

How to... Report Generation-skipping Tax

Presented by
Monica Haven, EA, JD, LLM
mhaven@pobox.com
www.mhaven.net



Learning Objectives

- Review the historical background of the GST regime.
- Define & identify skip “persons”.
- Correctly tax 3 types of transfers.
- Apply the tax only to transfers in excess of the GST exemption.
- Find ways to mitigate GST taxation.

Answer the 5 W's...

- **Why** is there an estate tax, a gift tax, *and* the GST?
- **Who** are related, unrelated, and entity skip persons?
- **What** are direct skips, taxable terminations, and taxable distributions?
- **When** do we calculate and apply the inclusion ratio?
- **(W)how** can we minimize taxpayer exposure to the GST?

The “Grandparent Tax”

Plan A

- Grandpa gifts \$10 million to Dad → \$4 million tax
- Dad gifts \$6 million to Grandson → \$2.4 million tax
- Net Gift to Grandson = \$3.6 million

Plan B

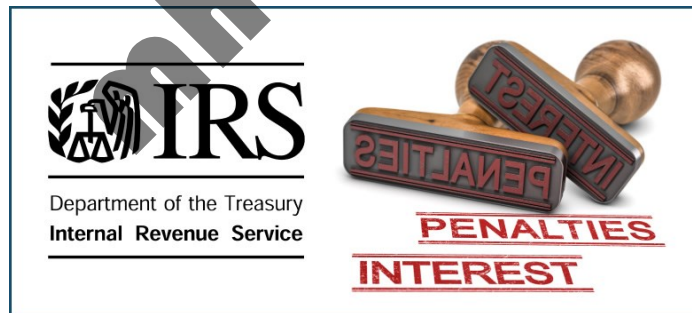
- Grandpa gifts \$10 million to Grandson → \$4 million tax
- Net gift to Grandson = \$6 million



Ahh, but...

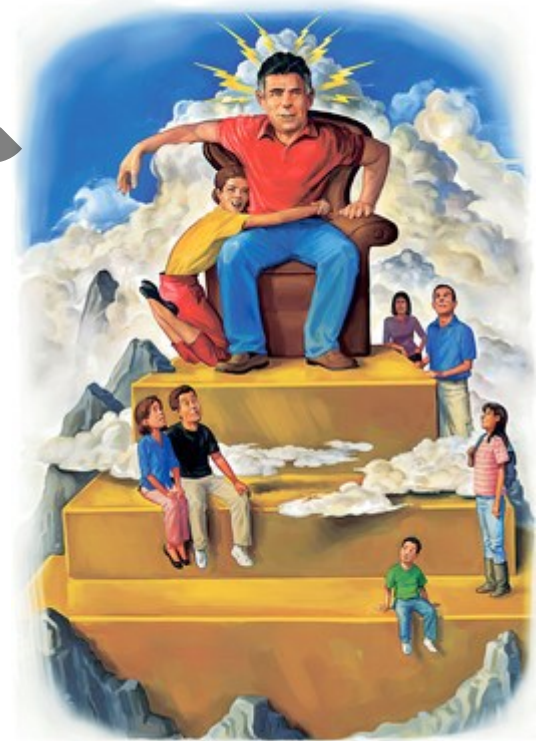
... the IRS penalizes skips

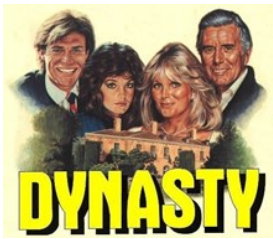
- Tax assessed on transfers ≥ 2 more generations below
- Computed at flat rate equal to highest estate tax rate in effect
- “Penalty” tax is usually higher than if tax assessed at each generation computed at graduated rates



Background

- Life estates were created to transfer(temporary) beneficial ownership to Beneficiary A for life & then transfer outright ownership to B when A died.
- Both estate & gift tax regimes designed to tax only permanent (outright) transfers, so life estate escaped taxation (!).
- Some life estates were created in perpetuity (Dynasty Trusts), allowing assets to pass from generation to generation without any taxation *ever*.





Dynasty Trust

(escapes or defers taxation)

	Dynasty Trust	No Dynasty Trust
Initial Gift	\$ 10,000,000.00	\$ 10,000,000.00
Value in 2042	\$ 43,219,423.75	\$ 43,219,423.75
Estate Tax	\$ -	-\$ 19,448,740.69
Net Value	\$ 43,219,423.75	\$ 23,770,683.06
Value in 2072	\$ 186,791,858.94	\$ 102,735,522.42
Estate Tax	\$ -	-\$ 46,230,985.09
Net Value	\$ 186,791,858.94	\$ 56,504,537.33
Value in 2102	\$ 807,303,650.49	\$ 244,209,354.27
Estate Tax	\$ -	-\$ 109,894,209.42
Net Value	\$ 807,303,650.49	\$ 134,315,144.85
Value in 2122	\$ 3,489,119,856.67	\$ 580,502,316.15
Estate Tax	\$ -	-\$ 261,226,042.27
Ending Value	\$ 3,489,119,856.67	\$ 319,276,273.88

After 4 generations: \$3 billion versus \$319 million!



