

Generation-Skipping Transfers

INTRODUCTION

In addition to the estate and gift tax systems, a third, separate, transfer tax system exists known as the generation-skipping transfer tax system (GSTT). The GSTT is an excise tax, imposed in addition to any gift or estate tax, on the transfer of property to a donee other than a spouse who is two or more generations younger than the donor.

The first GSTT was enacted by The Tax Reform Act of 1976 to remedy what Congress perceived as an abusive use of trusts to benefit several generations while avoiding estate and gift taxes. The 1976 GSTT was extremely complex, and it was widely criticized as conceptually flawed, unworkable, and ineffective. As a result, the 1976 GSTT was retroactively repealed by The Tax Reform Act of 1986 and replaced by a new GSTT system. The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA 2001) phases in a repeal of the GSTT over 10 years. Similar to the repeal of the estate tax system, if no new legislation makes the repeal permanent, the repeal of the GSTT falls under a sunset provision that will bring the GSTT system back in 2011 under the law in effect prior to EGTRRA 2001.

Unlike the estate tax system, which is a progressive tax, the GSTT rate is a flat tax rate equal to the maximum estate tax rate (45% in 2009) in effect at the time of the generation-skipping transfer (GST). This difference in the GSTT system coupled with the ability to elect the use of the GST exemption (discussed below) causes the calculation of GSTT to be different than the estate and gift tax calculations. The GSTT calculation is also discussed below.

Like the estate and gift tax systems, the GSTT system has an annual exclusion (\$13,000 in 2009), a lifetime exemption (\$3,500,000 in 2009), and an exemption for qualified transfers. The following exhibit identifies the similarities and differences among the GSTT, estate tax, and gift tax regimes that are covered throughout this chapter.

EXHIBIT 13.1 COMPARISON OF THE GIFT, ESTATE, AND GSTT TAX SYSTEMS

FEATURES	GIFT TAX TRANSFERS	ESTATE TAX TRANSFERS	GENERATION-SKIPPING TRANSFER TAX	
			GIFTS	BEQUESTS
Applies to	Lifetime Transfers	Transfers at Death	Lifetime Transfers to Skip Persons	Transfers at Death to Skip Persons
Calculation of Transfer Includes	Value of Lifetime Transfers, plus any GSTT Paid	Value of Transfers at Death, plus any GSTT Paid	Value of Lifetime Transfers to Skip Persons	Value of Transfers at Death to Skip Persons
Annual Exclusion (2009)	\$13,000	N/A	\$13,000	N/A
Lifetime Exemption (2009)	\$1,000,000 Cannot allocate	\$3,500,000 Note: Includes Gift Transfers	\$3,500,000 Can Allocate	\$3,500,000 Note: Includes GST Gifts
Nature of Tax Rate	Progressive	Progressive	Highest Gift Tax Rate (Flat) 45% for 2009	Highest Estate Tax Rate (Flat) 45% for 2009
Annual Exclusion Available for Transfers under Crummey Power	Yes	N/A	Yes for Outright Transfers Possible for Transfers in Trust (See Annual Exclusions)	N/A

N/A = Not applicable

PARTIES INVOLVED IN GENERATION-SKIPPING TRANSFERS

When discussing generation-skipping transfers, it is important to understand how each individual involved in the transaction is associated with the transfer and their impact on the GSTT system. Accordingly, the parties involved are specifically defined for GSTT purposes.

TRANSFEROR

Whether or not a transfer is subject to GSTT depends on whether the transferor is two or more generations older than the transferee. Thus, in order to determine the GSTT consequences of a particular transfer, one must first identify the transferor. When property is transferred during life and is subject to gift tax, the transferor is the donor. When the property is transferred at death and is subject to estate tax, the transferor is the decedent. If the property is subject to estate tax or gift tax at some future time, usually a new transferor is determined.

Theresa creates an irrevocable trust with income for life to her daughter, Catherine. When Catherine dies, the remainder will transfer to her daughter, Haley. If Catherine was given a general power of appointment over the trust assets, then the trust assets would be included in Catherine's gross estate when Catherine dies. Since the trust is an irrevocable trust, Theresa's transfer to create the trust was subject to gift tax. Therefore, Theresa is the original transferor of the trust assets for GSTT purposes. However, upon Catherine's death, Catherine becomes the transferor of the trust assets because the assets are included in Catherine's gross estate (due to the general power of appointment she held at her death) and subject to estate tax.

