Guaranty BANK & TRUST Wealth Management Group

Gifts to Minor Children and Grandchildren

There are several ways you can make gifts to your minor children or grandchildren. If your goal is to fund education, certain strategies are better suited for that. A separate summary, *Choices for Funding Education*, discusses the choices for funding a child or grandchild's education. This summary will give an overview of the main choices to be considered for gifts to minors when education funding is not the primary goal.

THE CHOICES

Outright gift

If you make a direct gift outright to your minor child or grandchild, that is the simplest way, but it puts the minor in full control, which you might not want.

UTMA/UGMA

These are Uniform Transfer to Minors Accounts, the modern day version of what were formerly Uniform Gifts to Minors Accounts. Also know as custodial accounts, you can easily establish a custodial account for the benefit of a minor. The named custodian is usually the minor's parent, who controls the assets and expends them for the benefit of the named minor. The custodian can use the asset for educational purposes or any other legitimate need of the minor beneficiary. Assets in the account become the beneficiary's (i.e., the custodianship ends) when the beneficiary turns 18 or 21 (depending on the governing State law).

Crummey Trust

Crummey is the name of the taxpayer in the tax case that established the gift tax treatment of these trusts. A *Crummey* trust is a trust that gives the beneficiary the right to withdraw contributions for a limited period of time, such as 30 days. (For a minor beneficiary, the parent would exercise this power.) This withdrawal right allows contributions to the trust to qualify for the $14,000 annual gift tax exclusion. Assuming the withdrawal right is *not* exercised, the funds then stay in trust on whatever terms the trust dictates and can be used for any purpose, including educational.

2503(c) Trust

Named for the section of the tax law authorizing it, this is a special gift trust for one beneficiary. By having the trust meet certain requirement, contributions qualify for the $14,000 annual gift tax exclusion without having to give the beneficiary a withdrawal right. To qualify as a 2503 (c) Trust, the Trust must provide:

1. - Principal and income must be available for distribution at the trustee's discretion while the beneficiary is under the age of 21;
2. - All accumulated principal and income must be distributed to the beneficiary at age 21, terminating the trust; and
3. - If the beneficiary dies before reaching age 21, all principal and income must be paid either to the beneficiary's estate or to the beneficiary's appointee pursuant to a general power of appointment.

CHOOSING THE MOST APPROPRIATE METHOD

Each of these gifting methods has advantages and disadvantages. Below is a summary of how they differ.

Ease of set up

- You can make an outright gift without any special set up.
- You can establish an UTMA easily at most institutions by filling out minimal paperwork.
- If you want to create a 2503(c) Trust or a Crummey Trust, both are trusts requiring legal documents that must be drafted by your attorney.

Beneficiary's access

- If you make an outright gift, the recipient has uncontrolled access.
- If you fund an UTMA or 2503(c) Trust, the custodian/trustee has full control over the assets.
- However, at age 21 (possibly s soon as age 18, depending on State law) the beneficiary must receive any remaining assets (or in the case of the 2503(c) trust must have the right to compel distribution of any remaining assets).

- If you create a Crummey Trust, the beneficiary has a right to withdraw contributed funds for a limited period of time, typically 30-60 days after a contribution. During that time, the beneficiary does have complete access; thereafter the trust's terms govern whether or not the beneficiary has any access.

Federal gift tax consequences (State laws may vary)

- All four methods of gifting would qualify for the $14,000 annual gift tax exclusion.
- The federal GST exemption, lifetime gifting limit total and estate exclusion amounts all are a maximum of - $5,250,000 per donor, over and above the annual gift limits per donee. -

Federal estate tax consequences (State laws may vary)

- If your make an outright gift, that would remove the assets from your taxable estate.
- If you fund a 2503 (c) Trust or a Crummey Trust, the assets transferred to trust would be removed from your taxable estate if the trust is drafted properly.
- If you are custodian of an UTMA for your child, the assets could be included in your estate regardless of the contributor, if under State law you could use the UTMA funds to discharge your support obligations.
- The federal GST exemption, lifetime gifting limit total and estate exclusion amounts all are a maximum of - $5,250,000 per donor, over and above the annual gift limits per donee. -

Federal Generation-Skipping Transfer (GST) tax consequences (State laws may vary)

