

What is GST Tax?

By Yahne Miorini, LL.M.

The main concern of gifting grandchildren is that the gift may be subject to Generation Skipping Tax (GST). The current GST tax has a rate of 45% and its exemption amount is \$2,000,000 (\$3,500,000 in 2009). The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) has scheduled to reset the GST on December 31, 2010 to be equal to \$1,000,000 adjusted inflation to the year 2011 with a maximum federal estate tax rate of 55%.

What is a Generation-Skipping Transfer?

Under section 2611(a) the IRC defines three new concepts: a taxable termination, a direct skip, and a taxable distribution.

- A **taxable termination** occurs when, the interest of a “non-skip” person” in property held in a trust terminates in favor of a “skip person” as a result of a death, the lapse of a period of time, the release of a power or otherwise. For instance, a parent (“transferor”) establishes a trust for the benefit of his/her child during the child’s lifetime

with the remainder payable to the transferor’s grandchild. Upon the death of the transferor’s child (“non-skip person”) there will occur a taxable termination because the interest of the transferor’s child in the trust will terminate in favor of the transferor’s grandchild (a “skip-person”).

- A **direct skip** is an immediate transfer of an interest in property to a “skip person,” which is subject to the gift tax or to the estate tax. A direct skip occurs if a grandparent makes an outright transfer of property to his/her grandchild or when a grandparent transfers property to a trust for the sole benefit of his/her grandchild. A direct skip may result in both a federal gift tax or a federal estate tax **and** a GST tax. However, a gift of a remainder interest to a skip person does not count as an interest taxable as a direct skip because future interests are not currently taxable.

- A **taxable distribution** is any distribution of either income or principal from a trust to a “skip person,” other than a “taxable termination” or a “direct skip.” For instance, a transferor established a trust, which pays income to his/her child for life, and one-half of the principal to his/her grandchild, when the grandchild attains the age 35. The payment to the grandchild upon attaining the age of 35 constitutes a taxable distribution since the transfer is a transfer to a skip person, which is neither a taxable termination nor a direct skip. Another example: a transferor established a discretionary trust for the benefit of his/her spouse, children, and grandchildren. The trustees choose to make a discretionary payment of income to one of the transferor’s grandchildren; the payment is a taxable distribution since it is a transfer to a skip person which

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is neither a taxable termination nor a direct skip.

What is a skip?

A direct skip person is either an individual assigned to a generation that is two or more generations below the generation assignment of the transferor (i.e., a grandchild), or a trust if: (1) all interests therein are held by skip persons; or (2) there is no person with an interest in the trust who is, and at no time may a distribution be made to, a non-skip person.

A skip person would be a lineal descendant of the transferor or transferor's spouse (or former spouse), such as a grandchild, a great-nephew or a great-niece. Adoptive relationships are deemed to be the equivalent of blood relationships, same for half-blood relationships.

When the donee is not a family member (non lineal descendants), the IRS is looking at the difference of age between the donee and the transferor. The transferor is assigned to a generation level based upon a deemed separation of generations every 25 years. An

individual who is not more than 12 ½ years younger than the transferor is assigned to the same generation as the transferor, and therefore is not a skip person. An individual who is more than 12 ½ years younger than the transferor, but who is not more than 37 ½ year younger than the transferor is deemed to be one generation younger than the transferor, therefore, is not a skip person. A skip person is an individual who is more than 37 ½ years younger than the transferor. However, a spouse of the transferor is deemed to be in the same generation as the transferor, regardless of the parties' relative ages. Finally, there is an exception for deceased parents. When a parent has predeceased, the donee takes the place of the parent for the calculation of generation.