Solution (?)

- Generation-skipping Transfer Tax (GSTT) enacted in 1976 to assess at the termination of each intervening life estate.
- BUT... tax applied only to transfers from trusts not individuals.



- GSTT was retroactively repealed in 1986.

A Better Fix

- GST was enacted under Tax Reform Act of 1986.
- Applied flat tax on indirect and direct intergenerational transfers > \$ 1 million/donor.
- Exemption rose and fell until set “permanently” at \$5 million (plus inflation adjustments) with passage of American Taxpayer Relief Act of 2012.
- Exemption increased under Tax Cut & Jobs Act of 2017, but reverts to \$5 million in 2026.

Exemption = \$12.92 million [2023]

Effective Tax Rate

- Always at highest marginal estate rate in effect in each year
- Rates as high as 55% (1997 – 2001) & as low as 35% (2011 – 2012)

Tax Rate = 40% [2023]

Transfer Taxes: A Refresher

Estate Tax

- Enacted in 1916.
- Wealth is taxed when transferred from decedent to heir (after death).
- Unlimited tax-free transfer to surviving spouse.
- Exemption = \$12.92 million [2023].
- Unused exemption may be passed to surviving spouse (DSUE portability).
- Taxable estate subject to graduated rates which top out at 40%.



Transfer Taxes: A Refresher

Gift Tax

- Enacted in 1932.
- Wealth is taxed when transferred from donor to donee (during lifetime).
- Annual exclusion = \$17K [2023].
- Spousal gift-splitting allowed.
- Lifetime exemption = \$12.92 million [2023].
- Taxable gift subject to graduated rates which top out at 40%




And...

GST Tax

- Wealth taxed when transferred during life *and* after death if transfer skips a generation.
- Imposes an *additional* layer of tax.
- Exemption = \$12.92 million [2023].
- No “Deceased” Spouse Unused Exemption (DSUE) portability.
- Taxable transfer subject to flat tax at highest prevailing estate tax rate [currently 40%]



THE * *
NITTY * *
GRITTY * *

GUIDEBOOK

GST Taxation: Elements

1. There must be a direct or indirect transfer of wealth
2. From a transferor
3. To a skip person: Related, unrelated or entity.

EXEMPT TRANSFERS:

- Gifts eligible for gift tax annual exclusion (incl. §529 plans).
- Direct payments of medical expenses & tuition.



Transferor

- The giver (a.k.a. donor or trustor).
- May become a transferor *later*.
 - Husband transfers property to Wife as per unlimited marital deduction (H ≠ transferor)
 - Wife then dies & property transfers to child (H = transferor)
- Individual with general power of appointment if exercised, released, or lapsed.
 - Has authority to select new owner (without restrictions)

Skip Person: Relative

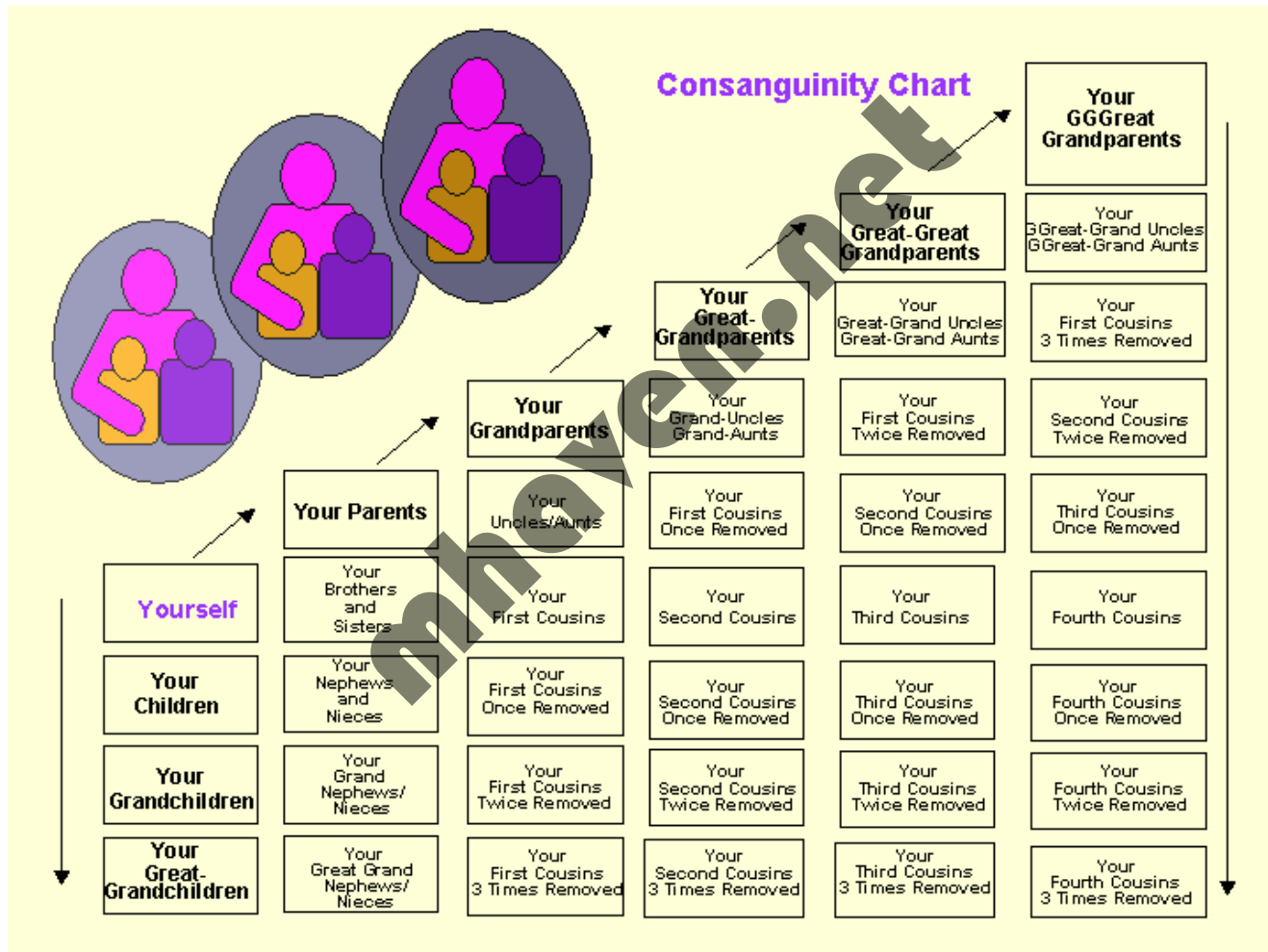
- Any family member at least 2 generations below transferor.

