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Autumn 2007 Newsletter

Trusts for Tots: Transferring Assets for the Benefit of Minors

Parents and grandparents wish to make gifts to minors for many reasons, including setting aside funds to help pay for a college education, reducing the size of their taxable estate for estate tax purposes, or simply making gifts outright for the minor's benefit or enjoyment. These gifts are usually made as annual exclusion gifts,[1] so that the donor is not required to use some of his or her gift tax exemption or be liable for a gift tax on the transfer. However, gifts to persons under the age of 18 years should not be made directly to them. Instead, an alternative method of making the gifts indirectly should be considered.

A primary benefit of making an indirect gift for the benefit of a minor is delaying or restricting the soon-to-be adult's access to and control of the gifted assets. Also, in Colorado, a person under the age of 18 cannot enter into binding contracts, or even open a bank or brokerage account. When a minor receives an outright gift or devise, court proceedings, which can be time consuming and costly, become necessary to appoint and monitor a conservator to manage these assets for the minor until he or she reaches the age of majority. Therefore, a number of common alternatives exist for making indirect lifetime gifts for the benefit of minors.[2]

Colorado Uniform Transfers to Minors Act (CUTMA)

Under the CUTMA, which became effective July 1, 1984, a gift can be made to an adult as "custodian" to hold property for the benefit of a minor (the "beneficiary"). During the custodianship, the custodian has a fiduciary duty to reasonably protect and invest the property, and, if any funds are distributed from the custodianship, they must be used for the beneficiary's needs.[3] When the beneficiary reaches age 21, or if the beneficiary dies before reaching age 21, the custodianship is terminated and the custodian must turn over the property to the beneficiary or the beneficiary's estate.

Use of a CUTMA custodianship should be carefully considered prior to making such a transfer. Transfers creating custodial property are irrevocable (even if there is substantial growth in asset value), the custodian may not use the custodial property for the benefit of anyone other than the named beneficiary, and the custodial property is legally owned by the beneficiary after the transfer. Therefore, if the beneficiary incurs a tort liability (*i.e.*, is sued in civil court) at any time, or enters into a contract after reaching age 18, the beneficiary's creditors may be able to reach the custodial property.

The donor of custodial property should carefully consider who to name as custodian. Although a custodian is held to a fiduciary standard in managing the custodial property, a custodian's statutory authority allows him or her significant rights in controlling the custodial property. For example, the custodian has

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[1] The annual exclusion amount is equal to $12,000 per donee in 2007 and 2008, and is adjusted periodically for inflation.

[2] This article discusses indirect gifts to minors via the CUTMA, 2503(c) trusts and Crummey trusts. Other alternatives, such as 529 plans and Coverdale Education Savings Accounts, are also available for indirect gifts specifically earmarked for qualified education expenses.

[3] In general, "fiduciary" is a term that applies to a person who is acting on behalf of another person with the other person's best interests in mind.

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complete discretion, without court approval, to make distributions to or for the use and benefit of the beneficiary. In addition, a non-donor custodian has the right to charge "reasonable compensation" for services rendered, which could deplete the amount of custodial property that ultimately passes to the beneficiary. Also, after the transfer of property to a custodian, the custodian may only be removed for cause by petitioning the appropriate court for removal. Finally, to avoid inclusion of the property in the donor's estate for estate tax purposes, the donor should never name himself or herself as custodian.

Based on the significant control granted to a custodian under the CUTMA, a donor may wish to consider making an indirect gift in trust rather than under the CUTMA to afford the donor more control over the fiduciary and the use of the gifted assets.

2503(c) Trusts

To qualify as an annual exclusion gift, a donor must give a present interest in the gifted property. Gifts to trusts are ordinarily gifts of future interests, because the trust beneficiary does not have a present right to use or enjoy the gifted property. Therefore, gifts to trusts generally do not qualify for the gift tax annual exclusion.

One exception to this future interest rule is found in the Internal Revenue Code (IRC) Section 2503(c), which states that a gift of a future interest qualifies for the gift tax annual exclusion if the gifted property and income from that property: (i) may be expended by, or for the benefit of the beneficiary before he or she reaches age 21, and (ii) will pass to the beneficiary when he or she reaches age 21 or, if the beneficiary dies before reaching age 21, will be payable to his or her estate or as the beneficiary may appoint under a general power of appointment. This type of trust is commonly known as a "2503(c) Trust".

The trustee of a 2503(c) Trust must use the trust property generally "for the benefit" of the beneficiary. This means that a donor using a 2503(c) Trust for indirect gifting cannot limit distributions to the "ascertainable standards" of the beneficiary's health, education, maintenance and support. However, as long as the trustee is given discretion to make distributions of the trust assets (as opposed to required distributions), assets of a 2503(c) Trust should be protected from a minor-beneficiary's creditors. However, once the assets are in the hands of the beneficiary (*i.e.*, at age 21 or upon distribution) a beneficiary's creditors will be able to reach the gifted assets.

If federal estate tax liability is a concern of the donor, the donor to a 2503(c) Trust should not be named as the trustee of the trust, because the broad discretion granted to the trustee could make the trust assets includable in the donor-trustee's estate. However, a donor may appoint another family member or spouse as trustee without risking inclusion of the assets in the donor's estate for estate tax purposes.

