

Michigan Law Review

Volume 54 | Issue 6

1956

Securities - Inter Vivos Gifts to Minors

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Recommended Citation

Stephen C. Bransdorfer S.Ed., *Securities - Inter Vivos Gifts to Minors*, 54 MICH. L. REV. 883 (1956).
Available at: <https://repository.law.umich.edu/mlr/vol54/iss6/21>

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RECENT LEGISLATION

SECURITIES—INTER VIVOS GIFTS TO MINORS—RECENT LEGISLATION—A statute recently enacted in twelve states¹ and expected to be considered by seven other states this year,² authorizes a new method for making gifts of securities to minors and for administering such gifts. The statute provides: (1) that irrevocable gifts of securities may be made to minors by use of statutory registration or deed of gift forms;³ (2) for the creation of a new type of fiduciary termed a custodian;⁴ (3) that the custodian shall have powers and duties over the minor's securities including authority to manage, sell, reinvest the proceeds from the sale and administer the securities for the child's benefit until he reaches twenty-one; (4) for an exoneration clause intended to afford protection from liability for any transfer agent or other person dealing with the custodian; (5) that no accounting is required of the custodian unless demanded within one year after the child reaches twenty-one; and (6) that the procedure set up by the statute is not to be the exclusive means of making gifts of securities to minors.⁵

The need for this type of legislation results from the legal disability of a minor at common law. A minor may own property in his own name, but can disaffirm any conveyance of his property made while under age. Without benefit of legislation⁶ or the use of the procedure listed below, any person dealing with property with knowledge that a child owns some

¹ *California*: Cal. Civ. Code Ann. (Deering, 1949; Supp. 1955) §§1154 to 1164; *Colorado*: Colo. Laws (1955) c. 286; *Connecticut*: Conn. Laws (1955), Act No. 277; *Georgia*: Ga. Code Ann. (1937; Supp. 1951) tit. 48, §§48-301 to 48-313; *Michigan*: Michigan Acts, No. 43 (1956); *New Jersey*: N.J. Stat. Ann. (1940; Supp. 1955) §§46.38-1 to 46.38-12; *New York*: 40 N.Y. Consol. Laws (McKinney, 1949; Supp. 1956) §§265 to 270; *North Carolina*: N.C. Gen. Stat. (1950; Supp. 1955) §§33-68 to 33-74; *Ohio*: Ohio Rev. Code (Page, 1953; Supp. 1955) §§1339.19 to 1339.28; *South Carolina*: S.C. Acts (1956), Act No. 667; *Virginia*: Va. Code (1956) §§31-19 to 31-25; *Wisconsin*: Wis. Laws (1955) c. 507. See 1 CCH Stock Transfer Guide ¶1,000 et seq. for annotation of these statutes.

² Arizona, Kentucky, Louisiana, Maryland, Massachusetts, Mississippi, and Rhode Island are listed by the Association of Stock Exchange Firms, co-sponsor of the act with the New York Stock Exchange, as states in which the act will be promoted in 1956. See the Association's information release, "Gifts of Securities to Minors Act," July 29, 1955.

³ If the gift is a registered security, the donor registers the gift in the name of the custodian for the minor. If the gift is in bearer form, a deed of gift is made out to the custodian for the minor and delivered to the custodian.

⁴ If the security is a registered one, the custodian may be the donor himself or any adult of the minor's family or a guardian of the minor. If the security is in bearer form, the custodian may be any adult of the minor's family other than the donor, or a guardian. The custodian receives no compensation other than expenses, except for a guardian who may be compensated as he would be if the property held as custodian were held in his capacity as guardian.

⁵ A thorough study of this legislation is currently being prepared for publication by the Legislative Research Center of the University of Michigan Law School.