EXCEPTIONS:

- Predeceased Ancestor Rule
A relative is *not* a skip person if the intervening generation has died.
- Spouse or ex-spouse is *not* a skip person.



Consanguinity Chart



Skip Person: Unrelated

Same Generation

- If $\leq 12\frac{1}{2}$ years younger *or older*

One Generation Below

- If $12\frac{1}{2}$ - $37\frac{1}{2}$ years younger

Two Generations Below

- If $37\frac{1}{2}$ - $62\frac{1}{2}$ years younger

BEWARE of gifts to unrelated individuals
younger than transferor!



Skip Person: Entities

“Persons”

- Trust

Deemed to be a skip person if *all* beneficiaries are skip persons.

- Non-profit or charity

Not considered a skip person.

mhaven.net



Types of Transfers: Direct Skips

- Transfers to individuals (not trusts).
- Treated as “single” skip if transfer skips 1 generation.
- ALSO treated as “single” skip even if transfer skips additional generations.

Example

Individual makes gifts to:

- Grandchild (= single skip)
- Great-grandchild (= single skip)

Types of Transfers: Taxable Terminations

- Occurs when the term of a trust comes to a close as per governing instrument or because non-skip beneficiary dies
- AND a *distribution* of trust assets is made to a skip person.

TERMINATED

NOTE: If trust assets are includible in transferor's estate, then no GST.

Types of Transfers: Taxable Distributions

- Trust distributions made to skip persons as per terms of governing instrument.

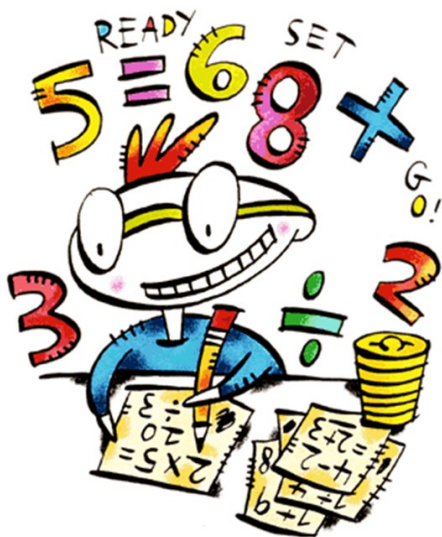
Example

Grandpa establishes trust for simultaneous benefit of son and grandchild → distributions to grandchild are subject to GST



Tax Computation

$$\text{Tax Due} = \text{Taxable Amount} \times \text{Tax Rate} \times \text{Inclusion Ratio}$$



- Taxable Amount = Value of gift on date of transfer
 - Can use Alternate Valuation Date if property includible in transferor's estate.
 - Can be reduced by amount of consideration given by transferee (if any).
- Tax Rate = Maximum estate tax rate currently in effect



Inclusion Ratio

$$\text{Ratio} = 1 - (\text{Allocated GST Exemption} \div \text{Property Value})$$

- Used to determine how much of transferred property will be subject to GST.
- Ensures that tax is applied only to amounts in excess of GST exemption.
- Ratio remains fixed for each transferred property, even if property value increases between date of transfer and eventual distribution.
- Can range from 0 (nothing is taxable) to 1 (everything is taxable).

