Using the Federal Generation-Skipping Transfer Tax Exemption Now

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What is using the federal generation-skipping transfer tax exemption now?

The federal government follows a complex transfer tax system. Transfer taxes come in three separate forms: gift tax, estate tax and generation-skipping transfer (GST) tax. The purpose of the GST tax is to ensure a transfer tax is imposed at each generation's level. The GST tax acts as a supplemental tax by applying it in addition to either the estate tax or the gift tax.

Each individual is allowed an exemption ($12,920,000 in 2023, $12,060,000 in 2022) from the GST tax, which is similar to the exclusion allowed from gift and estate taxes. From a planning perspective, the GST tax exemption's most important feature is that, once allocated, all future income from and appreciation of the assets will escape the GST tax. Individuals can leverage this feature to maximize the GST tax exemption's potential benefit. There are three general methods of leveraging the exemption. One method of leveraging the GST tax exemption is to allocate it as early as possible because the amount of the allocation is based on the current fair market value. All future appreciation will be covered by this initial allocation.

Another method of leveraging the exemption is by selecting assets with the most guaranteed appreciation potential to receive the GST tax exemption allocation.

Finally, individuals can leverage the exemption by establishing a dynasty trust. A dynasty trust is a trust that can last for several generations. The longer the trust term, the longer the trust assets will remain untaxed, compounding the appreciation of trust assets.

Determining how to best leverage the GST tax exemption is complex. It requires the careful analysis of options. You should consult with an experienced estate planning attorney.

Each individual's exemption is allocated, either automatically or by specific allocation, to a particular transfer or transfers. Specific allocations are made on Form 709 or Form 706, whichever is appropriate.

Tip: Some states may also have the equivalent of the GST tax exemption.

Deemed allocation rules

An individual's available GST tax exemption is automatically allocated to certain kinds of transfers, without any action on the part of the transferor. An individual's unused GST tax exemption is automatically allocated to transfers made during that individual's lifetime that are direct skips to the extent necessary to make the inclusion ratio zero for the property transferred. An indirect skip is a transfer of property (other than a direct skip) subject to gift tax that is made to a GST trust. A GST trust is, in general, any trust that could have a generation-skipping transfer. The automatic allocation also applies to an indirect skip occurring upon the post-2000 termination of an estate tax inclusion period.

An individual may elect out of the deemed allocation rules so that GST tax exemption will not be allocated automatically to a particular transfer that is an indirect skip. This election out with regard to a particular indirect skip will be deemed timely if made on a timely filed gift tax return for the calendar year in which the transfer was made, or deemed to have been made with regard to trusts subject to an estate tax inclusion period, or on such later dates as may be prescribed in regulations.

Additionally, an individual may elect out of the deemed allocation rules for indirect skips so that GST tax exemption will not be allocated automatically to any or all transfers made to the trust by that individual, regardless of when a transfer is, or may in the future be, made. This election out with regard to any or all transfers to the trust by that individual may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

Alternatively, an individual may elect to treat any trust as a GST trust with regard to any or all transfers made by that individual to the trust. If this election is made, the rules for the automatic allocation of the GST tax exemption will apply with regard to that individual's transfers to the trust. The election to treat a trust as a GST trust may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

IMPORTANT DISCLOSURES