

The best way to make gifts to grandchildren

BY JESSICA GALLIGAN GOLDSMITH

This is an excellent time to consider making substantial gifts to your grandchildren. Under current law, the federal gift and generation-skipping transfer ("GST") tax exemptions are \$5 million per person. This means that a married couple is now able to transfer up to \$10 million tax-free to their grandchildren during their lifetimes.



Gifts to grandchildren can be made in a number of ways. You can make annual gifts of up to \$13,000 to each grandchild without using any of your lifetime gift or GST exemptions, and you can also pay any amount of tuition and medical expenses on behalf of a grandchild directly to such grandchild's school, medical professional or medical institution without incurring any gift tax. Even small amounts can add up quickly.

However, you should avoid putting this money into bank accounts for each grandchild commonly known as Uniform Transfer to Minor ("UTMA") accounts. Although an UTMA account may seem like a simple way to make a gift to a new baby, these accounts can be problematic when the grandchild reaches age 21 and suddenly has unfettered access to this money. Annual gifts of \$13,000 made over the grandchild's lifetime can add up to a very substantial sum. Not many college students can handle the responsibility of receiving a check for \$250,000 or more, and the parents will not be happy if a grandchild suddenly has a lot less incentive to study hard or to look for a job after graduation.

A good alternative to an UTMA account is to create a grantor trust for each grandchild that is designed so that every annual gift qualifies for the annual gift tax exemption. You can name one or more trustees to invest the money and dispense it to or for the benefit of the grandchild in their discretion. You can also mandate distributions of income and principal at various ages that you determine to be appropriate. Such trusts can last as long as you wish, including for a grandchild's entire lifetime and then for great-grandchildren as well. In addition, with a grantor trust, you can choose to pay all of the income taxes due each year on the income earned by the trust, thereby allowing the principal to grow for the benefit of

one or more future generations.

If you have already established an UTMA account for your grandchild, don't worry. You can still set up a grantor trust to hold all future gifts. If the amount in the UTMA at the moment is still small, then this makes a nice graduation gift for the grandchild. If the amount in the UTMA account is already significant, the custodian of the UTMA can use this money for the grandchild's expenses and diminish the account before the grandchild attains age 21. Alternatively, the grandchild can set up his or her own trust at age 18 and assign the UTMA assets to the trust, thus eliminating the potential for a large uncontrolled distribution to the grandchild at age 21.

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If you can't afford to make lifetime gifts of the full \$5 million, it is still a good idea to consider making smaller gifts that use only a part of your new exemption. New York State has no state gift tax, and future appreciation earned on any property given away will be removed from your estate. Everyone now has the opportunity to make substantial new gifts. Even if you have exhausted your prior lifetime gift exemption of \$1 million, in 2011 and 2012 you can make up to \$4 million in "extra" gifts to grandchildren without paying any gift or GST tax.

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