**Gifting To Grandchildren**

Making large gifts to grandchildren and more remote descendants is challenging because of the need to understand and comply with complex rules about the generation skipping transfer (GST) tax application and exemptions, along with separate gift tax rules and exemptions. In 2010, this complexity was compounded by the repeal of the estate tax and its return in 2011 with uncertainty as to Congress’s intervening action or inaction. In 2018, the exemption was unexpectedly doubled, which was good, but again upset everyone’s planning efforts.

The GST Tax is a tricky tax that only applies when assets pass directly or indirectly (typically in a trust) from a donor to a beneficiary two or more generations below the donor (a “skip person”) because it effectively “skips” the first generation for taxation. If a recipient is not a spouse or a lineal or collateral descendant, the IRS uses age differences to determine generational levels for this tax. However, when the GST tax does apply, it is in addition to any gift or estate taxes. This tax is currently a flat 40%. When added to the 40% gift tax, a gift could lose 64% of its value for a gift made without consideration of and planning around these taxes.

For “direct transfers” made to a “skip person” that doesn’t exceed the donor’s unused GST and gift tax exemption, neither the donor nor the recipient will have a GST or gift tax. They might, however, have a reporting requirement if the gift exceeds $15,000 which is the current gift tax annual exclusion amount, or if the gift doesn’t qualify for this annual exclusion.

Direct transfers work when the “skip person” is an individual and not a trust whose beneficiaries are all skip persons, even though such a trust is also a “skip person” under the Internal Revenue Code. The problem with a trust is that while no GST tax applies to any transfer to such a trust in the year of the transfer, the donor’s GST exemption must allocated to the transfer on a gift tax return to avoid the tax upon future distributions.

Gifts that are not affected by the GST and gift tax uncertainty include payments directly to health care and educational providers. By statute, these gifts covering certain expenses are not considered gifts for GST tax purposes. Special trusts can be drafted to utilize this exception for multiple generations.

Although still subject to gift and GST taxes, contributions to 529 plans are great gifts for grandchildren’s educations. These gifts can be frontloaded for up to five years of the donor’s annual exclusion amount, or $75,000 per student per donor in 2018. This permits late gifts for high school and college students large enough to cover college costs. The donor just needs to survive the five years and not make additional gifts to that student during the five years. In Colorado, these gifts qualify for a state income tax deduction, saving the donor 4.63% of the gift, and there is no holding period before the funds contributed can be used.

In 2018, the 529 qualified expenses for distributions were expanded to include up to $10,000 per year for kindergarten through 12th grade expenses. Finally, if the intended beneficiary of the 529 plan doesn’t use the funds for education, they can withdraw them with a penalty for non-qualified use or the donor can transfer the account to other family members, including the donor, who can use the funds for qualified educational expenses.

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