TRANSFEEE

The transferee is the individual who receives the property. For GSTT purposes, individuals are categorized into two groups: (1) non-skip persons and (2) skip persons. Broadly defined, non-skip persons are those individuals to whom transfers do not result in generation-skipping transfer tax consequences, whereas skip persons are those individuals to whom the same transfers would result in GSTT consequences.

Skip Person

A skip person, or the person to whom a transfer may result in a generation-skipping transfer tax, is broadly defined as a transferee who is two or more generations younger than the transferor. When determining whether an individual is a skip person, the Code treats lineal and non-lineal descendants differently.

The IRC defines a skip person as any one of the following:

1. Any lineal descendent of the transferor's grandparent (or the transferor's spouse's grandparent) who is two or more generations younger than the transferor. (Certain exclusions may apply and are discussed below.)
2. Any person who is not a lineal descendent (as described in #1 above), is not the spouse of the transferor, and is more than 37½ years younger than the transferor.

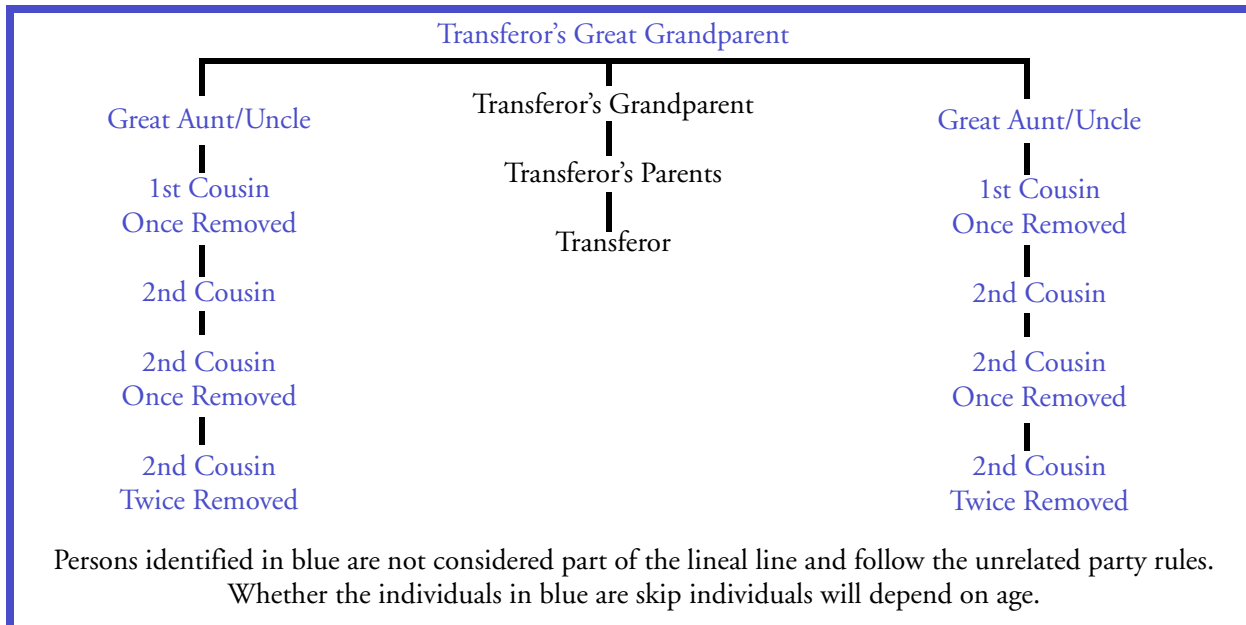
For the purpose of applying these rules, any spouse or former spouse of a transferor and all charitable organizations are always considered to be in the same generation as the transferor. Also, adopted relatives are considered the same as blood relatives.



