

The Generation Skipping Transfer Tax: Basics and Beyond

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The Dynasty Trust

- Is it a skip person?
 - Section 2613(a)(2): A trust is a skip person if (A) all interests in such trust are held by skip persons or (B) if no person holds an interest in such trust and at no time after the transfer may a distribution be made to a non-skip person.
 - What is an interest in a trust? Section 2652(c): A person has an interest in a trust if such person (A) has a right (other than a future right) to receive income or corpus from the trust, (B) is a permissible current recipient of income or corpus from the trust and is not described in section 2055(a), or (C) is a CRAT, CRUT or PIF

Automatic Allocation?

Dynasty Trust is not a skip person

Not a direct skip

In 1999, only direct skip gift got automatic allocation

Result of Manual Allocation

- 1999 transfer of \$2 million
- Harry gift split with Tina
- GST exemption available in 1999 was \$1,010,000
- Result: Each of Tina and Harry allocated \$1 million of GST exemption to the Dynasty Trust

- \$2,500,000 to the Dynasty Trust
- \$2,000,000 to the SLAT

Tina's 2010 Gifts

- Is the SLAT a skip person?
- Does the SLAT get automatic allocation?
Section 2632(c) "GST trust"
- What is unusual about 2010?

Result of 2010 Gift Splitting Election

- Section 2513: A gift made by one spouse to any person other than his spouse shall be considered as made one-half by him and one-half by his spouse for gift tax purposes.
- Treas. Reg. Sec. 25.2513-1(b)(4): If a gift is in part to a spouse and in part to third parties, that gift can only be split insofar as the interest of the third parties is ascertainable at the time of the gift and hence severable from the interest transferred to the spouse
- Section 2652(a)(2): If gift split for gift tax purposes, such gift shall be treated as split for GST purposes

- Tina:
- \$1 million used for 1999 gift to Dynasty Trust
- \$1.25 million used for 2010 gift to Dynasty Trust
- \$2 million used for 2010 gift to SLAT

- Total used: \$4.25 million

- (exemption in 2010 was \$5 million)

Scorekeeping as of 2010 Gifts

- Harry:
- \$1 million used for 1999 gift to Dynasty Trust
- \$1.25 million used for 2010 gift to Dynasty Trust

- Total used: \$2.25 million

Dynasty Trust's inclusion ratio

- Dynasty Trust has two transferors
- Need to analyze as two separate trusts. Section 2654(b)
- Tina: Numerator: \$1.25 million (from 2010) + \$1.25 million addition)
- Denominator: \$1.25 million (from 2010) + \$1.25 million (allocated in 2010)
- Applicable fraction = $1/1 = 1$
- Inclusion ratio: $1 - 1 = 0$
- Same analysis for Harry

2014 Gifts

- Exemption available in 2014: \$5,340,000
- Tina and Harry didn't gift split
- Tina had already used \$4,250,000 of her exemption
- Harry had used \$2,250,000 of his exemption
- 2014 gift of \$2,000,000 to Dynasty Trust

- Who is the transferor of the 2014 gift?

GST Exemption Allocation at Harry's Death

- Exemption available: \$5,340,000
- Exemption used: \$2,250,000

- Manual allocation by executor?
- Automatic allocation at death

- Automatic allocation
- GST trust
- Tina never filed

Tina's 2014 Allocation

- \$5,340,000 available
- \$4,250,000 already used
- \$1,090,000 to be automatically allocated to the Dynasty Trust

Dynasty Trust's inclusion ratio (2014)

- Before the 2014 Transfer, inclusion ratio of 0
- Applicable fraction:
 $\$3,000,000/\$3,000,000$
- Tina added $\$2,000,000$ (to denominator)
- Automatic allocation of $\$1,090,000$ (to the numerator)
- New applicable fraction:
 $\$4,090,000/\$5,000,000 = .818$
- Inclusion ratio = $1 - .818 = .182$

2021: Tina's death

- Exemption is \$11,700,000
- Tina has used \$5,340,000
- Dynasty Trust is valued at \$10,000,000
 - Has an inclusion ratio of 0.182
- SLAT is valued at \$3,500,000
 - Has an inclusion ratio of 0

How
should
Tina's
executor
use her
remaining
exemption?