⁶ There are statutes which, in particular situations, permit adults to deal with minors as if they were under no disability. E.g.: 4 N.Y. Consol. Laws (McKinney, 1950) §134 (1) (bank deposits); 27 N.Y. Consol. Laws (McKinney, 1949) §§245 to 247 (insurance); 37 N.Y. Consol. Laws (McKinney, 1943) §41 (negotiable instruments).

or all of it assumes an insurer's liability. If the transaction results in a loss, the minor may sue in tort for reimbursement. If a gain results, the child may affirm the transaction and accept the benefit.⁷ This makes it unsafe for a bank, stock transfer agent, or any other third party to handle a minor's property.⁸ Parents of the child, under a distinction usually not noted by laymen, are natural guardians of only the person of the child, not of his estate.⁹ Therefore, even a parent who deals with his child's property may be found liable.¹⁰ Because of this strict liability, the only safe means by which an inter vivos gift may be made to a child are (1) by having the gift made to a court appointed guardian, or (2) by making the gift through an inter vivos trust.¹¹ A consideration of both devices shows them to be unsuited to the simple "envelope in the Christmas stocking" gift of a security contemplated by many parents and primarily intended to be covered by the new law.¹²

Appointment of a legal guardian offers the greatest safety for the minor's property since the guardian must generally post bond, spend the child's money or otherwise deal with the minor's property only by court order, and make periodic accountings.¹³ But appointment of a guardian has been criticized as being too cumbersome and expensive.¹⁴

The use of a trust circumvents the rigidity of guardianship law, lets the trustee act as flexibly as the settlor directs in the trust instrument,¹⁵ offers numerous tax benefits,¹⁶ and allows for a gift over if the minor dies before

⁷ Browning, "Gifts to Minors," 27 *CONN. B.J.* 407 at 408 (1953); Rogers, "Some Practical Considerations in Gifts to Minors," 20 *FORD. L. REV.* 233 at 240 (1951).

⁸ *McKinnon v. First Nat. Bank of Pensacola*, 77 *Fla.* 777, 82 *S.* 748 (1919); *Grebe v. First State Bank of Bishop*, 136 *Tex.* 226, 150 *S.W.* (2d) 64 (1941); *Matter of Goodchild*, 160 *Misc.* 738, 290 *N.Y.S.* 683 (1936).

⁹ *Dagley v. Tolferry*, 1 *P. Wms.* 285, 24 *Eng. Rep.* 391 (1715); *In re Lucey*, 98 *N.J. Eq.* 314, 128 *A.* 677 (1925); *Perry v. Carmichael*, 95 *Ill.* 519 (1880); 6 *A.L.R.* 115 (1920).

¹⁰ *Bedford v. Bedford*, 136 *Ill.* 354, 26 *N.E.* 662 (1891); *Delafield v. Barret*, 270 *N.Y.* 43, 200 *N.E.* 67 (1936).

¹¹ See the articles cited in note 7 *supra*.

¹² This was pointed out by G. Keith Funston, President of the New York Stock Exchange, in his address, "Stock Gifts to Children—A New Approach," made before the National Association of Securities Administrators, Sept. 29, 1954. *PROC. OF 37TH ANNUAL CONVENTION OF NAT. ASSN. OF SEC. ADM.* 74 (1954).

¹³ See *SIMES AND BASYE, PROBLEMS IN PROBATE LAW* §§196-237 (1946); Condit and Liebenow, "Management of Estates of Minors and Incompetents," 1951 *UNIV. ILL. L. FORUM* 268.

¹⁴ A court appointed guardian is usually entitled to "just and reasonable" compensation. *SIMES AND BASYE, PROBLEMS IN PROBATE LAW* 214 (1946). This commission can be waived by the guardian but even if this is done the cost of legal fees and posting of bond still make expense a problem. See the representative figures shown by Rogers, "Some Practical Considerations in Gifts to Minors," 20 *FORD. L. REV.* 233 at 241-242 (1951).

¹⁵ The gift would be registered in the name of the trustee, and since the trust is a legal entity which may properly buy and sell securities, third parties such as security transfer agents would not run the common law risk of dealing with a minor's property. Browning, "Gifts to Minors," 27 *CONN. B.J.* 407 at 415 (1953).

¹⁶ These include the possibility of removing the income from the security from the donor's higher tax bracket, qualification for the annual gift tax exclusion under *I.R.C.* (1954), §2503 (c), and removal of the asset from the donor's estate, preventing application

a named age.¹⁷ However, since setting up a trust is costly, and administrative burdens are heavy for the non-professional trustee, it, too, is far from ideal for this type of gift.¹⁸ These problems have led at least one legal writer to advocate that a parent "informally" handle his child's securities under certain conditions, despite the risks involved.¹⁹

