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PLANNING FOR GIFTS TO CHILDREN OR GRANDCHILDREN

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Estate planning involves a careful blend of our wishes and the tax consequences of certain gifts, whether during our lifetime or at death. In planning for transfer of wealth from one generation to the next, we face additional challenges. Some of those challenges relate to predictions for the future, others to additional taxes involved. Passing these assets to other generations requires careful attention to the structure of gifts, use of specific trusts and the tax consequences of transfers.

GIFT AND ESTATE TAX RULES

Anyone who has recently reviewed an estate plan with professionals is aware of the gift and estate tax rules:

- Each donor may give up to \$11,000 per person per year. This amount is indexed and will increase gradually over time.
- If gifts exceed \$11,000 per person, then a gift tax return (Form 709) must be filed in that year. No tax will be paid until the lifetime or at-death limit of \$1,000,000 is reached.
- A married donor may do "gift splitting" with a spouse to allow a gift of \$22,000 per person per year. A gift tax return must be filed to elect gift splitting, but no tax will be paid and no use of the \$1,000,000 lifetime exclusion will be used if the gift does not exceed \$22,000.
- A donor may give an unlimited amount to a spouse ("marital deduction") or to charity ("charitable deduction").
- A donor may pay the medical or education expenses of another person, provided those payments are made directly to the provider (doctor, hospital or college, for example). The amount that can be paid is unlimited. These payments are not considered "gifts" for gift tax purposes.
- In addition to annual exclusion gifts, a donor may give up to \$1,000,000 during lifetime. The amount is per donor, not per donee. Any portion of this amount not given during lifetime will be available at death to the donor's estate.



THE CHALLENGE WITH THE NEXT GENERATION

One challenge with gifts to children or grandchildren is that some may be minors. Their personalities may not be fully developed. We cannot predict future events that may befall them.

There are other challenges involved in making these

gifts. Some of our beneficiaries may already have special needs requiring specific planning. Generation Skipping Transfer Tax ("GST") will apply to any gifts (including testamentary gifts) that pass to grandchildren or younger generations.

PLANNING FOR MINORS

The major challenge with minors is that by law they may not own property. There are several options for gifts to minors, each with benefits and drawbacks for consideration.

Uniform Transfers (Or Gifts) To Minors Acts And 2503(c) Trusts

Gifts made to a minor under the Uniform Transfer to Minors Act ("UTMA") or Uniform Gifts to Minors Act ("UGMA") of the minor's jurisdiction are easy to set up and administer. Their simplicity, however, masks certain risks.

First, too often a donor plans to serve as the custodian of these accounts. If the donor dies while custodian, however, the assets are included in the donor's estate for taxation purposes. The donor should always appoint someone else as the custodian.

Second, these accounts end at the age of 21 (or at age 18 in some jurisdictions). At that age, the young person can claim the full amount in the account by presentation of a birth certificate. While the age of 18 or 21 may be the age of majority, it may not be the age of discretion. The gifts made into these accounts may be spent on items the donor had not intended.

Gifts under the Internal Revenue Code Section 2503(c) trusts have the same drawbacks, since they must be distributed by age 21.

Education Trusts (And Other Irrevocable Trusts)

A donor should consider the benefits of an education trust. After establishing the trust, the donor gives assets to a trustee to invest until the beneficiary goes to college. In this way, the donor ensures that the gift will be spent on education. Normally, the trust provides that no direct distributions will be made to the beneficiary until certain ages, and then only if assets are left after expenses for education have been paid.

Several factors must be taken into account. For example, gifts into the trust are irrevocable, and they

may never revert to the donor (not even as a contingency). There are also technical administrative requirements, including use of a “Crummey” withdrawal technique to ensure the gifts into the trust qualify for the annual exclusion and the need to prepare an annual accounting and annual fiduciary income tax return. A major advantage to this trust is the assets are not taxed in the donor’s estate.

The trust should be flexible and may provide for other needs if the beneficiary does not go to college. It may provide for education besides college (e.g., private elementary or secondary education, or trade school, or post-graduate education). The trust may have other purposes than education altogether, such as for health needs, a first house, a thirtieth birthday or retirement.

The donor should not be the trustee to ensure that trust assets are not taxed in the donor’s estate. Normally, the child’s parent should not be the trustee since a parent has certain legal obligations to provide for the care of a child and payment of those obligations from trust assets could cause trust assets to be taxed to a parent. Consider the child’s aunt or uncle, a bank or professional to serve as trustee.

PLANNING FOR THE FUTURE

Planning opportunities for testamentary trusts for young people are similar to lifetime trusts. Those trusts can provide for a specific purpose, end at some defined age or continue through lifetime and provide flexibility in distributions.

When planning an estate, keep in mind that a beneficiary could predecease the donor. In that case, the gift may pass to a younger person. A contingency gift must be as carefully planned as the donor’s original intention.

While there are those who want to control “beyond the grave,” in general, the law will not enforce conditions that attempt to control lawful behavior. (For example, a bequest that is conditioned on a child’s divorcing his/her spouse is unlikely to be enforceable. Such a bequest is likely to pass to the child anyway.)

PLANNING FOR SPECIAL NEEDS

In some instances, planning is needed to provide for a disabled child or grandchild. There are also those situations where, even if not disabled, some beneficiaries should never receive outright distributions. If a trust is to continue for the lifetime of such a beneficiary, the trust must provide the flexibility for a succession of trustees and changing conditions during the beneficiary’s lifetime and upon the life beneficiary’s death.

Planning to supplement other sources of support can be tricky, particularly if the beneficiary may be receiving

some government entitlements (Medicaid or SSI payments). In general, if the beneficiary can require distributions, then so can the government or care provider. A carefully drafted trust can avoid these pitfalls.

GENERATION SKIPPING TRANSFER TAX

Any gift or bequest that skips a generation is subject to generation-skipping tax (“GST”). An intentional skip occurs when a grandparent gives a gift or bequest directly to a grandchild. Keep in mind, however, that an accidental skip may occur when a grandparent gives a gift or bequest to a child, but the child is not able to receive it and so the gift passes to the grandchild.

The GST tax rate is the same as the top estate tax rate, which is currently 50%. Exclusions exist for GST gifts totaling less than \$1,120,000 per donor. An exclusion election is made at the time of the gift, at the donor’s death (if the gift is made through the will or through a revocable living trust) or at the time the gift is received.

Hidden risks for GST occur anytime assets are placed in trust. First, assets in the trust are considered to pass directly from the grantor to the beneficiary without taking into account intervening events. Therefore an accidental skip that occurs when the child predeceases the donor and the gift passes to the grandchild will be taxed. The same gift outside a trust will not be taxed because the death of the child advances the grandchild to a “non-skip” status.

Second, assets placed in trust tend to increase over time. Some trusts may last a long time (such as the time for beneficiaries to reach specified ages). Assets that are not distributed tend to double every eight to ten years. The value of the assets at distribution can be much larger than the value when the trust was funded.

Several techniques can be used to minimize GST. First, make the earliest election possible. Second, minimize GST on accidental skips by making an election even if the gift is contingent on some event that may not happen. Third, include GST minimizing language in the Will or Revocable Living Trust.



Planning for transfer of wealth to a younger generation is just one step in the completion of an overall estate plan. If you would like to discuss gifts to young people or other estate planning issues with an attorney at Thomason and Hessmer, LLC, please call us at (301) 654-5112 so that we may answer your questions and provide you with additional information.