Inclusion Ratio

Example 1

Facts

- Taxpayer transfers \$1,500,000 property to GST Trust.
- Allocates \$1,000,000 to GST Exemption.

Result

Inclusion Ratio is $1/3$ [= $1 - (\$1 \text{ million} \div 1.5 \text{ million})$]

THUS: $1/3$ of any current or future transfers of *this* property will be subject to GST when...

- taxable distributions, or
- taxable terminations occur

Inclusion Ratio

Example 2

Facts

- GST Trust with Inclusion Ratio of 2/3 has assets valued at \$750K
 - \$250K allocated to GST exemption
 - remaining \$500K is GST taxable
- Taxpayer adds \$500K assets to trust
 - trust assets now total \$1.25 million
- Allocates additional \$250K to exemption

Inclusion Ratio (recomputed)

- New Ratio = $1 - [(\$250K + \$250K) \div \$1.25 \text{ million}] = 3/5$
 - 60% of all distributions will be GST taxable

REMINDER: Under original Inclusion Ratio, 67% would have been taxable.

NOTE: Subsequent transfers to existing trust change Inclusion Ratio for newly transferred property *only*



Rules to Remember

- Inclusion Ratio freezes the percentage of transferred property that will be taxable upon eventual distribution, even if property appreciates in value.
- The applicable GST rate is determined at the time the transferee receives the property (not when property is placed in trust).

GST Exemption

- Equal to current estate tax exemption (adjusted annually for inflation)

Year	GST Exemption	GST Tax Rate
2011	\$5,000,000	35%
2012	\$5,120,000	35%
2013	\$5,250,000	40%
2014	\$5,340,000	40%
2015	\$5,430,000	40%
2016	\$5,450,000	40%
2017	\$5,490,000	40%
2018	\$11,180,000	40%
2019	\$11,400,000	40%
2020	\$11,580,000	40%
2021	\$11,700,000	40%
2022	\$12,060,000	40%
2023	\$12,920,000	40%

Allocation of Exemption

Automatic

- By default, exemption is allocated in chronological order to transfers during transferor's lifetime until exhausted.
- If exemption remains at death, it is allocated to testamentary direct skips first, then trust terminations & distributions.

Affirmative Election

- Transferor (or personal representative) can choose to opt-out of automatic election for current transfer only or for current and future transfers.
- Can elect to have trust treated as GST Trust (to which exemption has been allocated).



Allocation Election

- Irrevocable.
- Must be made by attaching a statement to *timely* filed Forms 709 or 706 in year of transfer.
- May be filed later if election applies to future transfer or trust.
- May be applied retroactively in limited circumstances.
- Private Letter Rulings may be used to correct previous failure to allocate – relief at IRS discretion.

Notice of Allocation Requirements

- Clearly identify the trust and trust's EIN.
- If making a late allocation, state the year the transfer was reported.
- State the value of transferred assets on the effective date of allocation.
- State the amount of GST exemption allocated (OR use a formula).
- State the inclusion ratio of the trust.

Notice of Allocation Sample

TAXPAYER: JOHN DOE

TAXPAYER ID: XXX-XX-XXXX

Attachment to and Made a Part of
United States Gift (and Generation-Skipping Transfer) Tax Return, Form 709
Calendar Year 2016

SCHEDULE D, Part 2, Line 6

NOTICE OF ALLOCATION OF GST EXEMPTION

SCHEDULE A, Part 3, Item 1

Name of Trust: The Doe Family 2016 Trust
EIN of Trust: XX-XXXXXXX
Name(s) of Trustee(s): Jane Doe
Date of Trust: December 1, 2016
Date of Transfer of Assets: December 15, 2016

Value of Assets on Date of Transfer: \$100,000.00

Amount of GST Exemption Allocated to the Transfer: The taxpayer hereby allocates to the assets transferred to The Doe Family 2016 Trust so much of the taxpayer's unused GST exemption as shall be necessary so that The Doe Family 2016 Trust shall have an inclusion ratio of zero for GST tax purposes or, if that is not possible, the taxpayer's entire unused GST exemption.

Inclusion Ratio: Zero (0)

Estate Tax Inclusion Period

- Since exemption allocation – which affects the inclusion ratio – is changeable through late or retroactive elections, there's no guarantee that GST will never be assessed.
- ETIP = Estate Tax Inclusion Period
Time at which GST allocation can no longer be changed.
 - guarantees finality
 - Usually at transferor's death, or
 - Spouse's death if gift-splitting had previously been elected.

NOTE: Indirect skips are *automatically* deemed made at end of ETIP regardless of actual transfer date.

→ property is valued at close of ETIP

Who pays the GST?

Direct Skip

- Transferor is liable
- If transferor unable to pay, liability shifts to transferee

Taxable Termination or Distribution

- Trustee is liable



Type	Description	GST paid by...
Taxable Distribution	Trust makes payment to skip person	Trust OR skip person
Taxable Termination	All of trust passes to skip person(s)	Trust
Direct Skip	Assets pass to (un)related skip person(s)	Donor

Tax Exclusive vs. Inclusive

Assume gift of \$100K in 2023 when tax rate is 40%...

