

GENERATIONAL GENEROSITY

Would you rather transfer your wealth to the IRS or to your loved ones? If you answered *the IRS*, then disregard this article. On the other hand, if you answered *your loved ones*, then read on. We will review some of the relevant tax rules for lifetime gifting, then examine two common transfer methods (along with a few of their potential pitfalls).



Gifting Fundamentals

Every taxpayer may transfer up to \$12,000 each year to an unlimited number of individuals. This is known as the Annual Gift Exclusion (AGE). Through *gift splitting*, spouses may give a total of \$24,000 each year to an unlimited number of individuals (even if only one spouse is the sole source of the funds gifted). Such lifetime gifts made within these dollar limitations do not trigger gift taxes when made, nor do they reduce the combined *Applicable Exemption Amount* available to protect lifetime transfers of wealth exceeding AGE limits and postmortem transfers of wealth.

Accordingly, maximizing transfers within the limits of the AGE has been and remains a prudent method to transfer wealth between generations. [Exception: Qualified payments in any amount made *directly* to an educational institution for tuition and *directly* to a provider of medical care on behalf of any individual are fully excluded from gift tax consideration and may be made without dollar limitation.]

EGTRRA Exemption

Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), taxpayers are able to make total lifetime tax-exempt

INSIDE

Would you prefer to transfer more wealth to your family instead of the IRS? There are many estate planning strategies to help accomplish this. Our front-page article summarizes the lifetime gifting rules and two common do-it-yourself transfer methods.

On page three we review how lifetime gifting to a Crummey Trust may reveal the financial maturity level of your loved ones now, so you may make proper plans for them later. Beware, though, the path to safety is very narrow.

transfers of wealth totaling \$1 million independent of the AGE limitations. For example, a widow with five grandchildren could transfer a total of \$1.06 million to them free of gift taxes all in the same calendar year. Additionally, this \$1.06 million would be excluded from her estate for determining any future estate tax liability, as would any future appreciation on the gift. [Note: On the downside, however, the grandchildren would receive their grandmother's *cost basis* in the gift, triggering potential capital gains taxation on any appreciation above cost basis. Proper estate

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planning often requires balancing your tax and non-tax objectives.]

Depending on the size of your overall estate and your ability to make gifts without affecting your lifestyle, maximizing your lifetime wealth transfers may be a tax-savvy strategy given the uncertain future of the estate tax. Nevertheless, once you have made the decision to be inter-generationally generous, the next decision is how to make the transfer. Two popular methods are *outright gifts* and *custodial accounts*.

Outright Gifts

An outright gift with no strings attached is the simplest method of making a lifetime wealth transfer. You simply deliver the asset directly to the donee. Once in the hands of the donee, however, your gift may be taken away from them through a divorce, lawsuit or bankruptcy. More commonly, your gift may be *squandered*, because you have no further control over an outright gift once delivery is made. Fact: No one appreciates the value of a

dollar like the person who earned it (and paid taxes on it). Fortunately, the law provides at least one simple alternative to protect gifts, particularly when made for the benefit of minors.

Custodial Accounts

Custodial accounts established under the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA) are very popular methods of making transfers to loved ones who are minors. They are popular because they are convenient and inexpensive to create. Almost all

financial institutions offer such arrangements.

Beware: The account becomes the *unrestricted* asset of the beneficiary upon reaching age 18 or 21, depending on applicable state law. In other words, it could be used for fast cars and stereos, instead of books and tuition.

Summary

Inter-generational generosity makes good sense for a variety of reasons. However, great care must be given to the method of transfer to avoid the potential pitfalls of these do-it-yourself methods.



Word Puzzler

Search this scrambler for words related to "Generational Generosity."

