

## Estate Planning for Grandparents

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March 2012

*The tax laws provide many opportunities for grandparents to provide for their grandkids' financial, educational and other needs*

If you have grandchildren, or anticipate their arrival, providing for their future security may be a major priority in your estate planning. The tax laws provide many opportunities to achieve that objective, including some that are specific to generations beyond the next one.

Leaving part of your estate to a grandchild involves additional planning considerations that can be easily integrated into your overall estate plan. This article touches on four grandchild-related strategies:

- *Annual gifts*
- *Education funding*
- *Custodial accounts*
- *Savings bonds*

### ANNUAL GIFTS

Under current tax law (which is scheduled to expire December 31, 2012), an individual can make gifts of up to \$13,000 per year, per beneficiary, tax-free. Current law also allows for a lifetime gift-tax exemption for monetary gifts of up to \$5.12 million (this, too, is set to change at the end of 2012, dropping to \$1 million). And, specifically for grandparents giving monetary gifts to their grandkids, there is a \$5.12 million per donor “generation-skipping” tax exemption (for 2012). That means you can put your gifts to work immediately — e.g., in a brokerage account or a living trust — with no adverse tax consequence.

This tax exemption includes gifts of cash, securities or other property and contributions to a 529 savings plan (discussed below), a custodial account (also discussed below) or other qualifying accounts. These gifts are not counted as taxable income to your grandchildren and, again, do not count toward the lifetime gift tax exemption limit. For many grandparents, the best way to make these contributions is directly into a gift trust.

Another way of gifting is to pay for your grandchildren’s educational and medical costs. For grandparents, there is no limit on these gifts, meaning that you can pay these expenses in addition to making annual gifts; however, you must pay the school or medical provider directly.

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## **EDUCATION FUNDING**

Aside from the direct payment of education costs mentioned above, Section 529 college accounts offer attractive tax benefits for saving money for a child or grandchild's college education. Anyone can contribute to a Section 529 plan, regardless of income levels or estate value.

When a Section 529 account is initially opened, the account owner designates a beneficiary – in most cases, the person who is expected to attend college some day. (You can change beneficiaries at any time, giving you flexibility to accommodate additions to your family.) For Arizona taxpayers, contributions to a 529 account in any state are deductible (up to \$1,500 per couple or \$750 per individual) on their state income tax return (but not federal), and when distributions are made from the account for qualified educational expenses for the designated beneficiary, the earnings generated by contributions to the account are not taxed. (“Educational expenses” are broadly defined in Section 529 and can include things like tuition, housing, books and even transportation.) *Caution:* Earnings in a 529 account that are not used to pay for education will be subject to taxes and penalties.

A cousin to the Section 529 account is the Coverdell Education Savings Account. Coverdell contributions are limited to \$2,000 per donor per donee per year, but they offer one valuable feature that 529 accounts do not: payment of elementary and high school costs as well as higher education.

## **CUSTODIAL ACCOUNTS**

Under the Uniform Gifts to Minors Act (UGMA) and the Uniform Transfers to Minors Act (UTMA), you can make gifts to a custodial account set up for a child under 18. Gifts to a custodial account are counted as taxable income to the grandchild, but the grandchild's income tax rate is generally lower than that of the person making the gift. You can gift cash, investments, real estate, and more through these accounts.

However, be aware of drawbacks to UGMA/UTMA contributions, such as:

- After you transfer assets into a custodial account, you can't take them back.
- When the child becomes an adult (generally 18 or 21), the custodian must turn all of the account's asset over to the child, whether or not the child's parents or grandparents believe the child is ready
- A custodial account belongs to only one child; thus, you have no flexibility in spreading existing contributions among multiple children or grandchildren.

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- Funds in a custodial account can get in the way of a child qualifying for college loans.

Generally speaking, custodial accounts are well suited to relatively small dollar amounts because they're quick, cheap and simple. However, if you're thinking of transferring many thousands of dollars to a child, a trust may be a much better vehicle.

### **SAVINGS BONDS**

If you purchase savings bonds in the name of your child, and your son or daughter makes less than \$65,600 a year as a single parent or less than \$98,400 as a married couple, the proceeds from the sale of the bonds can be used tax-free for your grandchild's education.

The purchase of zero-coupon bonds, which generally mature in seven to 10 years, is another route you can take. Zero-coupon bonds can generate a substantial amount of money for younger grandkids – depending on the interest rates and yield curve at the time of purchase. However, if the bond market into which you buy has weak spreads, the return may be smaller than you anticipated.

### **DO NOT TRY THIS AT HOME**

If any of these methods of securing a brighter future for your grandchildren appeals to you, we strongly recommend that you get counsel from an experienced estate planning attorney or tax advisor before proceeding. While the benefits of these strategies are significant, professional guidance will help you maximize those benefits and minimize possible disappointments.