

Generation Skipping Transfer Tax

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*The Educational Series
Insurance Trust Monitor, Inc.*

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Today's Webinar

Dealing with Non-Responsive Grantors in an Irrevocable Life Insurance Trust (ILIT)

March 6, 2014

Today's Speaker:
Randy Pople
Pople Financial Consulting, Inc.
www.poplefinancial.com



Please Note: Handbooks have been provided for this session. If you have not received one, email us at admin@youritm.com.

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Beginning Thoughts

- **Why the Mystery?**
 - Organization strategy on minimum account size
 - Planning is often left to the attorney and CPA
- **Brush up on your POA knowledge – Key to understanding GST**
 - General Power of Appointment
 - A Trust which grants a lifetime or testamentary GPOA will cause the value of the trust to be included in the beneficiary's taxable estate

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Beginning Thoughts

- o **Limited Power of Appointment**
 - A Trust which grants lifetime income and/or limited powers of appointment will not cause inclusion in the beneficiary's taxable estate – A target for GSTT legislation
- o **Look at GST through the eyes of the IRS.**
 - If a child's taxable estate does not include the residual of all non-charitable transfers they want to know why

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A. The Tax

- **Rate 40%**
- **Exclusion - \$5,340,000 for 2014**
- **In addition to gift and estate tax**
- **No portability**

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B. Purpose of the Tax

- To ensure that property is subject to U.S. Transfer tax at each generational level

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C. Terminology



- **Skip Person** – A person assigned to the second generation or more below the transferor
- **Non-Skip Person** – Any person who is not a skip person

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C. Terminology



- **Taxable Transfers**
 1. **Direct Skip** – A transfer, subject to estate or gift taxation, of an interest in property to a skip person. (IRC 2612 (c))
 - a. **Example:**
T transfers \$50,000 outright to GC

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C. Terminology

- **Taxable Transfers**
 2. **Taxable Distribution** – A distribution from a trust to a skip person (IRC 2612 (a))
 - a. **Example:**
T creates a trust for the benefit of C for life, remainder to GC. Any distribution to GC during C's life is a taxable distribution

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C. Terminology

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- **Taxable Transfers**

3. **Taxable Termination** – A termination of an interest of the last non-skip person in a trust survived by interests held by skip persons (IRC 2612 (b))

a. **Example:**
T creates a trust for C, remainder to GC. A taxable termination occurs on C's death



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- **Taxable Transfers**

4. **Who pays the tax:**

a. Direct skips are tax exclusive similar to gift tax – tax is paid by the transferor

a. Taxable Terminations and Taxable Distributions are tax inclusive similar to Estate Tax



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C. Terminology

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- **Taxable Transfers**

i. Taxable Termination – Tax is paid by the trust



i. Taxable Distribution – Tax is paid by the recipient



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C. Terminology

- Generation Skipping Transfer Tax Exemption –**
The maximum value of Generation Skipping Transfers that an individual can shelter from taxation – 2014 - \$5,340,000





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C. Terminology

- Inclusion Ratio** – The amount (ratio) of the transfer subject to GSTT.

- Example 1:**
T transfers \$3,000,000 in trust income for C for life, remainder to GC. If at the time of the gift, T allocates \$3,000,000 of his \$5,340,000 exemption to the trust, the trust will have an inclusion ration of zero. At C's death, there will be a taxable termination but no tax will be due.





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C. Terminology

- Inclusion Ratio** – The amount (ratio) to the transfer subject to GSTT.

