GIFTS TO MINORS

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This memorandum describes several methods by which you may make lifetime gifts to minors.

Generally, you are subject to the federal gift tax whenever you give property to individuals. Three types of gifts are exempt from the gift tax: (1) gifts to a spouse, (2) gifts to other individuals of up to $14,000 in value per donee per year (this amount is indexed), and (3) direct payments for tuition or medical care for other individuals. Your gifts to minors do not generate any income tax deduction, but they can reduce your estate tax and they do avoid gift tax to you (if they do not exceed $14,000 in value per minor per year).

Gifts to minors may be made either outright to the minor or by one of several alternative methods. An outright gift to a minor generally is unsatisfactory (except for nominal gifts), both because minors usually cannot transact financial business (other than handling a simple bank account) and because many minors lack the judgment and responsibility to manage their own financial affairs. The following are four common alternative methods to make gifts to minors.

Custodianship

You may create a custodianship by designating an adult, other than yourself or your spouse, as custodian for the minor to receive the gift under the Uniform Transfers to Minors Act ("UTMA"). The custodian controls the management of the gifted property and determines whether to make distributions for the minor until the minor attains age 21. At age 21, the minor must receive whatever property is held by the custodian. You may create a custodianship by establishing an account or transferring cash or other property to the adult as follows:

"[Adult's name] as custodian for [Minor's name] under the Uniform Transfers to Minors Act."

For income tax purposes, the custodianship property belongs to the minor, and the minor must file income tax returns. No tax returns need be filed by the custodian.

2503(c) Trust

You may establish a trust that in effect terminates when the minor reaches age 21. At that age (or before), the trust must either terminate automatically or give the minor the right to withdraw all of the trust property from the trust during a 30-day "window." You may provide that, if the minor does not withdraw the trust property, the trust will continue for a further period specified in the trust instrument. This trust sometimes is called a "2503(c) trust" (the relevant Internal Revenue Code section). The trust offers the following advantages over a custodianship: (1) the trust's income is taxable to the trust rather than to the minor, which at least may be advantageous for minors, who are generally taxable at the parent’s tax rates; and (2) the trust is "on track" to continue beyond the minor's 21st birthday unless the minor elects to withdraw the trust property.
For income tax purposes, the trust is a separate taxpayer with a taxpayer identification number

(similar to a Social Security number), and the trust files its own income tax return each year.

You should select someone other than yourself or your spouse to serve as Trustee. To establish a 2503 (c) trust, you will need to sign a trust instrument.

Irrevocable Trust

A third method of making gifts to minors also involves a trust. Use of an Irrevocable Trust is not limited to minors and may be used for gifts in trust for a beneficiary of any age. The unique characteristic of this trust is that, any time you give property to the trust, the minor (or the minor's guardian) must have the right to withdraw the contribution during a 30-day window; if the minor does not withdraw the trust property, the gift becomes final and is locked in the trust until the trust terminates at an age specified by you in the original instrument. The Irrevocable Trust offers the following advantages: (1) although the minor has a right to withdraw any contribution, this right is rarely, if ever, exercised; and (2) unlike the custodianship and 2503(c) trust, the minor has no right at age 18 or 21 to receive the property, and the trust continues for as long as specified in the instrument (even for the minor's lifetime).

For income tax purposes, this trust is treated more like a custodianship than a 2503(c) trust. Although the trust is a separate taxpayer with a taxpayer identification number and files a simple "grantor" tax return, the trust's income tax consequences flow to the minor, who must file income tax returns.

You should select someone other than yourself or your spouse to serve as Trustee. To establish an Irrevocable Trust, you will need to sign a trust instrument.

Section 529 Plans

An alternative to the use of a trust for a minor is to transfer gifts to a tax deferred savings plan for education created under Internal Revenue Code § 529. Under a Section 529 plan, funds are held in an investment account for tuition and related educational expenses. Growth of the funds is protected from income taxation. The funds can be reclaimed by the Donor or used for non-educational purposes subject to penalty, and may be redirected to another beneficiary.

The matters addressed in this memorandum are for general informational purposes only, and are not intended to be applied to the specific needs of individual clients without further consultation.