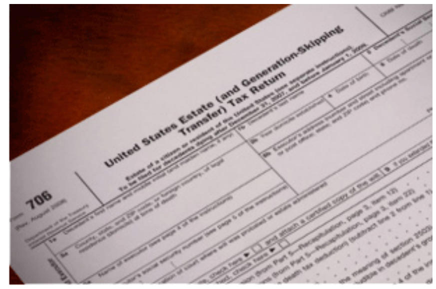
Generation-Skipping Transfer Tax



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 This very complex law was repealed in 1986 but was replaced with a similar law set forth in IRC Secs. 2601-2663.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 $11,700,000[1] 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 gift tax.

[1] 2021 value. This amount is subject to adjustment for inflation in future years.

Reducing the Impact of the Generation-Skipping Transfer Tax

- Consider making full use of the annual gift tax exclusion of $15,000[1] 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.
- 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 to the trust by the insured qualify for the annual gift tax exclusion and that the insured correctly allocates part of his or her $11,700,000 exemption to each transfer.

Seek Professional Guidance

The generation-skipping transfer tax is a very complex area of the law. Documents must be very carefully drafted to avoid this tax in larger estates. The advice and guidance of trained, experienced legal and tax professionals is strongly recommended.

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