

The Estate Planning Advisor

Trusts for Minors – The 529 Plan Alternative

By Richard J. Shapiro, J.D.

Families continually seek ways to save for the ever-increasing cost of a college education. One method that has gained popularity over the past decade is the 529 college saving plan. These tax-favored savings plans have been established in each state, with some states implementing more than one type of plan. Each state typically subcontracts with an investment company (New York now uses Vanguard) to administer the 529 plan. The funds in the plan grow tax-free, and New York residents who are enrolled in and contribute to a New York plan are also eligible for an income tax deduction.

While the 529 plans are appealing, the investment performance of many of the plans has been less than stellar. Furthermore, if withdrawn funds are not used for educational purposes, they are subject to a 10% federal tax penalty, and may be subject to state tax penalties.

As an alternative to the 529 plan, parents and grandparents may consider using an irrevocable “gifting” trust for minors. The trust is created by the parents or grandparents, usually naming a trusted family member (e.g., the minor beneficiary’s parent) or professional advisor as the Trustee. While a single trust can be created for multiple grandchildren, it is usually more efficient to create separate trusts for each grandchild to whom gifts are to be made.

Once the trust is established, gifts can be made to the trust, often in an amount that does not exceed the annual gift tax exemption amount, presently \$13,000(or \$26,000 if two parents or grandparents are making the gift). Ordinarily, gifts made into a trust are not considered gifts of a “present interest,” and do not qualify for the annual gift tax exemption. However, so long as the trust provides that (i) the Trustee is authorized to make distributions of income and principal for the minor’s benefit and (ii) all trust assets must be distributed to or for the benefit of the minor beneficiary on or before the beneficiary’s 21st birthday, the trust gifts will indeed qualify for annual gift tax exemption.

But many parents and grandparents fear the potential of “affluenza” if children or grandchildren were to receive large lump-sum distribution at age 21, and would prefer that the trust remain in place beyond the beneficiary’s 21st birthday. To prevent a large potential windfall for a beneficiary who turns 21, the trust can be drafted to provide that upon attaining the age of 21, the trust beneficiary possesses the right to withdraw all or part of the trust assets within a certain limited time period (often 30 days). If the designated time period elapses and the withdrawal right has not been exercised, the assets may remain in the trust, with specific instructions provided to the Trustee regarding how

the trust assets may be utilized; if the beneficiary hopes to receive future gifts from a parent or grandparent, they would be wise not to exercise the withdrawal right.

The Trustee may be afforded complete discretion to use the trust assets for any need of the beneficiary. Distribution options may be more narrowly tailored to specific “needs” (typically health, education and maintenance). The trust can also permit the beneficiary to become a Cotrustee upon reaching a designated age, thereby allowing a “training period” for the beneficiary to learn how to manage his or her assets. Finally, the assets in a properly structured “gifting” trust will be protected from the beneficiary’s future creditors, including a divorcing spouse.

Gifting trusts for minors are wonderful, if underutilized, planning tools. Not only do they provide more flexibility than 529 plans in making distributions to or for the beneficiary, but minor’s trusts also permit a greater range of investment choices. And, if drafted with the “hybrid” language allowing the trust to continue beyond age 21, these vehicles can be used as effective lifetime gifting tools.

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