Key Concepts

Underline/highlight the answers to these questions as you read:

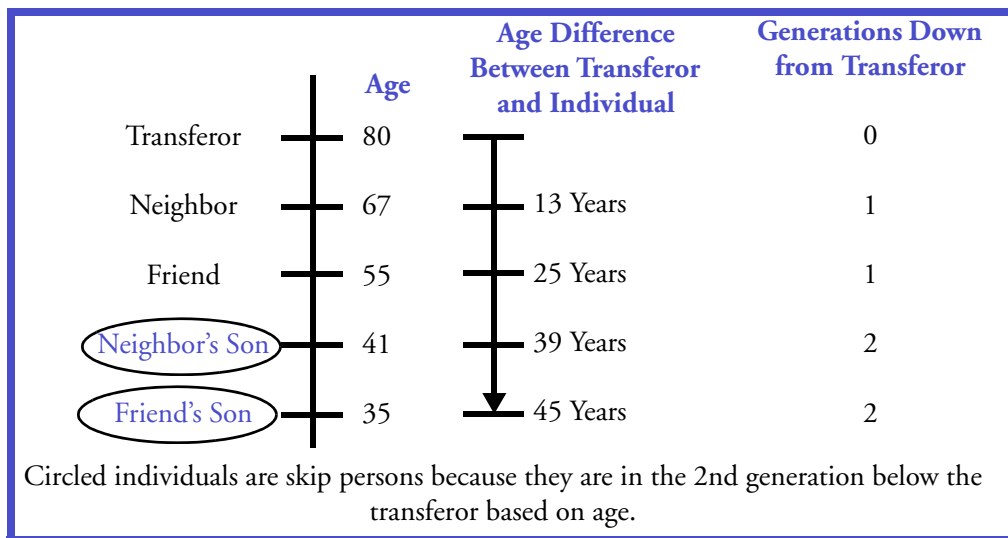
1. Describe who is a skip person and who is not a skip person for both lineal and nonlineal descendants.
2. Explain the predeceased ancestor exception.



A generation is defined as a 25 year time period. Exhibit 13.4 illustrates an 80-year-old transferor. His generation would include all individuals $12\frac{1}{2}$ years older than him and $12\frac{1}{2}$ years younger than him. The next generation includes all individuals born within the next 25 years below the first $12\frac{1}{2}$ years. Therefore, all individuals between the ages $67\frac{1}{2}$ and $42\frac{1}{2}$ would be one generation below the transferor. Since neighbor is 67 (13 years younger than transferor), neighbor is one generation below transferor. Friend, age 55, also falls one generation below transferor. Individuals between the ages of $42\frac{1}{2}$ and $17\frac{1}{2}$ are two generations below transferor, and are therefore skip individuals. Thus, both neighbor's son and friend's son are skip persons, and any transfer from transferor to neighbor's son and/or friend's son are generation-skipping transfers.

If transferor had a child the same age as neighbor's son, the child would not be considered a skip person because the child is a lineal descendent. As detailed above, lineal descendents are deemed skip persons based on the transferor's family tree. Therefore, transferor may have a child the same age as neighbor's son, and transferor's child would not be a skip person even though neighbor's son would be a skip person.

EXHIBIT 13.4 UNRELATED PERSONS AND NONLINEAL DESCENDENTS



Trusts

A trust may also be considered a skip person (1) if all interests in the trust are held by skip persons, or (2) if the trust distributions can only be made to skip persons. For purposes of the first definition, a person is deemed to have an interest in a trust if he has the present right to receive income or principal distributions from the trust.

EXAMPLE 13.2

Anthony recently established an irrevocable trust for his grandson, Allen. The trust will pay income to Allen for his life, and at Allen's death the remaining trust assets will be distributed to Allen's children. Since Allen and his children are all skip persons and they are the only individuals that can receive distributions, the trust is also a skip person.

EXAMPLE 13.3

Beau created an irrevocable trust to pay income to his daughter, Joann, and his grandson, David. In this instance the trust is not a skip person because Joann, who is not a skip person holds a present right to receive distribution from the trust. Remember that if you have one person holding an interest in the trust that is not a skip person then the trust will NOT be a skip person for GSTT purposes until the last non-skip beneficiary's interest expires.

As mentioned, charitable organizations are considered to be in the same generation as the transferor. If a charitable organization holds an interest in a trust, then the trust cannot be a skip person. For this purpose, a charitable organization is deemed to have an interest in a trust (1) if it has a present, nondiscretionary right to receive income or principal, or (2) if the organization is the remainder beneficiary of a qualified charitable remainder trust or pooled income fund (as defined in Chapter 9).