- Example 2:**
If in the example stated before, T allocated \$1,000,000 of his exemption to the trust, the inclusion ration would be .667. Assuming a tax rate of 40% at the time of the termination, the tax rate applied would be 26.68% (40% X .667)





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D. Other Issues

Determining Generation Assignment

1. **Lineal Descendent**
 - a. Child
 - b. Grandchild
 - c. Great Grandchild
2. **Relatives (Collateral Heir)**
 - a. Look to the grandparents of the transferor
 - b. The integrity of the generations serve as the guide






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D. Other Issues

Determining Generation Assignment

3. **Spousal Rules**
 - a. **Spouse and transferor are assigned the same generation**
 - i. **Example 1:**
T age 87 gives \$100,000 to his wife, W, age 30. W is a non-skip person so that the gift is not subject to GSTT.
 - ii. **Example 2:**
T dies at age 79. His will leaves \$100,000 each to his grandchild G, age 25 and her husband, H age 80. G is a skip person and H is deemed to be in the same generation level as G. Both bequests are GSTs.






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D. Other Issues

Determining Generation Assignment

4. **Non-Relatives – Individuals more remotely related than first cousins**
 - a. IRS assigns 25 years to a generation
 - b. The transferor is assumed to be in the middle of his/her generation
 - c. 12 ½ years younger or less – transferor's same generation
 - d. More than 12 ½ years younger but not more than 37 ½ years younger – one generation below the transferor



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D. Other Issues

Determining Generation Assignment

4. Non-Relatives – Individuals more remotely related than first cousins

- e. **More than 37 1/2 years younger – skip person**
 - i. Example:
T makes a \$75,000 gift to his next door neighbor who is 40 years younger. The gift is subject to GST tax.
- f. **Trusts follow the same generational rules as individuals**
 - i. Example:
T creates a trust for the benefit of his grandchild GC with remainder to GC's children. The trust is a skip person.



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D. Other Issues

Determining Generation Assignment

4. Non-Relatives – Individuals more remotely related than first cousins



- g. **Predeceased Ancestor Exemption – Acts to move up the transferee's generation assignment**
 - i. Example:
T gives \$50,000 to T's grandchild, G. At the time of the gift C (G's father) is deceased. G is moved up one generation so that G is treated as a non-skip person and not subject to GST tax.

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E. GST Allocation



- GST exemption can be allocated by the donor or the executor at any time from the transfer date through the date for filing on either form 706 or 709 as appropriate.

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E. GST Allocation



- **Deemed (automatic) Allocation Rules**
 1. Apply if an individual does not affirmatively allocate GST exemption
 2. Direct skips during life
 3. Indirect skip to a GST trust subject to gift tax

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E. GST Allocation



- **Deemed (automatic) Allocation Rules**
 4. **No automatic allocation on a non-GST trust**
 - a. 25% of property must or could be distributed to a non-skip beneficiary prior to age 46.
 - i. Example:
Trust created for T's son with dispositive language allowing withdrawals of 25% at age 30 and again at 40. No automatic allocation of GST.
 5. **Deemed allocation to transferees at death**
Unused portion of GST exemption, first to direct skips and then to trusts likely subject to a taxable distribution or taxable termination

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F. Estate Tax Inclusion Period (ETIP) Rules



- **GST exemption cannot be allocated to a lifetime gift during the period (ETIP period) that the gift would be included in the transferor's estate if the transferor died.**
 1. Grantor Retained Annuity Trusts (GRAT)
 2. Qualified Personal Residence Trusts (QPRT)
- **ETIP Termination**
 1. The time at which no portion of the property could be includible in the transferor's estate – death of transferor or termination of trust
 2. Allocation of GST exemption can only be effective at the termination of the ETIP

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G. Basic Planning Points

- **Goals for Inclusion Ration**
 1. One – Totally subject to GSTT
 2. Zero – Exempt from GSTT
- **Crummey Power Warning**
 1. Withdrawal rights above the safe harbor – (5% or \$5,000)
 - a. Lapse/Release
 2. Deemed withdrawal
 3. Deemed gift

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G. Basic Planning Points


- **QTIP Planning**
 1. Should include language to start the marital trust into an exempt QTIP and a non-exempt QTIP
 2. Qualified Severance –back up plan
 3. Statutory language may provide similar relief
 4. Inclusion ration Zero or One
 5. Reverse QTIP election
 6. Trust administration
 - o Investment objective
 - o Order of distribution




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