The new statute presents many advantages over these existing methods for transferring securities to minors. First, it is simple; irrevocable title is passed to the child by registration for the child in the custodian's name, or by execution of a deed of gift, depending on the type of security.²⁰ The custodian has complete discretion in handling the security for the child's benefit and is not required to follow restrictive guardianship procedures. Those who deal with the custodian are protected from liability. Finally, the child is, by legislative mandate, entitled to full possession of the security and unexpended income at age twenty-one. A delay in possession, limited in extent only by the rule against perpetuities, such as can be accomplished by a trust cannot be imposed under the provisions of the act. On the other hand, enactment of the statute may give rise to problems in the areas of conflict of laws,²¹ taxation,²² and creditor's rights.²³ However, the most serious problem seems to exist in the removal of safeguards protecting the minor's gift from dissipation by the custodian.²⁴ The custodian need make no accounting unless requested by the minor, his parents, or rep-

of the federal estate and state inheritance taxes. These benefits are not confined to an inter vivos trust. They may also be received by the donor making a direct gift to the minor via the guardianship procedure.

¹⁷ Browning, "Gifts to Minors," 27 CONN. B.J. 407 at 415 (1953).

¹⁸ Rogers, "Some Practical Considerations in Gifts to Minors," 20 FORD. L. REV. 233 at 257 (1951).

¹⁹ Browning, "Gifts to Minors," 27 CONN. B.J. 407 at 418 (1953).

²⁰ This makes a gift of securities to a minor about as simple to make and administer as a gift of United States Treasury Bonds. See 31 C.F.R. (Supp. 1955) §§315.39-315.42.

²¹ Many states take the view that the validity of a living trust of securities is governed by the law of the situs of the securities. However, the picture is not at all clear. See 2 BEALE, CONFLICT OF LAWS §294.3 (1935).

²² The tax consequences would seem to be analogous to those of trusts set up for minors. A full discussion is beyond the scope of this note. See Fleming, "The North Carolina Gift of Securities to Minors Law—Its Federal Tax Implications," 34 N.C. L. REV. 207 (1956). Cf. 1955 Cum. Bul. No. 30, p. 34, July 25, 1955.

²³ Whether a gift under this act could be held analogous to a partial spendthrift trust or a trust for support (neither of which is subject to the donee's creditors) is an open question. That this possibility may exist can be seen by noting similarities between both types of trusts and provisions of the act giving the custodian authority over the minor's securities to manage, sell, invest and administer the securities for the support, maintenance, education and general benefit of the minor. However, it should be noted the child holds legal title to the securities under the act, while only equitable title is owned under a trust arrangement. See 1A BOGERT, TRUSTS AND TRUSTEES, §222, 226 (1951).

²⁴ See Virtue, "Improvement of Judicial Control of Guardianship Proceedings," ABA REAL PROPERTY, PROBATE AND TRUST LAW SECTION PROCEEDING (Probate and Trust Law Divisions) part 1, p. 77 (1955). This ABA committee report criticizes the danger of dissipation of the minor's assets made possible by the statute.

representative within one year after the minor attains twenty-one. It would be possible under the act for a gift, such as a bearer security, to be transferred by the statutory deed of gift to the custodian with the minor having no knowledge of the gift until long after the period of accounting was past. No remedy would then be available to the minor if the securities had been dissipated. In addition, the custodian's "absolute discretion" in management for the minor's benefit makes proof of misuse a difficult problem for the minor. Lastly, the exoneration clause may be so broadly interpreted by the courts that it may protect a third party dealing with the seller of the securities even if the seller were a thief.²⁵ These deficiencies in the protection given the minor, while potentially harmful, do not seem to override the benefits the statute offers. This is especially true since the statute would be a dubious device for any donor desiring to make an extremely large gift of corporate securities. Common sense would seem to dictate that the protection of a court appointed guardian or the control of the gift by means of a trust would be essential. However if the problems outlined are not properly understood by any lay donor, it could well prove a trap to him or the donee minor.²⁶

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²⁵ The exoneration clause provides that the transfer agent or other person shall assume no responsibility for dealing with any person "purporting" to be the custodian. How broadly the word "purporting" will be defined by the courts is conjectural.

²⁶ The danger of this is underlined by such items as this, from the New York Stock Exchange President's speech, cited in note 12 supra, at 79: "And most important of all, from the point of view of public policy, it [the new act] does not reduce *in any way* the protection afforded our children." Emphasis added.