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ESTATE PLANNING LIBRARY

Number Ten

Making Gifts for Children or Grandchildren

AN OVERVIEW

1. What client would be interested in these techniques?

Actually, there are many reasons for adults to make gifts to minors, the most common reasons are:

- Provide a source of funds for educational expenses.
- Reduce the donor's future taxable estate.
- Provide a source of funds for a disabled child that is protected from Medicaid claims.
- Provide a source of funds for the purchase of a first home or other significant expenditures.

2. What are the various methods to make gifts and how do they work?

There is actually a fairly limited range of methods to make gifts to minors. I will discuss each of the main techniques and list their benefits and negative aspects, if any. Since this Brochure concerns significant gifts, we exclude gifts directly to the minor as a possibility. It is important to remember that the primary estate and gift tax concern with gifts to minors is making sure the gifts qualify for the annual \$11,000 gift tax exclusion so that the donor's tax exempt amount is not wasted. The most frequently used techniques that qualify for the exclusion are:

- **Uniform Transfer or Uniform Gifts to Minors Accounts:** These are accounts governed by state laws allowing an account to be opened in the name of a minor so as to make gifts to minors administratively simple. However, the simplicity obscures two significantly adverse aspects of these accounts. If

grandmother makes annual gifts to an UTMA/UGMA account, and is the custodian and grandmother dies while the account is in existence, the account balance will be included in the grandmother's estate. The donor to the account should not also be the custodian to prevent this problem. However, the most serious problem is that the account balance **must** be distributed to the child upon the child's attaining the age of majority. Many parents and grandparents are faced with the problem of having to give, in many cases, hundred's of thousands of dollars to an 18 or 21 year old. While many donors simply do not let the child know of the account, they are breaching their fiduciary duty. The UTMA account is also available to pay the claims of judgment creditors of the minor. This is why we do not recommend these forms of accounts.

- **IRS Approved "2503(c)" Trusts for Minors:** These are trusts for which the IRS has set forth requirements that, if satisfied, qualify gifts to the trust for the annual exclusion. Their main benefit over the UGMA/UTMA accounts is that there is considerably more flexibility as far as investments are concerned. However, they require that the funds be given to the child at age 21. For that reason alone, we do not recommend these trusts as a "safe" vehicle for gifts to minors.
- **Irrevocable Gift Trusts:** Irrevocable Gift Trusts are trusts that allow the beneficiary to withdraw an amount from the trust in any year that a contribution is made. These trusts are also known as "Crummey" trusts. The name "Crummey" refers to a court case in which the court held that because the beneficiary had a right to demand the money, the gift to the trust qualified for the \$10,000 indexed for inflation, annual gift tax exclusion. Unlike the techniques discussed above, there is no requirement regarding distributions of trust funds to the beneficiaries. This is by far the most effective estate and gift tax planning vehicle for making gifts to minors. While the cost to prepare and administer the trusts is certainly of consideration, those costs protect against having a child receive the balance of the funds at the age of majority, or having a creditor take the funds away from the child. This is our recommended technique.
- **Section 529 Qualified State Tuition Programs:** This is a method allowed by Internal Revenue Code Section 529 which, stated simply, allows a donor to either make deposits into an account that can be used for the education of the named beneficiary, or purchase from the state tuition credits of certificates that may be used at a state educational institution. These plans qualify for the annual gift tax exclusion and can be a valuable technique for funding anticipated education costs. It is possible to make advanced use of four years annual exclusions so that a total of 55,000 may be contributed for each child without incurring any gift tax.
- **2503(e) Exclusion for Qualified Education and Medical Expenses:** These are transfers that the IRS excludes from taxable gifts without any limitation. The transfers excluded are payments of tuition made directly **to the** institution or for medical expenses paid directly to the care provider. These are of considerable value and should be considered as a method to reduce a potential donor's estate. The beneficiary of the payment may be any individual and is not limited to family members.

3. How is the estate planner involved in this type of planning?

Essentially, the planner needs to inform the client of the estate and gift tax aspects of the various techniques for making gifts to minors. If the client does not want to pay the costs of an Irrevocable Gift Trusts, the planner will guide the client to some of the less costly methods.

4. What are the client's responsibilities?

The client primarily has to advise the planner of the client's goals with respect to assisting their children and consider the planner's advice before making a decision to pursue a particular strategy.