

News You Can Use

Tools for Corporate Executives

A Guide To Generation-Skipping Transfer Tax

The Generation-Skipping Transfer Tax (GSTT) is the government's defense against an end run around estate and gift taxes that imposes a flat tax on gifts and bequests above the estate/lifetime gift exclusion that avoid gift or estate tax by skipping one or more generations. The GSTT is fairly straightforward, but advisors need to be aware of recent and ongoing changes.

Reigning in Life Estates

Originally instituted in 1976, the GSTT has been changed throughout the years, including a retroactive repeal of the law in 1986 with the current version being instituted. In 1995 and 2001, changes to the GSTT were made to account for inflation. Currently, the GSTT exemption is \$3.5 million and is scheduled to repeal in 2010, although the Obama administration and some in congress have indicated their desire to avoid repeal of the estate tax and preserve the exemption at the current levels.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) extended the exemption to automatically allocated to indirect skips (in addition to direct skips), although it is limited – transfers must be in a GST trust that's subject to the gift tax and an estate tax inclusion period that ends after the EGTRRA's effective date.

Strategies for Exemption Allocation

A "skip person" is defined as one or more younger generations related to the transferor by blood, marriage or adoption. An unrelated person is a skip person if he or she is more than 37 ½ years younger than the transferor.

Direct Skips

A direct skip is a transfer directly to a skip person. Taxpayers who make any direct skips in excess of the annual exclusion rate (\$13,000 per donor or \$26,000 for married couple) must report all GSTT direct skips.

Transfers in Trust

Transfers in trust are more complicated than direct skips. They can occur in two ways: by a taxable distribution from a trust to a skip person or a taxable termination, which occurs when an interest in a trust terminates.

Allocating GSTT Exemption to Trusts

Taxpayers must opt out of automatic allocation to direct skips so their exemption is preserved for taxable distributions or taxable terminations, which are known as indirect skips. Opting out is a two step process. The first step is to address their direct skips, while the second step is to address their indirect skips.

Late Allocations

Allocation of the GSTT exemption should be made on a timely filed gift or estate tax return.