- First allocate to get a zero inclusion ratio on her lifetime trusts
 - Dynasty Trust: Value of \$10 million, inclusion ratio of 0.182
 - $\$10,000,000 \times 0.182 = \$1,820,000$
allocation to achieve 0 inclusion ratio
 - SLAT: Value of \$3.5 million, inclusion ratio of 0
 - No additional allocation
 - Remaining exemption: \$11,700,000 less \$5,340,000 less \$1,820,000 = \$4,540,000
 - Additional bequest to Dynasty Trust of \$4,540,000

Could they have done better?

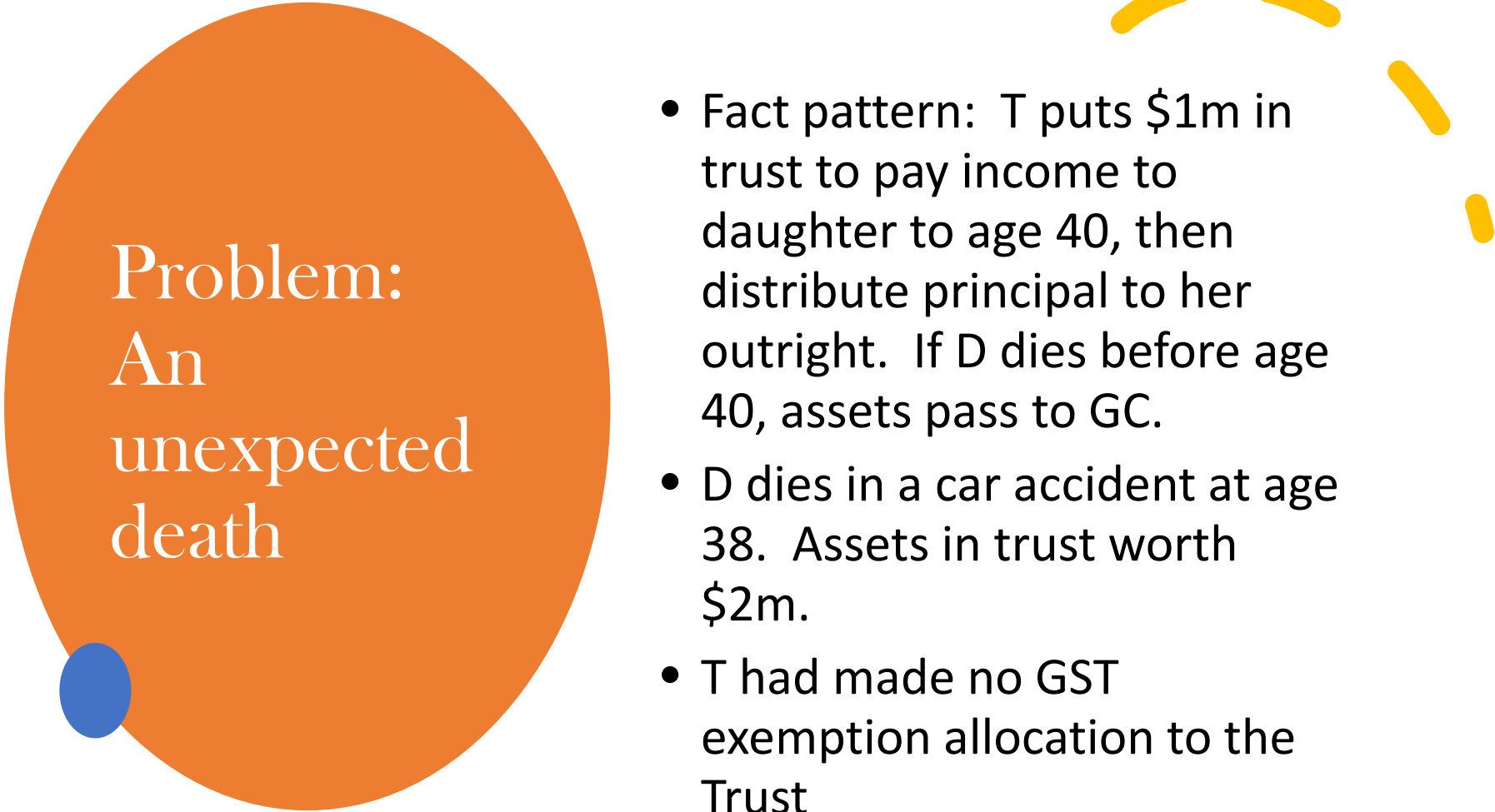
- 2014 gift could have been split with Harry
 - Consent to gift splitting can be made on a late gift tax return as long as it is the first return filed for the year
 - Consent can be made by Harry's executor
- Result of gift-splitting: Tina and Harry are each transferor as to \$1 million
 - More of Harry's GST exemption used, less wasted at death
 - Tina had enough GST exemption (\$1,090,000) to cover her half of the gift, giving dynasty trust a 0 inclusion ratio
 - Bequest at Tina's death would be \$1,820,000 higher, total of \$6,360,000 added to the Dynasty Trust at Tina's death

