

ABCs of GST

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Generation Skipping Transfer Tax

- Tax designed to shape behavior:
 - Limit multi-generation planning
 - Collect estate tax at every generation
- Understanding the GST means:
 - Understanding who is a “transferor”
 - Identifying whether the transferee is a skip person
 - Determining whether the transfer is covered by the GST
 - Or is subject to an exclusion or exception

GST Exemptions

- Lifetime exemption
 - \$3,500,000 in 2009
 - Equals the applicable exemption for 2003-2008
 - \$1,000,000 before 2003, indexed for inflation
 - ??? For 2010 and beyond

Transferor

- Individual
- For whom property transferred was most recently subject to estate or gift tax
- Holder of special power of appointment
 - If exercise extends trust beyond perpetuities period
- Spouse, if gifts split for gift tax purposes

Skip Person

- Natural person two or more generations down
- Trust
 - If all interests are held by skip persons
 - Interest = Current right to mandatory or discretionary income or principal distributions
- Counting generations
- Adoption and $\frac{1}{2}$ blood = full relationship

Skip Person

- Spouses always same generation
- Predeceased parent exception
 - Grandchild steps up to deceased parent's generation
 - Parent must have been deceased at time of transfer
 - Applies to nieces and nephews
 - Can apply if parent dies within 90 days after transfer

Types of Transfers

- Taxable termination
- Taxable distribution
- Direct skip
- Indirect skip
- Non-taxable gift

Taxable Termination

- Any termination of interest in a trust UNLESS
 - A transfer subject to estate or gift tax occurs with respect to trust property
 - A non-skip person has an interest in the trust immediately after the termination
 - OR
 - At no time after the termination may a distribution be made to a skip person

Taxable Termination

- Grandparent dies in 2000
- Created trust for child
 - Income for life
- Child dies in 2009
 - Remainder to grandchild or
 - Trust continues for grandchild
- What if Child #2 was also beneficiary?

Taxable Distribution

- Any distribution from a trust
- To a skip person

Taxable Distribution

- Grandparent dies in 2000
- Created trust for child and grandchild
 - Income sprinkled to child and grandchild
 - Distributions to grandchild are taxable distributions

Direct Skip

- Any transfer to a skip person
- Includes transfers to trusts which are skip persons

Indirect Skip

- Not a GST transfer
- Allocation of GST exemption rule
- Any transfer of property
 - Subject to gift tax
 - Made to a GST Trust
 - And which is not a direct skip

Indirect Skip – GST Trust

- Any trust that could have a taxable termination
- Or a taxable distribution
- With respect to the transferor
- Exceptions to “GST Trust”
 - See outline, page 11

Non-Taxable Gifts

- IRC §2503(b) – annual exclusion
- IRC §2503(e) – education and medical expenses
- Direct skip of annual exclusion amount to a trust if:
 - Skip person the only beneficiary during his/her life
 - If skip person/beneficiary dies, assets includible in skip person's estate

Allocation of GST Exemption

- Each person may allocate as desired
- Must be made before filing the Form 706
 - Executor has last shot at making allocations
- Unless elect out
 - Deemed, automatic allocation of GST exemption to indirect skips
 - Deemed, automatic allocation of GST exemption to lifetime direct skips

Allocation of GST Exemption

- Other Automatic Allocations
 - After allocations to lifetime direct skips and indirect skips
 - Property subject to direct skip at death
 - To trusts from which there might be a taxable termination or taxable distribution
 - If GST exemption insufficient:
 - Prorata among transfers in the class

Other Allocation Rules

- Unnatural orders of death
 - Retroactive allocation
 - Year in which “unnatural” order of death occurs
 - File a timely form 709
- ETIP – Estate Tax Inclusion Period
 - Allocation, including a deemed allocation
 - Occurs at close of ETIP
 - Value determined at close of ETIP

Reverse QTIP

- Estate tax marital deduction – QTIP election
 - QTIP assets included in surviving spouse's estate
 - Estate tax purposes
 - GST allocation purposes
- GST Reverse QTIP election
 - QTIP assets still included in surviving spouse's estate for estate tax purposes
 - But can allocate predeceasing spouse's GST exemption to QTIP property

Valuation Issues

- Value is generally determined as for estate and gift tax purposes
- Value is generally determined as of the date of the GST transfer
 - Late allocation
 - Value at time of allocation
 - May seek extension of time to make the allocation

Valuation Issues

- Taxable terminations
 - All property with respect to which termination occurred
 - Reduced by IRC §2053 type expenses
- Taxable distributions
 - Value of property received by transferee
 - Including GST tax paid on distribution

Valuation Issues

- Direct skips
 - Value of property received by transferee

Inclusion Ratio

- 1 = fully subject to GST tax
- 0 = fully protected from GST tax
- Inclusion ratio = 1 minus applicable fraction

Applicable Fraction

- The fraction that determines the % of the property which will be protected from GST
- It is multiplied by the highest FET rate to determine the rate of GST Tax
- GST exemption allocated to trust or property
- OVER
- Value of Property - FET/SDT + Charitable Ded

Calculation of GST Tax

- Applicable Fraction:
 - \$1,000,000 numerator
 - \$1,000,000 denominator
- Inclusion Ratio $1 - 1 = 0$
- Tax Rate $45\% \times 0 = \text{no GST Tax}$

- If numerator had been 0 . . .

Planning Points

- Choice of Tax
 - Federal estate tax or
 - Federal GST Tax
- Better to structure assets included in child's estate?
 - Would child's estate otherwise incur a federal death tax?
 - Is basis adjustment on child's death an issue?

Planning Points

- Is GST planning tax driven?
 - Is child wealthy?
- Is GST planning control driven?
 - Spendthrift beneficiary
 - Beneficiary vulnerable to creditor's claims
 - Incompatible values between transferor and beneficiary

Planning Points

- Does GST trust planning
 - Prevent wealth transfer by child
 - Marital deduction
 - Gifts to child's children
- Consider state death tax issues
 - Pa does not tax property subject to a general power of appointment

Crummey Trust Issues

- Is the trust designed to be a GST trust?
- Could it become a GST trust because of order of deaths?
- Do the indirect skip rules apply?
 - Don't rely on the automatic allocation rules
 - Deliberately elect GST exemption allocation
 - Or
 - Deliberately elect out

Crummey Trust Issues

- Who is the transferor
- New Trust
- Grandparent contributes \$13,000
- Child has right to withdraw \$13,000
- Grandparent remains transferor of \$5,000
- Child becomes transferor of \$8,000

Crummey Trust Issues

- Who is the transferor
- New Trust
- Grandparent contributes \$13,000
- Grandchild has right to withdraw \$13,000
- Grandparent remains transferor of \$5,000
- Grandchild becomes transferor of \$8,000
- Grandchild deemed to receive a taxable distribution