

## THE BEST LAID PLANS.....

PITFALLS OF MAKING GIFTS TO YOUR CHILDREN

By Robert Prior



"The best laid plans of mice and men often go awry." So said Robert Burns. Many parents make gifts to their children and grandchildren. The gifts can be for various reasons: to provide a savings nest-egg, to pay for a child's or grandchild's education, to pay for an adult child's medical costs, to shift wealth to children and to avoid income tax at the parents' taxable rate. While the gifts may be well-intended, they can be traps for the unwary, and "oft go awry." This article will address some of these issues.

The good news is that most gifts are not taxed. There is no income tax assessed on property received by gift. And, as long as the gifts for any one individual do not exceed \$14,000 per year (in 2017), then there are no gift tax consequences. This means that a husband and wife may collectively give \$28,000 per year (\$14,000 each) to each of their children and grandchildren with no tax concerns.

Over and above annual exclusion gifts are amounts paid directly to a medical institution for a child's medical care and amounts paid directly to an institution of higher learning for a child's education. These gifts may be paid without any limitation and without incurring gift tax consequences.

A pitfall of gifting to children during your life concerns tax basis. If you gift capital assets to a child during your life (e.g., stock, bonds, or real estate) then that child will take your tax basis in the capital asset. This means that if the child later sells the asset, they will pay capital gains tax on the difference in the sales price and your tax basis. Alternatively, if you wait to leave your capital asset to your child at your death, the tax basis in the asset "steps up" to the value on the date of death. The child could sell the asset following your death and pay substantially less in capital gains tax.

Another trap for the unwary is known as the "Kiddie Tax." This tax relates to unearned income of minor children. "Unearned income" generally means income like rents, dividends or interest that the child did not work to earn. Parents often gift income producing assets to their children so that unearned income is taxed at the child's marginal tax rate, which is typically substantially lower than the parents' rate. The Kiddie Tax prohibits this by subjecting unearned income of a child over \$2,100 (in 2017) to the parents' marginal rate.

If you make gifts directly to a minor, either during your life or at death, and make no plan for the gift to be held in trust, then the gift will be subject to the Georgia Transfer to Minors Act (or

the equivalent act in the state where you live). Under this Act, a gift made to a minor outside of a trust is held in a custodial account controlled by the child's parents or guardian. At age 21, the child automatically owns the account outright and can spend the funds as he or she pleases. The gifted assets are also subject to the claims of the child's creditors and may be considered marital property in a divorce proceeding. This type of planning often leads to unforeseen (and sometimes tragic) results, primarily because most 21-year-olds are not ready to manage wealth.

An alternative to a custodial account requires planning, but can have great benefits. Instead of making gifts directly to the child, the donor can establish a trust for the child's benefit. The trust can be established at the donor's death (known as a testamentary trust) or during the donor's life (an inter vivos trust). If properly structured, an inter vivos trust can remove assets from the donor's taxable estate and protect those assets well beyond the age of 21 from poor financial decisions, creditors and divorce. There are several different types of trusts that may be used for this purpose, all of which should be drafted with the assistance of a qualified trust attorney.

Consult with your estate planning attorney before making gifts to your children. A little planning can ensure that your goals are accomplished and your children are protected.



*Bob Prior is a partner in the Athens law firm of Prior, Daniel & Wiltshire, LLC. His practice is focused on estate planning and elder law. Mr. Prior is a former Marine infantry officer and JAG and has been in private practice for 20 years.*

## Estate Planning Elder Law

Robert T. Prior, Sr., J.D., LL.M.

### Professionals Specializing In:

Estates  
Trusts  
Probate

Elder Law  
Medicaid Planning  
VA Planning

Tax Planning  
Life Insurance Planning  
IRA Planning



Prior, Daniel & Wiltshire, LLC  
706.342.0606      bprior@pdwlawfirm.com