Direct Transfer → tax-exclusive

- Transferor pays tax of \$40K
- Transferee pockets total amount (\$100K)

Indirect Transfer → tax-inclusive
(taxable terminations & distributions)

- Transferee pays tax of \$40K
- Transferee pockets net amount (\$60K)





Where to Report

	<u>DIRECT SKIPS</u>		<u>INDIRECT SKIPS</u>			
	Payable by Transferor	Payable by Estate	Payable by Certain Trusts	to Trusts not currently subject to GSTT	Taxable Distributions	Taxable Terminations
<i>Inter vivos</i>	Form 709 Schedule A Part 2			Form 709 Schedule A Part 3	Form 706- GS(D)	Form 706- GS(T)
<i>Post mortem</i>		Form 706 Schedule R Part 2 *	Form 706 Schedule R-1	Form 706 Schedule R Part 1, Line 9	Form 706- GS(D)	Form 706- GS(T)
<i>Taxes paid by</i>	Transferor	Estate	Trustee	No tax	Beneficiary	Trustee

* Part 3 if will specifies that GST tax is not to be paid from the transferred property interests.

Form 709, Schedule A

Inter vivos Direct Skips & Indirect to Trust not subject to GST

Part 2—Direct Skips. Gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1							

Gifts made by spouse —complete *only* if you are splitting gifts with your spouse and he/she also made gifts.

Total of Part 2. Add amounts from Part 2, column H ▶

Part 3—Indirect Skips. Gifts to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1							

Gifts made by spouse —complete *only* if you are splitting gifts with your spouse and he/she also made gifts.

Total of Part 3. Add amounts from Part 3, column H ▶

(If more space is needed, attach additional statements.)

Form 709 (2012)

Form 709, Schedule D

GST Tax Computation

SCHEDULE D Computation of Generation-Skipping Transfer Tax

Note. Inter vivos direct skips that are completely excluded by the GST exemption must still be fully reported (including value and exemptions claimed) on Schedule D.

Part 1 – Generation-Skipping Transfers

A Item No. (from Schedule A, Part 2, col. A)	B Value (from Schedule A, Part 2, col. H)	C Nontaxable Portion of Transfer	D Net Transfer (subtract col. C from col. B)
1			
Gifts made by spouse (for gift splitting only)			

(If more space is needed, attach additional statements.)

Form **709** (2012)

Form 709, Schedule D (continued)

Tax paid by Transferor

Part 2—GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election

Check here if you are making a section 2652(a)(3) (special QTIP) election (see Instructions)

Enter the item numbers from Schedule A of the gifts for which you are making this election

1 Maximum allowable exemption (see Instructions)	1	
2 Total exemption used for periods before filing this return	2	
3 Exemption available for this return. Subtract line 2 from line 1	3	
4 Exemption claimed on this return from Part 3, column C total, below	4	
5 Automatic allocation of exemption to transfers reported on Schedule A, Part 3. To opt out of the automatic allocation rules, you must attach an "Election Out" statement. (see Instructions)	5	
6 Exemption allocated to transfers not shown on line 4 or 5, above. You must attach a "Notice of Allocation," (see Instructions)	6	
7 Add lines 4, 5, and 6	7	
8 Exemption available for future transfers. Subtract line 7 from line 3	8	

Part 3—Tax Computation

A Item No. (from Schedule D, Part 1)	B Net Transfer (from Schedule D, Part 1, col. D)	C GST Exemption Allocated	D Divide col. C by col. B	E Inclusion Ratio (Subtract col. D from 1.000)	F Maximum Estate Tax Rate	G Applicable Rate (multiply col. E by col. F)	H Generation-Skipping Transfer Tax (multiply col. B by col. G)
1					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
Gifts made by spouse (for gift splitting only)							
					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
Total exemption claimed. Enter here and on Part 2, line 4, above. May not exceed Part 2, line 3, above				Total generation-skipping transfer tax. Enter here; on page 3, Schedule A, Part 4, line 10; and on page 1, Part 2—Tax Computation, line 16			

(If more space is needed, attach additional statements.) Form **709** (2017)

Form 706, Schedule R

Post-mortem Direct Skips & Indirect to Trust not subject to GST

Tax paid by Estate

Form 706 (Rev. 8-2012)

SCHEDULE R—Generation-Skipping Transfer Tax

Note. To avoid application of the deemed allocation rules, Form 706 and Schedule R should be filed to allocate the GST exemption to trusts that may later have taxable terminations or distributions under section 2612 even if the form is not required to be filed to report estate or GST tax.

The GST tax is imposed on taxable transfers of interests in property located outside the United States as well as property located inside the United States. (see instructions)

Part 1. GST Exemption Reconciliation (Section 2631) and Special QTIP Election (Section 2652(a)(3))

You no longer need to check a box to make a section 2652(a)(3) (special QTIP) election. If you list qualifying property in Part 1, line 9 below, you will be considered to have made this election. See instructions for details.

