Chicago Daily Law Bulletin®

Volume 161, No. 48

Funding the future: Grandparents have many ways to help loved ones

My family has had the pleasure of welcoming the next generation of Markuses. My 2-year-old niece, Lex, has enough personality and style to be nicknamed "Manhattan." And my nephew, Nathan, just arrived on the scene. While his personality is still developing, I'm thinking "Mr. Giggles" may be appropriate for this very happy 3-month-old.

The joy they bring to the family is immeasurable. And my generous parents, like countless other clients, say, "I want to see my children and grandchildren enjoy the fruits of our labors. What should we do?" The key is to gift strategically.

The current estate tax exemption is $5.43 million per person at the federal level but only $4 million for the state. Illinois residents face an estate tax of 28.5 to 50 percent.

So for clients with taxable gross estates, gifting plays a critical role in wealth transfer. Even for those with more modest means, it's important to incorporate strategic adjustments when gifting to the next generation.

Use 'em or lose 'em

On an annual basis, the IRS allows you to gift a certain amount to any beneficiary, also known as an annual exclusion gift.

In 2015, the gift exclusion is $14,000 per person (or $28,000 for a married couple). Thus, grandma and grandpa could gift $28,000 to each grandchild free of gift taxes. These annual exclusion gifts are in addition to the $5.43 million lifetime gift exemption.

Unfortunately, however, if a gift is not made in a particular calendar year, it cannot be rolled over to the next year. Thus, use it or lose it.

For example, if grandma wanted to gift $114,000 to her grandson, $14,000 would be considered an annual gift, and she would have to file a gift tax return notifying the IRS she has utilized $100,000 of her lifetime gift exemption and, upon her death, she will pass $5.33 million. No gift tax would be owed, but the return must be filed for informational purposes.

Boo-boos and ABCs

Under Section 2503(e) of the Internal Revenue Code, tuition payments made directly to an educational organization (for anything from private nursery schools to graduate schools) or health-care provider are not treated as taxable gifts (they are not considered part of the donor's $14,000 annual gift exclusion or $5.43 million lifetime exclusion).

With respect to educational expenses, the gift tax exclusion is only for tuition payments, not room, board or other ancillary expenses. In addition, the payments cannot be made to reimburse someone for the expenses; payments must be made directly to the provider.

To ease payment for education and medical bills, many families are obtaining "family" credit cards to be used for qualified expenses. Grandma and grandpa can then use their bonus airline mileage (or other benefits) to travel with their grandchildren.

529 plans

With college costs continuing to skyrocket, more clients are eager to help put money away for the lil' peeps — and they recognize the importance of starting early. Funding a child's education is likely the best gift one can give.

THE BUZZ

LINDSEY PAIGE MARKUS

Lindsey Paige Markus, a principal at Chuhak & Tecson P.C., draws on her early career in business, finance and clinically applied neuroscience to communicate with clients and to develop creative solutions to fit their estate planning, wealth protection and corporate needs. She has been recognized as one of the 40 Illinois Attorneys Under Forty, a Woman Making an Impact in the Law and an Illinois Super Lawyer Rising Star. She is a collaborative law fellow and is licensed in Illinois and Florida.

A 529 plan is a tax-advantaged investment vehicle designed to encourage saving for educational expenses of a designated beneficiary. Characteristics include:

- Capital appreciation grows tax-deferred.
- Distributions for qualified educational expenses are exempt from taxation. Qualified expenses include tuition, fees, books, most room and board, supplies and equipment required for study.
- Many states provide income tax deductions for all or part of the contributions of the donor. Illinois allows a deduction up to $10,000 per individual or $20,000 for a married couple filing jointly.
- Contributions made to the 529 plan are considered taxable gifts.
- Donors can contribute up to $70,000 (or $140,000) prorated over five years and not incur a federal gift tax.
- 529 plans do not count as an asset on financial aid applications.
- Distributions not used for a qualified expenses are subject to income tax and penalties.
- Beneficiaries can be changed so, as a family grows, funds can be shared among qualified members.

Depending on your particular goals, there are many creative estate planning tools available that can be customized to meet your specific needs and facilitate the transfer of wealth from generation to generation.

UTMAs

In my experience, uniform transfer to minor accounts, or guardian accounts, can be somewhat dangerous, as assets can quickly grow over time.

In many states, when a beneficiary turns 18, she or he can go to the bank and withdraw everything from the UTMA. I've heard some stories where families put money into a UTMA for many years and later discovering a child with special needs would not qualify for governmental assistance.

When the UTMA gets too large, one option is to transfer the property to a 2503(c) trust, which allows the assets to be held in trust for a minor beneficiary provided that the beneficiary has a 30- to 60-day window to withdraw all of the principal and income upon turning 21.

Another option is to transfer the funds to a limited liability company managed by a parent. Keep in mind that once the funds are gifted to a minor outright, they are included in the minor's taxable gross estate. With proper planning, clients are encouraged to consider trusts, instead of UTMAs, for the estate tax and asset-protection benefits.

IDGTs

If clients desire to gift other assets, such as interests in a closely held family business, intentionally defective grantor trusts are recommended. These irrevocable trusts are defective for income tax purposes, whereby all of the tax attributes flow back to the grantor who created the trust.

When grandpa is the grantor, the payment of tax liabilities are not considered gifts, and additional wealth is transferred. Language can be added to the trust allowing the trustee the ability to distribute funds to the grantor to cover tax liabilities if there is an issue with grandpa paying the tax liability in a given year.

The trust is protected from creditors and, if properly structured, can be excluded from the beneficiary's taxable gross estate, allowing the funds to pass estate tax-free from generation to generation.

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