Other Tools for Fixing Mistakes

Relief for “out of order”
deaths

Qualified Severance for
mixed inclusion ratios

9100 Relief for missed
elections



Problem:
An
unexpected
death

- Fact pattern: T puts \$1m in trust to pay income to daughter to age 40, then distribute principal to her outright. If D dies before age 40, assets pass to GC.
- D dies in a car accident at age 38. Assets in trust worth \$2m.
- T had made no GST exemption allocation to the Trust

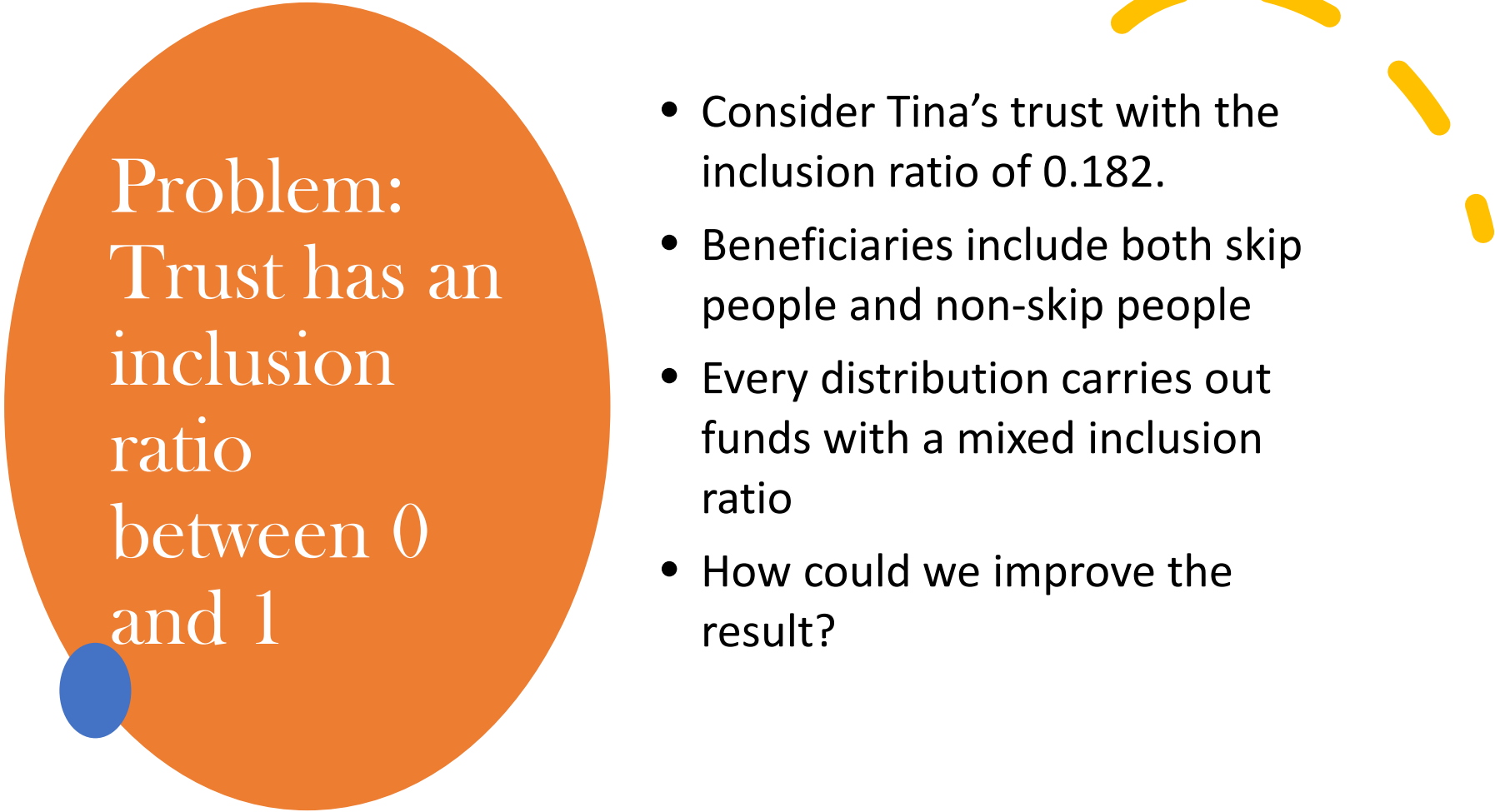
Solution: Code section 2632(d)