1 Maximum allowable GST exemption	1	
2 Total GST exemption allocated by the decedent against decedent's lifetime transfers	2	
3 Total GST exemption allocated by the executor, using Form 709, against decedent's lifetime transfers	3	
4 GST exemption allocated on line 6 of Schedule R, Part 2	4	
5 GST exemption allocated on line 6 of Schedule R, Part 3	5	
6 Total GST exemption allocated on line 4 of Schedule(s) R-1	6	
7 Total GST exemption allocated to <i>inter vivos</i> transfers and direct skips (add lines 2-6)	7	
8 GST exemption available to allocate to trusts and section 2032A interests (subtract line 7 from line 1)	8	
9 Allocation of GST exemption to trusts (as defined for GST tax purposes):		

A Name of trust	B Trust's EIN (if any)	C GST exemption allocated on lines 2-6, above (see instructions)	D Additional GST exemption allocated (see instructions)	E Trust's Inclusion ratio (optional—see instructions)



Form 706, Schedule R-1

Voucher if tax on Direct Skip is payable by Trust

Tax paid by Trustee

SCHEDULE R-1
(Form 706)
(Rev. August 2012)
Department of the Treasury
Internal Revenue Service

Generation-Skipping Transfer Tax

Direct Skips From a Trust
Payment Voucher

OMB No. 1545-0015

Executor: File one copy with Form 706 and send two copies to the fiduciary. Do not pay the tax shown. See instructions for details.

Fiduciary: See instructions for details. Pay the tax shown on line 6.

Name of trust		Trust's EIN
Name and title of fiduciary	Name of decedent	
Address of fiduciary (number and street)	Decedent's SSN	Service Center where Form 706 was filed
City, state, and ZIP or postal code	Name of executor	
Address of executor (number and street)	City, state, and ZIP or postal code	
Date of decedent's death	Filing due date of Schedule R, Form 706 (with extensions)	

Part 1. Computation of the GST Tax on the Direct Skip

Description of property interests subject to the direct skip	Estate tax value



Form 706-GS(D)

Taxable Distributions from Trust

Tax paid by Beneficiary

Form 706-GS(D) (Rev. November 2011) Department of the Treasury Internal Revenue Service	Generation-Skipping Transfer Tax Return For Distributions ▶ Use for distributions made after December 31, 2010. For calendar year _____	OMB No. 1545-1144
---	---	-------------------

Attach a copy of all Forms 706-GS(D-1) to this return.

Part I General Information

1a Name of skip person distributee	1b Social security number of individual distributee (see instructions)
2a Name and title of person filing return (if different from 1a, see instructions)	1c Employer identification number of trust distributee (see instructions)
2b Address of distributee or person filing return (see instructions) (number and street or P.O. box; city, town, or post office; state; and ZIP code)	

Part II Distributions

a Trust EIN (from Form 706-GS(D-1), line 2a)	b Item no. (from Form 706-GS(D-1), line 3, column a)	c Amount of transfer (from Form 706-GS(D-1), line 3, column f (Tentative transfer))
3 Total transfers (add amounts in column c)		3

Part III Tax Computation

4 Adjusted allowable expenses (see instructions)	4	
5 Taxable amount (subtract line 4 from line 3)	5	
6 Maximum federal estate tax rate (see instructions)	6	%
7 Generation-skipping transfer tax (Multiply line 5 by line 6)	7	

Form 706-GS(T) Taxable Termination of Trust

Tax paid by Trustee

Form **706-GS(T)** Generation-Skipping Transfer Tax Return For **Terminations**
(Rev. November 2013)
 Department of the Treasury Internal Revenue Service

► Use for terminations made after December 31, 2012.
 ► For calendar year _____ .
 ► Information about Form 706-GS(T) and its separate instructions is at www.irs.gov/form706gst.

OMB No. 1545-1145

Part I General Information

1a Name of trust _____ 1b Trust's employer identification number (see instructions) _____

2a Name of trustee _____

2b Trustee's address (number and street or P.O. box; apt. or suite no.; city, town or post office; state and ZIP code) if you have a foreign address, also complete the spaces below (see instructions).

Foreign country name _____	Foreign province/county _____	Foreign postal code _____
----------------------------	-------------------------------	---------------------------

Part II Trust Information (see the instructions)

	Yes	No	Sch. A number(s)
3 Has any exemption been allocated to this trust by reason of the deemed allocation rules of section 2632? If "Yes," describe the allocation on the line 7, Schedule A, attachment showing how the inclusion ratio was calculated			
4 Has property been contributed to this trust since the last Form 706-GS(T) or 706-GS(D-1) was filed? If "Yes," attach a schedule showing how the inclusion ratio was calculated			
5 Have any terminations occurred that are not reported on this return because of the exceptions in section 2611(b)(1) or (2) relating to medical and educational exclusions and prior payment of Generation-Skipping Transfer (GST) tax? If "Yes," attach a statement describing the termination			
6 Have any contributions been made to this trust that were not included in calculating the trust's inclusion ratio? If "Yes," attach a statement explaining why the contribution was not included			
7 Has the special QTIP election in section 2652(a)(3) been made for this trust?			
8 If this is not an explicit trust (see the instructions under <i>Who Must File</i>), check here and attach a statement describing the trust arrangement that makes its effect substantially similar to an explicit trust			<input type="checkbox"/>

