 94041

DATE : 5/3/89

RE : AB 1818 as Introduced

SECTION RECOMMENDATION: Oppose

ANALYSIS:

(1) Existing Law: There is no provision of California Law for a custodial trust.

(2) Change proposed by the Bill: This Bill would enact the California Uniform Custodial Trust Act, as promulgated by the National Conference of Commissioners on Uniform State Laws. The Bill provides for the creation of a custodial trust, by an unwitnessed, written transfer or declaration which is irrevocable by the transferor. It specifies the duties of the trustee, the rights of third persons dealing with the trustee, and the rights of the beneficiary.

(3) Discussion:

(a) Public policy aspects: The National Conference of Commissioners on Uniform State Laws takes the position that the Act fills a very particular need of ordinary people for a simple "do it yourself" trust, which can be created without the involvement of attorneys for the management of assets of unlimited value during life and the disposition of those assets at death.

The Section takes the position that there is no demonstrated need for such an unprotected and unsupervised testamentary device when one considers the available alternatives, such as formal trusts, conservatorships, durable powers of attorney for

estate management and joint tenancy. Legislation is now pending to curb a perceived abuse of conservatorships despite the fact that they are protected by court supervision. This Act goes in a diametrically opposed direction by enabling the secret disposition of assets of unlimited value with no court supervision. The Section's most serious concern with the Act is that it appears to be an open invitation to fraud. In addition, this Section has numerous specific objections to the Act as a trap for the unsophisticated, and possibly elderly, user as follows:

1. The Act denies the right to create a true grantor trust where the transferor is the trustee, and forces the transferor to transfer assets to a third party where all lifetime benefits from the trust are for the transferor.

2. The trust is irrevocable by the trustor and can only be revoked by a beneficiary or the conservator of an incapacitated beneficiary. If the beneficiary, who may be the trustor, previously has had the foresight to execute a durable power of attorney for estate management, the agent designated in the power to protect the interest of the beneficiary in the event of incapacity is denied the right to revoke the trust or direct its administration (Section 4107(f)).

3. California law specifically protects the Special Needs Trust for the long-range protection of the disabled beneficiary entitled to public benefits. The original concept of the custodial trust was to expand the Uniform Transfers to Minors Act to provide a means of transferring funds for the benefit of adult disabled beneficiaries. As expanded into the Custodial Trust Act, this objective is totally defeated. Because the Custodial Trust is immediately revocable by the beneficiary, the attempt by a concerned family member to utilize the Custodial Trust for the benefit of a disabled beneficiary would have the effect of dissipating family assets because the principal of the trust immediately would be subject to being exhausted before public benefits could be received.

4. The unsophisticated transferor who creates a Custodial Trust to protect a third party beneficiary will be deceived because this is not a trust at all, but an immediate gift to the beneficiary unprotected by any spendthrift clause, because it is subject to immediate termination by the beneficiary.

5. The Act makes no attempt to deal with the equal rights of spouses to management and control of community property. In fact, it violates the right of the spouse by providing that the Custodial Trustee has all the rights and powers over the

custodial trust property, which an unmarried adult owner would have over individually owned property. (Section 4108(a)).

6. Tax problems are rampant in the drafting of the Act, and affect both large and small estates. If the trust is set up for a beneficiary other than the trustor, it constitutes an immediate gift, subject to gift tax consequences if it exceeds \$10,000 in value, and regardless of value resulting in a loss of a step-up in basis at the death of the trustor. If the trust is set up for the benefit of the trustor's spouse, it results in a loss of the marital deduction, by the provision for sprinkling principal and income for the benefit of others than the spouse, should the spouse become incapacitated. (Section 4109(b)). If the trust designates the recipient of the property upon the death of the beneficiary, the possibility of using the alternative valuation date for Federal Estate Tax purposes is lost by the requirement for distribution upon termination of the trust. (Section 4117). There is no possibility for post mortem income tax planning, because the requirement for distribution upon termination eliminates the possibility of split income which would have been available through probate estate administration.

(b) Potential fiscal ramifications: There are no direct fiscal ramifications of the Act. However, to the extent unscrupulous persons are enabled to defraud the naive and trusting into secretly naming them as custodians without the knowledge of the family, resulting in the pauperization of the transferor who then becomes a ward of the State, there will be an adverse affect on public funds.

(4) Purview: The Section is concerned both with the planning for disposition of property at death, and the maintenance, preservation and management of property during life. As the population ages, the Section has become increasingly concerned with the preservation and management of property for those who by reason of illness or age may require protection and assistance. The Section particularly is concerned with the protection and management of assets for the benefit of the elderly and disabled and the disposition thereof upon death with minimum tax consequences.

Jackson R. Gualco, Esquire

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SECTION EXPERTISE:

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The comments on the Bill set forth herein represent only the views of the Executive Committee of the Estate Planning, Trust and Probate Law Section. They have not been acted upon by the Board of Governors and do not necessarily reflect the views of the Board or of the State Bar of California.

cc: Robert H. Oliver, Esquire, BCLC Liaison (with copy Bill)
Irwin D. Goldring, Esquire, Section Chair
Theodore J. Cranston, Esquire
Ms. Pres Zablan-Soberon, Section Administrator
David Long, Esquire, Director of Research ✓