If:

- a non-skip person has an interest in a trust to which any transfer has been made,
- such person is a lineal descendant of a grandparent of the transferor or the transferor's spouse or former spouse, and
- is assigned to a generation below the transferor's

Then:

- the transferor may allocate GST exemption to any previous transfer to the trust and, if the allocation is made on a timely filed gift tax return (determined as if the date of death was the date of the gift),
- the effective date of the allocation will be immediately before the death of the individual,
- the value of the property for purposes of establishing the denominator will be determined on the date of the original transfer and
- the amount of the transferor's unused GST exemption will be determined immediately before the death of the non-skip person.



Problem:
Trust has an
inclusion
ratio
between 0
and 1

- Consider Tina's trust with the inclusion ratio of 0.182.
- Beneficiaries include both skip people and non-skip people
- Every distribution carries out funds with a mixed inclusion ratio
- How could we improve the result?

Solution: Code section 2642(a)(3)

- If a trust is severed in a **qualified severance**, the trusts resulting from such severance shall be treated as separate trusts **thereafter** for purposes of this chapter.
- Statutory requirements for qualified severance:
 - Single trust divided on fractional basis
 - Terms of new trusts, in the aggregate provide for same succession of interests as original trust
 - Resulting trusts must have inclusion ratio of 0 and 1
- Regulations at § 26.2642-6(b)

Result here

If the trustees had done a severance immediately after Harry's death when the assets were valued at \$8.5 million:

Trust is already divided between Tina and Harry:

Tina: $5/8 = \$5,312,500$

Harry: $3/8 = \$3,187,500$

Inclusion ratio for Tina's share: 0.182

GST exempt trust funded with \$4,345,625

Non-exempt trust funded with \$966,875

Distribute N-E to non-skip persons, exempt to skip persons



Problem: Missed Election

GST has many elections regarding allocation of exemption

- 2632(b) to elect out of automatic allocation to direct skip
- 2632(c)(5)
 - To elect to treat a trust as a GST trust
 - To elect not to treat a GST trust as a GST trust
 - To make the above elections for a single gift or for all future gifts

More commonly pre-2001, failure to allocate GST exemption

Solution: Apply for 9100 relief

- Relief available under Code section 2642(g)
- Requirements are in Treas. Reg. § 301.9100-3
- Notice 2001-50 says these rules apply until regulations are issued
- Taxpayer must have acted reasonably and in good faith
- Grant of relief sought must not prejudice the interests of the government