Part III Tax Computation

9a Summary of attached Schedules A (see instructions for line 9b)

Schedule A No.	GST tax (from Sch. A, line 10)
1	9a1 _____
2	9a2 _____



Due Date

Direct Skip

- Lifetime transfers – payable when Form 709 due [April 15th + extensions].
- Testamentary transfers – payable when Form 706 due [9 months after death + extensions].

Indirect Skip

- Lifetime transfers – April 15th + extensions.
- Testamentary transfers – 10 months after DOD if alternate valuation elected.

How much is due?

Examples...

- **Direct Skip** – assets transferred to 2nd generation at death.
- **Testamentary Termination** – trust assets transferred to 2nd generation when intervening generation dies.
- **Testamentary Distribution** – trust assets transferred to 2nd generation while 1st generation still alive
- **Estate Tax** – trust assets transferred to 2nd generation after transferor dies.

EXAMPLES

Example 1

Direct Skip

Facts

- Grandpa (G) dies in 2023: He makes a testamentary gift to Grandchild (GC) of \$6 million
- G had previously allocated \$2 million of his lifetime exemption to earlier gifts when exemption was \$5.25 million [in 2013]

GST Due

- Inclusion Ratio = $1 - (\$2 \text{ million} \div \$5.25 \text{ million}) = 62\%$
- Tax = $\$6 \text{ million} \times 40\% \text{ tax rate} \times 62\% = \mathbf{\$1,488,000}$

Example 2

Testamentary Termination

Facts

- Grandpa (G) establishes trust & gifts \$6 million for benefit of Son (S) for life
- When S died in 2017, corpus (now \$7 million) passed to Grandchild (GC)
- G's entire exemption [\$5.49 million in 2017] is allocated to trust

GST Due

- Inclusion Ratio = $1 - (\$5.49 \text{ million} \div \$6 \text{ million}) = 9.15\%$
- Tax = \$7 million X 40% tax rate X 9.15% = **\$256,200**

TIP: G instead gifts amount exactly equal to exemption. As a result, the inclusion ratio would be 0...

→ All future growth of trust assets will pass tax-free to GC.

Example 3

Testamentary Distribution

Facts

- Grandpa (G) establishes trust & gifts \$6 million FBO Son (S) & Grandchild (GC) – trust makes distribution of \$10K to GC
- G's entire exemption [\$5.49 million in 2017] is allocated to trust

GST Due

- Inclusion Ratio = $1 - (\$5.49 \text{ million} \div \$6 \text{ million}) = 9.15\%$
- Tax = $\$10,000 \times 40\% \text{ tax rate} \times 9.15\% = \mathbf{\$366}$

TIP: G instead establishes 2 trusts: One for benefit of GC equal to exemption (\$5.49 million) & one for benefit of S for balance (\$510K). G then allocates GST exemption entirely to GC's trust...
→ No GST tax will be due on any distributions.

Example 4

Adding in the Estate Tax

Facts

- Grandpa (G) dies in 2023 shortly after putting his entire estate valued at \$20 million into trust for Grandchild (GC).

Estate Tax Due

- Tax = (\$20 million – \$12.92 million exemption) X 40% [in 2023] = **\$2,832,000**

GST Due

- GC receives remainder of after-tax estate (\$17.168 million)
- Inclusion Ratio = $1 - (\$12.92 \text{ million} \div \$17.168 \text{ million}) = 24.74\%$
- Tax = \$17.168 million X 40% tax rate X 24.74% = **\$1,698,945**

Net to GC

- \$20 million – 2,832,000 – 1,698,945 = \$15,469,055 [$\approx 77\%$ of G's estate]

Example 4 (cont'd)

Adding in the Estate Tax

Net assets transferred to GC after estate tax applied = \$20 million – 2.832 million = \$17.168 million

Alternate Scenario # 1: G has no GST exemption available.

- Inclusion Ratio = $1 - (\$0 \div \$12.92 \text{ million}) = 1$
- Tax = \$17.168 million X 40% tax rate X 100% = **\$6,867,200**
- Net to GC = \$10,300,800 million [$\approx 51\%$ of G's estate]

