

Like the federal Estate tax, the federal Generation-Skipping Transfer ("GST") tax is currently repealed for 2010. If Congress continues on its "do nothing" approach to tax reform, the GST tax will reappear on January 1, 2011 at a top rate of 55%.

Unlike the estate tax where one has to die in 2010 to benefit from the repeal, there are some options this year for those who are planning on living until 2011. By way of background, the GST tax was implemented by Congress in 1976 as a way to stop rich people from passing wealth down to future generations tax free. It was designed to tax distributions that did not get passed down from one generation to the next (i.e. parent to child) by taxing distributions that "skipped" a generation. Thus, in addition to income tax, estate tax, and gift taxes Congress leveled a new tax (the GST tax) for transfers that are classified as "generation skipping transfers" to or for the benefit of a "skip person". This system was so complicated that Congress decided in 1976 to give every taxpayer a \$1M dollar exemption from GST taxes. In 1976 \$1M was a lot of money. From 1976 to 2001 the GST exemption was increased to \$1,060,000. Suddenly, people who had never heard of the GST tax [Chapter 13 of the Internal Revenue Code] were paying more in taxes. Congress ratcheted the exemption up to \$3,500,000 by 2009. We are now poised for the return of the GST tax on January 1, 2011 at the base rate of \$1M with perhaps some minor inflation adjusted amount.

A skip person is generally a person more than one generation removed (think grandchild and beyond) from the transferor. A skip person can also include a trust for the benefit of beneficiary or beneficiaries of a skip person(s). A generation skipping transfer can be either:

1. a "Direct Skip" which is an outright transfer to a skip person or a trust for a skip person;
2. a "Taxable Distribution" from a trust to a skip person; or
3. a "Taxable Termination" of a trust or non-skip person's interest in a trust that vests property in a skip person, which could include the termination of all non-skip persons' interests in the trust, leaving only skip persons as beneficiaries.

Certain trusts may be "GST Exempt" trusts because they were set up before the date of the enactment of the GST tax (i.e. they are "grandfathered") or the maker of the trust allocated his or her GST exemption on a validly filed GST tax return to allow the GST Exempt trust to have an inclusion ratio of "0".

Several planning opportunities present themselves in 2010. For example, a donor can make direct gifts to grandchildren without any GST tax in 2010. However, the federal Gift tax still remains in effect. The highest federal Gift Tax rate for 2010 is 35%. Gifts that are less than \$13,000 per donee per calendar year are exempt from gift tax. In addition, a person may allocate any part of their \$1M dollar lifetime gift tax exemption to such gifts. Note that the gift tax rate is down 10% from last year (45%) and will be 20% less than the projected current gift tax rate of 55% for next year.

If a grandparent who has exhausted all of one's annual exclusions and gift tax exemption were to gift \$1,000,000 to a grandchild this year, the transfer tax would be \$350,000. That same gift if made in 2011 would incur a combined gift tax and GST tax liability of \$1,100,000! That is a tax rate of 110%! If a grandparent were to make gifts to great-grandchildren, such gifts would skip two generational levels.

Many grandparents have established gift trusts for grandchildren. Each calendar year the grandparent would gift \$13,000 into such a trust for the benefit of the grandchild. Normally Section 2611 (b)(2) of the Code would protect future distributions from such trusts from GST tax in the future since the original transfer to the trust was subject to GST. A transfer to such a trust in 2010, however, would NOT be subject to GST. Therefore, the protection of Section 2611 (b)(2) may not apply. Accordingly, grandparents should not make annual exclusion gifts to gift trusts in 2010. Instead, one may wish to consider either direct transfers to skip persons or to a Uniform Transfer to Minors Account for such a grandchild in 2010. Consideration needs to be given to the appropriateness of such gifts to a grandchild outright.

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