

Generation Skipping Transfer Tax

Prepared for:
Mile Marker Club Members

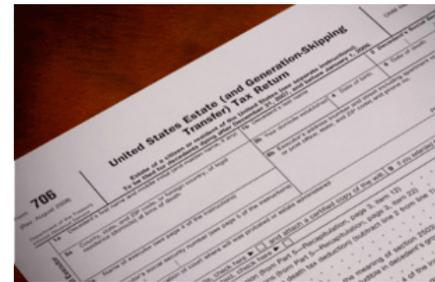
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Generation-Skipping Transfer Tax

Estate owners can often reduce death taxes by skipping a generation of heirs; e.g., bypass their children or give the children only a right to income for their lifetime with the remainder passing to their grandchildren.



Under prior law, when a child died under such an arrangement, the assets were not subject to federal estate tax and therefore a generation of death taxes was skipped.

In order to reduce the loss of this tax in larger estates, Congress enacted the generation-skipping transfer tax in 1976. This very complex law was repealed in 1986 but was replaced with a similar law set forth in IRC Secs. 2601-2663.

Two Common Types of Transfers

- **Generation-sharing transfers:** The transferor (e.g., grandparent) typically places assets in a trust which pays income to his or her child for life and then the remainder passes to grandchildren after the child is deceased.
- **Direct generation skip:** The transferor bypasses his or her children and gives the asset either directly to the grandchildren or a trust for their benefit.

Exempt Transfer

Each transferor has a \$11,180,000¹ exemption which can be allocated between gifts made during his or her lifetime and transfers made at time of death.

Rate of Tax

Generation-skipping transfers, which exceed the exemptions shown above, will be subject to the maximum estate tax rate of 40%. This tax is in addition to the federal estate and gift tax, and is reported on IRS Forms 706GS(D), 706GS(T) or 709. See Treas. Reg. 26.2662-1.

¹ 2018 value. This amount is subject to adjustment for inflation in future years.

Generation-Skipping Transfer Tax

Reducing the Impact of the Generation-Skipping Transfer Tax

- Consider making full use of the annual gift tax exclusion of \$15,000¹ to any number of donees, e.g., children, grandchildren, in-laws, etc.
- Encourage children or grandchildren (or trusts for their benefit) to purchase and own large life insurance policies on the parent or grandparent. At death, the insurance proceeds would not generally be subject to federal estate tax or the generation-skipping transfer tax.

Note: In order to keep the assets of an irrevocable life insurance trust from being subject to the generation-skipping transfer tax, care must be taken to see that transfers (after 3/31/88) to the trust by the insured qualify for the annual gift tax exclusion and that the insured correctly allocates part of his or her \$11,180,000 exemption to each transfer.

The generation-skipping transfer tax is a very complex area of the law. Documents must be carefully drafted to avoid this tax in larger estates. For more information, examine IRS Forms 706 GS(D), (D-1) and (T) and their instructions.

¹ 2018 value. This amount is subject to adjustment for inflation in future years.

Effects of Skipping a Generation

The long-term effect of skipping a generation of estate taxes can be very substantial. Each estate owner has a \$11,180,000¹ exemption from the generation-skipping transfer tax (GSTT). The chart below compares three possible plans for removing \$11,180,000 from your estate.

Plan A: A gift of \$11,180,000 to your child.

Plan B: A gift of \$11,180,000 to your grandchild.

Plan C: A gift of \$11,180,000 to your grandchild who pays \$150,000 per year for 10 years (a total of \$1,500,000) for an insurance policy on your life in the amount of \$11,180,000.² The remaining \$9,680,000 the grandchild (or a trust) retains and invests.

Comparison of Three Plans

	Plan A	Plan B	Plan C
Current gift to child ³	\$11,180,000	\$0	\$0
Current gift to grandchild ³	0	11,180,000	11,180,000
Additional amount in child's estate	11,180,000	0	0
Growth for 20 years at 5%	29,663,868	0	0
Additional estate tax at child's death (assumes 40% tax bracket)	11,865,547	0	0
Amount passing to grandchild	17,798,321	0	0
Additional amount in grandchild's estate			
Transferred at child's death	17,798,321		
Invested at 5% for 20 years	47,224,244		
Gift to grandchild now	0	11,180,000	9,680,000
Non-insurance portion	0	78,707,074	68,147,091
Growth at 5% for 40 years			
Portion used to purchase life insurance	0	0	1,500,000
Insurance face amount	0	0	11,180,000
Growth at 5% for 30 years ⁴	0	0	48,319,316
Total amount at grandchild's death	47,224,244	78,707,074	116,466,406
Federal estate tax (at 40%)	18,889,698	31,482,830	46,586,563
Net to great grandchildren	\$28,334,547	\$47,224,244	\$69,879,844

Note: Assumes child or grandchild is in 40% bracket before gifts.

¹ 2018 value. This amount is subject to adjustment for inflation in future years.

² The insurance that can be purchased will vary greatly depending on age, health, etc. (Assumes 60-year old male.)

³ A federal gift tax will be due at the time of the gift on any amount in excess of the current (2018) applicable exclusion amount of \$11,180,000.

⁴ Assumes the insured dies 10 years after the gift.

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