A limitation of using a 2503(c) Trust is that the trust should be created for the benefit of only one beneficiary. Also, under both the gift and generation-skipping transfer (GST) tax rules, all assets of the trust must be made available for withdrawal by the beneficiary or distributed to the beneficiary at age 21. This requirement can make the 2503(c)Trusts less desirable for donors looking to delay the beneficiary's access to the gifted assets beyond age 21.

Crummey Trusts

Another exception to the future interest rule discussed above are "Crummey Trusts" (named for the court case that approved their use), and which potentially provide the most flexibility and control over the use of gifted assets. Under this approach, after a donor makes a contribution to the trust, the beneficiary is given a present limited right to withdraw the contribution. Notice of the contribution and the withdrawal right must be given to the beneficiary (or to a designated adult capable of making the withdrawal for a minor beneficiary), and the withdrawal right must be in existence for a reasonable period of time.[4]

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[4] The IRS has privately ruled that a 30-day period for the existence of a withdrawal right is a reasonable amount of time.

★ ★ ★ ROLL CALL ★ ★ ★

On September 9th **Tom Stover** successfully completed a century (100 mile) ride as part of the Buffalo Bicycle Classic which supports scholarships in the College of Arts and Sciences at the University of Colorado. In July, he rode in the 2007 Courage Classic Bicycle Tour which helped raised over $2 million for the sick and injured kids at The Children's Hospital in Denver. In June, Tom continued with his active involvement in the American College of Trust and Estate Council (ACTEC) attending the 2007 summer meeting in Salt Lake City. He is currently preparing a comprehensive paper on Generation-Skipping Transfer (GST) trusts which will be presented to members of the Colorado bar at various venues in 2008.

Jennifer M. Spitz continues to serve as Co-Chair of the Taxation, Estate Planning and Probate Section of the Boulder County Bar Association. In that capacity, she organizes presentations on topics of interest to trust and estate attorneys. She also continues to serve as a Council Member for the Trust and Estate Section of the Colorado Bar Association. In November, she will be making a presentation on the topic of estate planning in light of the uncertain future of the estate tax.

David Brantz has become the newest member of the Legal Committee of the Community Foundation of Boulder County. The Community Foundation is a tax-exempt public charity that allows people to establish permanent endowment funds and gift funds within the confines of one large foundation, and offers an inexpensive, value-added way to establish a named family foundation, all of which serve to improve the quality of life in Boulder County. As a member of the Legal Committee, David works to ensure that the actions of the Community Foundation comply with the requirements of state and federal law, including the Internal Revenue Code.

Following her May wedding, our receptionist, **Denise**, has changed her last name to Poepping (which is pronounced Pep-ing).

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The primary benefit of a Crummey Trust is that, after the lapse of the withdrawal right, the contributed assets can remain in trust subject to the terms of the trust agreement. This means that distributions from the trust can be limited to the extent desired, and trust assets can be held in trust until the beneficiary reaches an older age (above age 21), or kept in trust for distribution to a beneficiary's future descendants. Because of this characteristic, Crummey Trusts are often combined with GST tax planning (see page 4 for more about GST tax).

Similar to a 2503(c) Trust, as long as the trustee of a Crummey Trust is given discretion to make the distributions of the trust assets, assets should be protected from a beneficiary's creditors, and a donor may appoint another family member or spouse as trustee without risking inclusion of the assets in the donor's estate for estate tax purposes.

Conclusion

Many alternatives exist for making indirect lifetime gifts for the benefit of persons under the age of 18. Each alternative discussed above can allow a donor to make annual exclusion gifts to minors, while designating an adult fiduciary with the power to control the gifted assets for the benefit of the minor. Based on the minor's needs, the size of the gifts, the amount of creditor protection desired, the age at which a donor wants to give the minor access and control to the gifted assets, and the desired tax consequences of these various alternatives, a donor should carefully consider which alternative best suits his or her wishes to make indirect lifetime gifts for the benefit of a minor.

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AUTUMN 2007 NEWSLETTER

GST TAX IN A NUTSHELL

If you have done any recent reading about estate planning (including this newsletter) it is likely you have seen references to GST tax. "GST" stands for generation-skipping transfer. A generation-skipping transfer is a transfer made to a recipient who is two or more generations below the transferor. For non-relatives, the Internal Revenue Service considers that a transfer is generation skipping if the recipient is 37½ years younger than the person making the transfer.

The GST tax is a federal tax levied in addition to the federal estate and gift tax on transfers of assets that skip a generation and is equal to the maximum federal estate tax rate, which is currently 45%. However, every person is permitted to shelter a certain amount of property from GST tax, this known as the "GST exemption amount".

The GST exemption amount is currently $2 million dollars and is scheduled to increase to $3.5 million dollars in 2009 (in tandem with the estate tax exclusion amount). Essentially, the GST exemption allows a person to pass assets equal to the GST exemption amount directly to grandchildren (or more remote descendants) or to trusts that will distribute to grandchildren (or more remote descendants) without incurring any GST tax or being subject to estate tax again in the transferor's child's estate.

The provisions of the Internal Revenue Code governing GST tax are some of its most complicated and this is but the briefest of explanations. If you wish to discuss the inclusion of GST tax planning in your estate plan, please call us at 303-682-0433 to set an appointment.

This publication is intended ONLY to provide general legal information. The information contained herein should not be acted upon without professional advice related to specific situations.
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