Alternative	Custodial
Dollar	Downside
Education	Estate
Exclusion	Future
Gift	Grandchildren
Lifestyle	Lifetime
Outright	Prudent
Rules	Tax
Taxpayer	Trigger
Uncertainty	Value

G T A X K R I G Z C L J U Y S
 I R F U R A L L O D E E X D J
 F I A N N E T I D K T D J D L
 T G U N O C D T F I A U E T I
 E G L L D I E I C E T C K E F
 R E L S K C S R S O S A B Y E
 U R O A U Z H U T N E T E S T
 T W U U I E S I L A W I Y E I
 U N S R T D U Y L C I O N L M
 F J E H H R O L G D X N D L E
 P T L D E V I T A N R E T L A
 Z X U F U J B G S V X E K Y Q
 P V R C Y R A K H U J O N B N
 K V R E Y A P X A T C A F H G

CRUMMEY TRUSTS

There are many non-tax benefits to making lifetime gifts to loved ones, aside from the obvious tax benefits. For example, what better way to preview the financial maturity of your loved ones with an inheritance in the future than through a *dress rehearsal* in the present ... while you are still in the audience?

Keeping Control

If you are like most people, you may be reluctant to part with control over how your lifetime gifts will be used once transferred. Unfortunately, when you retain direct control over a gift, the value of the gift (and its appreciation) may be included in your estate upon your death for estate tax purposes. Worse yet, the gift may be taxable at the time of transfer as a *future interest gift*, rather than treated as a nontaxable *present interest gift*.

To qualify as a *nontaxable present interest gift*, the donee must be able to exercise complete and unrestricted control over the gift. Fortunately, there are exceptions to this general rule, such as custodial accounts for minors as described. Another exception is the *Crummey Trust*, as created in the landmark case of Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968).

Although the *Crummey* case carved an exception to the general rule regarding the present interest requirement for nontaxable gifts, the path to safety is very narrow. Therefore, it is essential for the success of your *Crummey Trust* that you dot all of the legal *i*'s and cross all of the procedural *t*'s. Truly, the devil is in the details here. [Note: If a *Crummey Trust* is properly created, administered and funded with life insurance, then 100 percent of the eventual insurance proceeds will be *excluded* from the

trustmaker's estate under current tax law.]

Crummey Requirements

First, you create an irrevocable trust agreement (you cannot change its terms once signed by you) containing all of the *strings* you wish to attach to the future gifts to the trust.

Second, you make lifetime gifts to the trustee on behalf of your trust beneficiary (or beneficiaries).

Third, the trustee must provide written notice to the beneficiary (or their legal guardian, if the beneficiary is a minor) each time you make such a gift, giving the beneficiary a period of time (typically not less than 30 days) to exercise their right to withdraw all or part of the gifted amount.

If the beneficiary does not exercise this withdrawal right, then the gift *lapses* and the trustee administers the gift for the beneficiary according to the strings you attached. These strings may provide valuable

protection for your gifts from divorces, lawsuits, bankruptcies and squandering. Conversely, if the beneficiary exercises this withdrawal right, then you may have gained a valuable insight into their current financial maturity level. In either case, you may wish to revise your estate plan accordingly.

As on Broadway, a dress rehearsal today may prevent bad acting tomorrow.



HOME-COOKED GOODNESS

Italian Biscotti

The word *biscotti* means *twice-baked*... or in this case, wonderful.

- 2 C. all-purpose flour
- 1-1/2 tsp. baking powder
- 3/4 C. granulated sugar
- 1/2 C. (1 stick) unsalted butter, room temperature
- 1 tsp. grated lemon zest
- 1/4 tsp. salt
- 2 large eggs
- 3/4 C. almonds, coarsely chopped

Preheat oven to 350° F. Line a heavy baking sheet with parchment paper. Whisk the flour and baking powder together in a medium bowl. Using an electric mixer, beat the sugar, butter, lemon zest and salt in a large bowl. Beat in the eggs, one at a time. Add the flour mixture and beat just until blended. Stir in the almonds. Form the dough into a 3-inch wide by 13-inch long log. Bake 40 minutes until pale golden brown. Cool for 30 minutes. Using a serrated knife, cut the log on a diagonal into 1/2 to 3/4-inch thick slices. Arrange the biscotti, cut side down, on a baking sheet. Bake 15 minutes. Transfer to rack and cool. Optional: Top cooled biscotti cookies with Nutella hazelnut/chocolate spread.



To live is so
startling it leaves
little time for
anything else.”
— Emily Dickinson

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Note: Nothing in this publication is intended or written to be used, and cannot be used by any person for the purpose of avoiding tax penalties regarding any transactions or matters addressed herein. You should always seek advice from independent tax advisors regarding the same. [See IRS Circular 230.]
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