



Serving Clients Throughout Central Florida

## 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 and then examine two common transfer methods (along with a few of their potential pitfalls).



### Gifts Fundamentals

Every taxpayer may transfer up to \$13,000 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 \$26,000 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 *Estate Tax Exemption Amount* available to protect lifetime transfers of wealth exceeding AGE limits and post-mortem 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. They may be made without dollar limitation.]

### Lifetime Gift Exemption

In addition to transfers under the Annual Gift Exclusion, taxpayers are able to make total lifetime tax-exempt

## INSIDE

Would you prefer to transfer more wealth to your family instead of the IRS? Our front-page article summarizes the relevant lifetime gifting rules and considers two common *do-it-yourself* transfer methods.

On page three we investigate how lifetime gifting to a *Crummey Trust* may help reveal the financial maturity level of your loved ones. There are certain *i*'s to dot and *t*'s to cross, however, to ensure the successful operation of your *Crummey Trust*.

transfers of wealth totaling \$5 million independent of the AGE limitations. For example, a widow with five grandchildren could transfer a total of \$5,065,000 to them free of gift taxes all in the same calendar year. [Note: Given the ongoing budget negotiations in Congress, this gift exemption amount must be closely monitored. Regardless, it is scheduled to expire on December 31, 2012.] One tax downside to lifetime gifting in the example above is that the grandchildren would receive their grandmother's *cost basis* in the gift, triggering potential capital gains taxation

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on the appreciation above cost basis. Proper estate 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.



## Ask Yourself ...

*These Questions Regarding "Generational Generosity."*

- |  |     |    |          |
|--|-----|----|----------|
| 1. I am taking advantage of my Annual Gift Exclusion (and gift splitting, if married) to maximize the transfer of my wealth to my loved ones instead of the IRS.   | Yes | No | Not Sure |
| 2. In addition to taking advantage of my Annual Gift Exclusion, I plan to use all or part of my lifetime gift tax exclusion (but only after appropriate legal and tax advice).   | Yes | No | Not Sure |
| 3. I understand that any qualified payments I make directly to an educational institution for tuition and directly to a provider of medical care on behalf of any individual are not subject to gift taxation, regardless of the amount transferred. | Yes | No | Not Sure |
| 4. I am comfortable making outright gifts to my loved ones, even if such gifts may be taken through their divorces, lawsuits, bankruptcies or squandering.   | Yes | No | Not Sure |
| 5. Even though I worked hard to earn the money I give to my grandchildren for their college education, I would not care if they used it to purchase depreciating consumer goods, throw lavish parties, and travel like celebrity jet-setters.        | Yes | No | Not Sure |

# 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. Another exception is the *Crummey Trust*, as created in the landmark case of *Crummey v. Commissioner*, 397 F2d 82 (9<sup>th</sup> Cir. 1968).

Although the Crummey case carved a very narrow exception to the general rule regarding the present interest requirement for nontaxable gifts, the path is narrow that leads to safety. 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 (i.e., 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 a 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 or 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.

## POCKET PROTECTORS

### Tips to help you protect your pocket!

#### Is it Time to Review Your Plan?

Proper estate planning is a *process*, not simply a one-time event. Therefore, it only makes sense to periodically review your planning goals and legal instruments. Review this list of life changes that could alter your estate-planning needs. If you notice some areas that might apply to you or your family, it may be time for an estate plan check-up.

1. Marriage, remarriage or divorce
2. Death of a spouse
3. Substantial change in estate size
4. Death or incapacity of an executor, trustee or guardian
5. Move to another state
6. Acquisition of property in another state
7. Birth or adoption of a child or grandchild
8. Serious illness of a family member
9. Change in business interest or retirement
10. Change in insurability for life insurance
11. Marriage or divorce of a beneficiary
12. Change in beneficiary attitudes
13. Financial irresponsibility of a child
14. Change in tax law
15. More than two years since review of plan with attorney

*“Our greatest  
responsibility  
is to be good  
ancestors.”*  
— Jonas Salk

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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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In this ever-changing world, it can be difficult to predict the future. Fortunately, there are many steps that you may be able to take to protect your family or your business from unnecessary harm stemming from unforeseen events. With the guidance of an experienced lawyer, these steps can help you gain peace of mind in knowing that your family or your business will be protected throughout any contingency.

At the Law Office of Vincent J. Profaci, P.A., we understand how difficult it can be to resolve complex legal issues relating to the well-being of your family or business. With more than 20 years of experience and a detailed knowledge of many legal practice areas, our attorney works to provide the detailed and personalized advice you need to address your unique concerns and pursue the most favorable resolutions possible.

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