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Memorandum

TO: LeBlanc & Young Clients

DATE: January 2017

SUBJECT: Gifts to Minors

Transfers of assets to or for the benefit of minor beneficiaries often make sense for a variety of reasons. Shifting assets to a minor beneficiary may be a helpful savings strategy to provide for future education costs. It may also be a device to reduce eventual estate taxes by moving assets out of the estate of a wealthy grantor. Assets can be transferred to minor beneficiaries in a variety of ways. If assets of significant value are involved, a trust may well be an appropriate vehicle for such transfers.

If assets are to be transferred to a minor beneficiary, gift tax implications must be considered. For gift tax purposes, up to $14,000 per year (for the year 2017) can be given to a single donee. If the donor is married and the spouse joins in the gift by signing a gift tax return, or if the gift is from both spouses, up to $28,000 per year per donee may be given. The $14,000 per year annual exclusion is available, however, only for gifts of "present interests." A current transfer of cash or a current deed of a fractional share interest in real estate would be a transfer of a present interest, and the $14,000 per year gift tax exclusion would shelter the first $14,000 of value from gift tax. However, a gift to a trust from which the beneficiary will not receive anything until some future date is typically a gift of a future interest, to which the $14,000 per year exclusion is unavailable. Gifts of LLC membership interests or other minority interests in closely held entities that are unduly restricted may also not qualify as annual exclusion gifts because of the lack of control and restrictions on transferability.

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If a donor pays medical expenses or education expenses (limited to tuition), the transfer is not treated as a taxable gift. Tuition payments must go directly to the educational institution, not to the student or another family member. A gift that is not sheltered by the annual exclusion or the education/medical exclusion will use up some of the grantor's $5,490,000 lifetime exemption against gift taxes.

This memorandum outlines some of the ways assets can be transferred to minors, including minor's trusts and various alternatives to such trusts.

I. UNIFORM TRANSFERS TO MINORS ACT

Parents and grandparents can make gifts for the benefit of minors under the Maine version of the Uniform Transfers to Minors Act. 33 M.R.S.A. § 1651 *et seq*. If the documentation at the time of the original gift provides for the account to continue until the child reaches age 21, that will

control. Absent that direction in the original documentation, an UTMA account can only run to age 18. Upon the termination of an UTMA account, the custodian is required under Maine law to provide an accounting (i.e. a record of income and expenses) to the child and to the Probate Court. Because a child at age 21 (or 18!) may not be as responsible as one might wish, UTMA accounts are undesirable if a significant amount of money or other assets will be contributed to the account.

II. 529 PLANS AND JOINT ACCOUNTS

Parents and grandparents may wish to consider the use of a 529 Plan account for the benefit of a minor child or grandchild. A 529 Plan account is particularly useful as a device to pay college costs. Contributions to a 529 Plan account are eligible for the $14,000 annual exclusion for gift tax purposes. A donor may front load the account by making a $70,000 contribution to a 529 Plan account, which uses the donor's annual exclusions for the year of the gift and the next four years. A 529 Plan account grows tax free. If the funds are withdrawn to pay for college, the proceeds from the account are not subject to income tax on the withdrawal. If the proceeds are ultimately withdrawn for purposes other than paying for college, the earnings portion of the proceeds is subject to income tax, and under some circumstances, an additional 10 percent penalty tax.

Each state sponsors at least one 529 Plan. A donor can establish an account under any state's plan, so there are a wide range of choices. The states charge various fees and rely on various investment managers to run these accounts. A useful website which provides details regarding each state's plans, including investment performance and fees, is www.savingforcollege.com.

If a parent or grandparent wishes to make a gift for the benefit of a minor, he or she could establish a joint bank or brokerage account with the minor, a "pay on death" bank or brokerage account for the minor, or joint or "pay on death" Series EE treasury bonds. The account could be set up under either the donor's Social Security number or the minor's Social Security number, for income tax reporting purposes. Note that in general the investment income of a child under the age of 18 (up to age 24 for full-time students) who has more than $2,100 of investment income (for 2017) is subject to tax at the parent's top marginal rate. IRC § 1(g).