- If you make an outright gift qualifying for the $13,000 annual gift tax exclusion, that would also be exempt from GST.
- If you fund an UTMA or a 2503(c) Trust, both are exempt from GST if your contributions qualify for the $14,000 annual gift tax exclusion.
- If you fund a Crummey Trust with multiple beneficiaries, that will not be exempt from GST, even if your contributions qualify for the $14,000 annual gift tax exclusion. Rather, you would have to allocate some of your GST exemption to the trust. If the Crummey Trust has a single beneficiary, then your contribution would indeed be exempt from GST if (i) your contributions qualify for the $14,000 annual gift tax exclusion, (ii) your contributions can be used only for the benefit of the single beneficiary, and (iii) the trust assets are includible in the beneficiary's taxable estate if death occurs before the trust terminates.
- The federal GST exemption, lifetime gifting limit total and estate exclusion amounts all are a maximum of - $5,250,000 per donor, over and above the annual gift limits per donee. -

Federal income tax consequences-the kiddie tax (State laws may vary)

- If you make an outright gift to a child or grandchild under 19 (or 24 if a full-time student), investment income in excess of certain thresholds could be taxed at the parents' highest federal income tax rate under the so-called *kiddie tax*. The *kiddie tax* applies to a minor child (under 18) and to a child aged 18 – 24 if his or her earned income is less than one-half of the cost of the child's support.
- If you fund an UTMA, those assets belong to the beneficiary even though the custodian controls them. Therefore, the beneficiary is taxed on the UTMA's income. IF the beneficiary's total investment income is in excess of certain thresholds. It would be taxed at the parents' highest federal income tax rate under the *kiddie tax.*
- If you fund a Crummey Trust and if the withdrawal power is *not* exercised, the result could be that thereafter the income on that asset could be income-taxed (i) to trust itself or (ii) to the non-withdrawing beneficiary as a *grantor* trust. You should consult with your tax advisor to be clear on this.
- If you fund a 2503(c) Trust, its income would be taxed to the trust, though distributions would carry out that income to the beneficiary, who would be taxed. This income would be taken into account for purposes of the kiddie tax.

Federal income tax consequences – basis carryover (State laws may vary)

Regardless of the form of your gift, your basis in the asset will carryover and become the recipient's basis. This is true whether the recipient is the minor (in the case of an outright gift) or a trust. If your basis is greater that the fair market value of the gifted asset, then the recipient's basis would be the fair market value for the purpose of determining loss. This prevents giving away capital losses. In that case it might be more tax efficient for you to firs incur the tax loss and then make a gift of the proceeds.

SPECIAL ASSET SITUATIONS Life Insurance

It is a very common estate tax planning technique to make gifts each year that will pay life insurance premiums on a policy on your life. Often a specific type of Crummey trust – an Irrevocable Life Insurance Trust (ILIT) – owns the policy. This allows the death proceeds to escape your estate tax. A Crummey Trust is the only one of these four gifting methods that can achieve all three of the following goals, which are typical of a life insurance trust: (1) accommodate multiple beneficiaries; *and* (2) have the assets stay in trust beyond age 21, *and* (3) have contributions qualify for the annual gift tax exclusion.

With an ILIT, you contribute funds to the trust, and your beneficiaries (or their parents if the beneficiaries are minors) will have the right to withdraw the funds for a certain period of time (e.g., 30 days). Assuming the beneficiaries do not exercise the withdrawal rights, the funds could then be used by the ILIT trustee to pay for lift insurance.

Real Estate

It can be very complicated to make gifts of less that total ownership of real estate. For example, if you own real estate worth $1,400,000 and wanted to gift $14,000-worth to a grandchild, whether outright or in trust, that would mean gifting a 1% interest as a joint tenant or tenant in common. This results in the real estate being "fractionalized," which is not ideal.

One solution is to use a Family Limited Partnership (FLP) or a Family Limited Liability Company (FLLC). You can first transfer the real estate to the FLLC, initially being the sole owner. You could them make gifts of non-voting interest in the FLLC. This allows the real estate to always have only one owner, the FLLC which you control by retaining the voting interest. This use of the FLLC is valid for any asset to avoid "fractionalized" ownership.

Gifting FLLC interests can raise valuation issues. Sometimes valuation discounts are appropriate due to the recipient's minority interest and/or lack of voting control. You should consult with your attorney to determine the proper gift tax value of any FPL/FLLC interest.