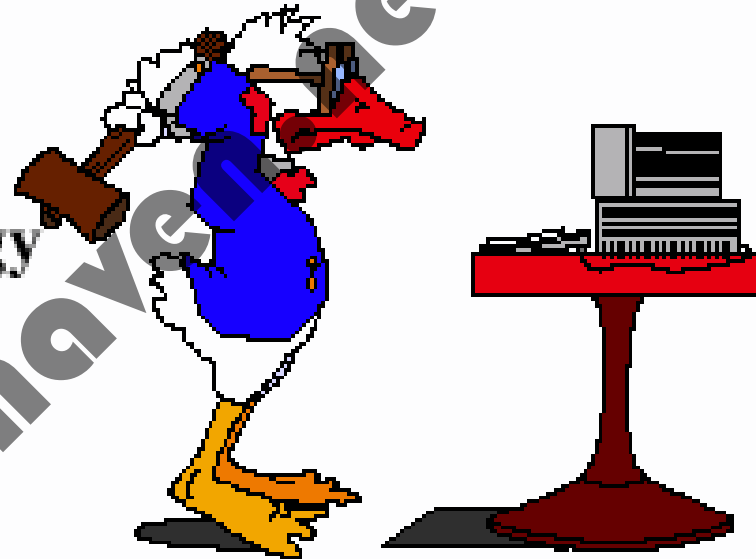
Alternate Scenario # 2: G *also* has no lifetime estate exemption available.

- Estate Tax = \$20 million X 40% = **\$8,000,000**
- GST Tax = \$12 million X 40% = **\$4,800,000**
- Net to GC = \$7.2 million [$\approx 36\%$ of G's estate]

LESSON: G must plan to avoid GST...

STRATEGIES

❖ Choose the right strategy for the task.



GST Planning Strategy # 1

Maximize GST-exempt gifts

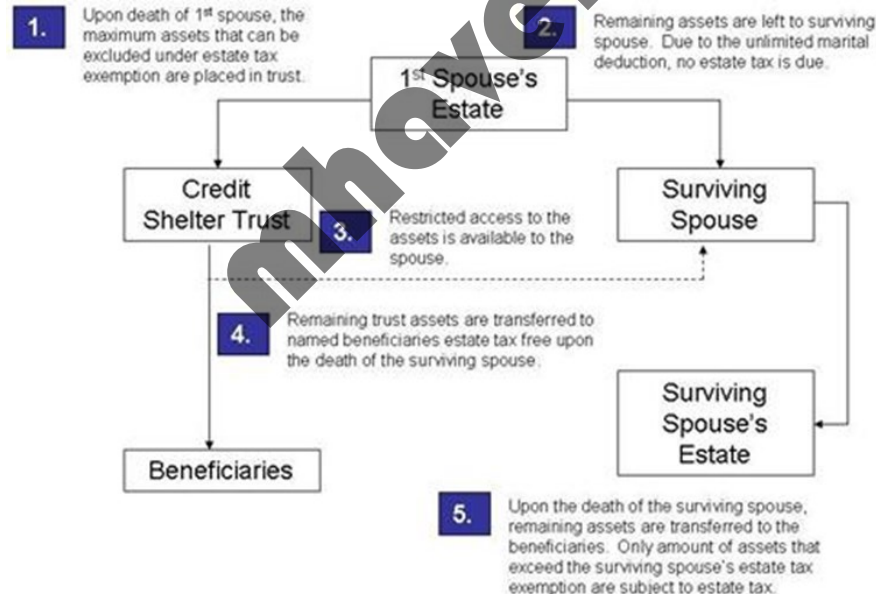
- Direct payment of tuition & medical expenses.
- Annual gift tax exclusion [\$17K in 2023; \$34K if gift-splitting].
- 529 Plan: Aggregate 5 years of exclusion [\$85K in 2023; \$170K if gift-splitting].

REMINDER: Must gift *present* interest to use annual exclusion → offer *Crummey* withdrawal provision or make gift to Minor's Trust.

GST Planning Strategy # 2

Establish GST Trust

- Allocate maximum available GST exemption to GST Trust to reduce inclusion ratio to zero.
- If married, use A/B Trust to shelter some (all) assets of first-to-die spouse.



GST Planning Strategy # 3

Disclaimers

- Skip beneficiary may elect to forfeit inheritance.

NOTE: Decedent must have named alternate beneficiary or GST Trust in his estate planning instrument.





GST Planning Strategy # 4

Irrevocable Life Insurance Trust

- Transferor gifts uses trust to purchase life insurance on himself.
- Since life insurance is owned by trust, it is not part of transferor's taxable estate.
- Annual gifts to trust (with *Crummey* withdrawal rights*) are used to pay insurance premiums.
 - * Must notify trust beneficiaries of right to withdraw contributed amount for minimum of 30 days to convert gift to "present interest".

NOTE: Gifts to trust with *multiple* beneficiaries qualify for gift exclusion but not GST exclusion → must affirmatively allocate GST exemption to transferor's gifts.

GST Planning Strategy # 5

General Power of Appointment

- Transferor [Grandfather] may grant testamentary power to trust beneficiary [Son] so that asset will be includible in beneficiary's (not transferor's) estate.
- Distributions [to Grandchild] & termination of trust will avoid GST.

Monica Haven, E.A., J.D., L.L.M.

PHONE: (310) 286-9161

FAX: (310) 557-1626

E-MAIL: mhaven@pobox.com

WEBSITE: www.mhaven.net

Student Text to accompany this presentation is available on the Publications page of my website.

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.