III. 2503(c) TRUST

There are a number of forms of irrevocable trusts used to accept gifts that individuals would like to make for the benefit of minors and defer the minor's interest while still taking advantage of the annual exclusion for the gift from the donor. One such trust is a 2503(c) trust, an irrevocable trust established under the requirements of Section 2503(c) of the Internal Revenue Code, which provides that a transfer in trust for a minor is not treated as a gift of a future interest if the property and the income derived from it:

(1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and

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(2) will to the extent not so expended (A) pass to the donee on his attaining the age of 21 years, and (B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment.

The IRS has ruled that a trust complies with these requirements if the child who is the beneficiary of the trust has the opportunity at age 21 to require that the assets of the trust be distributed to him. This opportunity must be open for a reasonable time, such as 30 or 60 days. If the child does not exercise the right to request the assets of the trust within that time period, the trust can then by its terms continue to age 25 or 30 or beyond.

A 2503(c) trust should be irrevocable. It will not, however, be a "grantor" trust for income tax purposes. The trust will pay taxes on its income, and the beneficiary will not be taxable except to the extent the trust actually makes distributions to or for the benefit of the beneficiary. Such distributions would sweep taxable income from the trust to the beneficiary.

As with any minor's trust, the donor should not be a trustee of a 2503(c) trust. If the donor is the trustee, even though the trust is irrevocable, the donor's ability to control the timing of distributions to the beneficiary will result in the assets of the trust still counting as part of the donor's estate for estate tax purposes

IV. CRUMMEY TRUST

Another form of minor's trust is a so-called "Crummey trust," named after the case of *Crummey* v. *Commissioner*, 397 F.2d 82 (9th Cir. 1968). The *Crummey* case provides that if a trust is funded, but the beneficiary is given the right for a period of time to withdraw the contribution to the trust, then the contribution will be treated as a present-interest gift because of the immediate right to withdraw it. If the right of withdrawal is not exercised, then the contribution can remain in the trust for the duration of the trust. Because the withdrawal power makes the contribution a present interest gift, the trust does not need to provide for the beneficiary to withdraw the assets of the trust at age 21. The trust can be drafted from the outset to run until age 25 or 30 or beyond. Where the beneficiary is a minor, the notice of the right to withdraw can be sent to a parent of the beneficiary. It is critical that the trustee send a notice of the gift and the beneficiary's right to withdraw it every time there is a gift to a Crummey trust in order to make certain that each gift qualifies for the annual exclusion and does not use up any of the donor's lifetime gift exemption.

The donor should not be a trustee of a Crummey trust. If the donor is the trustee, even though the trust is irrevocable, the donor's ability to control the timing of distributions to the beneficiary will result in the assets of the trust still counting as part of the donor's estate for estate tax purposes. If someone other than the donor of the assets is trustee, then once the trust is funded, the assets are out of the donor's estate for estate tax purposes.

If the notice of withdrawal rules are observed each time a gift is made to the trust, the trust is deemed a grantor trust for income tax purposes, with the child as grantor. This means that the trust must file an annual income tax return, but it is a shortened form and shows that the income is taxed on the beneficiary's own personal tax return. The advantage of this is that the trust will not be subject to income tax at the accelerated rates that apply to trusts, but instead the income

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will be taxed at the rates applicable to the beneficiary, which are often lower and subject to more deductions and exemptions.

The primary difference between a Crummey trust and a 2503(c) trust is that the Crummey trust gives the beneficiary the right to withdraw each year's contribution, but does not give the beneficiary an opportunity to withdraw the entire value of the trust at age 21. The 2503(c) trust does not give the beneficiary an annual opportunity to withdraw funds, but gives the beneficiary the opportunity to withdraw the entire trust at age 21. This may be an unsuitable age to give the beneficiary access to the entire trust. Consequently, Crummey trusts are more frequently used than 2503(c) trusts.

Please note that federal requirements set forth in Circular 230 now regulate written communications from our law firm about federal tax matters. Such communications can be either "opinions" or other written communications. Nothing set forth hereinabove is intended to be an opinion for purposes of Circular 230. As a result, nothing set forth herein may be relied upon to avoid any federal tax penalties. If you would like to receive a written opinion from us about a federal tax matter, please contact us.

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