

## 18. Generation- Skipping Transfer Tax

The federal estate and gift tax system is structured, subject to certain credits, deductions and exemptions, to tax property as it passes from one generation to the next. Usually this occurs as property passes from parent to child. One technique used by estate planners to avoid the transfer tax, particularly for wealthier clients, is to transfer property from one generation to another so that it skips a generation. For example, a transfer from a parent to a grandchild can avoid tax at the child's level.

The Tax Reform Act of 1986, enacted October 22, 1986, imposes a special transfer tax on "generation-skipping" transfers occurring after that date. (This new generation-skipping transfer tax repealed an earlier generation-skipping transfer tax retroactively to its effective date of January 11, 1976.)

The generation-skipping transfer tax applies to transfers, outright or in trust, during life or at death, to beneficiaries who are two or more generations below the transferor's generation. Such beneficiaries are called "skip persons."

The 2001 Tax Act increases the generation-skipping transfer tax exemption to \$1,500,000 beginning in 2004. Until 2004, the exemption will be \$1,000,000 adjusted for inflation. (In 2001, the exemption is \$1,060,000.) From 2004 through 2009, the exemption will be the same amount as the estate tax exemption, and the tax rate will be the maximum transfer tax rate. For each year's exemption and tax rate, please see the table included in the discussion of changes to the estate tax (Chapter 17). In 2010, the generation-skipping transfer tax is repealed subject to resurrection in its pre-2002 form if the 2001 Tax Act provisions are not extended.

### Exemptions

Several exemptions apply to this tax. Every individual is allowed an exemption as discussed above, which may be allocated by the individual, or his or her personal representative, to generation-skipping transfers made during the individual's life or at his or her death. Any transfer not in trust which is exempt from gift tax under the \$11,000 annual exclusion or the exclusion for tuition or medical expense payment is similarly exempt from the generation-skipping transfer tax. (See related article on federal taxation of gifts.) A transfer to a trust for a skip person that qualified for these gift tax exclusions may also qualify for a generation-skipping transfer tax exemption if the trust meets particular requirements. Any generation-skipping transfers not exempt are taxed at a flat rate equal to the *maximum* gift and estate tax rate in effect at the time of the generation-skipping transfer (49% as of 2003).

The generation-skipping transfer tax is complex, and it is not possible to deal with its numerous provisions in this article. If you expect your estate (or, if married, the

combined estates of you and your spouse) to exceed the amount of the generation-skipping tax exemption at your death, or if you expect the estates of any of your children may exceed the amount of the estate tax exempt amount, you should consult with your estate planning professionals about generation-skipping transfers and about trusts that will benefit multiple generations and minimize the generation-skipping transfer tax.