

# The Generation Skipping Transfer Tax and Your Estate Plan: What You Need to Know

September 28, 2022



If you're planning to share some of your wealth with your grandchildren or great grandchildren through future gifts or bequests, it's critical to consider and plan for the generation-skipping transfer (GST) tax. The GST tax is among the harshest and most complex in the tax code. Here are a few details and intricacies to keep in mind as you approach your estate planning.

## **GST tax explained**

The GST tax is a flat, 40% tax on transfers to "skip persons," including grandchildren, family members more than a generation below you, nonfamily members more than 37½ years younger than you and certain trusts with

beneficiaries that are all skipped persons. However, gifts that fall within the annual gift tax exclusion (currently, \$16,000 per recipient; \$32,000 for gifts split by married couples), either outright or to qualifying “direct skip trusts,” are shielded from GST tax. Although note that the dates of such gifts can be crucial because a GST annual exclusion might not necessarily be available if a gift tax annual exclusion was allocated to another gift made earlier in the tax year. This can result in a wasted GST exemption if the timing of the gifts is not planned for properly in advance.

### **Why GST tax can be confusing**

Even though the GST tax enjoys an annual inflation-adjusted lifetime exemption in the same amount as the lifetime gift and estate tax exemption (currently, \$12.06 million), it works a bit differently. For example, while the gift and estate tax exemption *automatically* protects eligible transfers of wealth, the GST tax exemption must be specifically *allocated* to a transfer to shelter it from tax.

The tax code does contain automatic allocation rules designed to prevent one from inadvertently losing the exemption, but it can be dangerous to rely on these rules. In some cases, the exemption isn’t automatically allocated to transfers that may trigger costly GST tax. And in others, the exemption is automatically allocated to transfers that are unlikely to need its protection, wasting those exemption amounts. For example, suppose one establishes a trust for their children, with the remainder passing to their grandchildren. One would assume the automatic allocation rules will shield the trust from GST tax. But the trust gives one of the children a general power of appointment over 50% of the trust assets, disqualifying it from GST trust status. Unless the GST exemption is affirmatively allocated to the trust, distributions or other transfers to the grandchildren will be subject to GST tax.

Just as timing of the gifts can become crucial, timing for making GST elections are just as important. There are specific deadlines to either elect out of automatic allocation rules or to affirmatively allocate for the GST exemption, and a missed deadline can result in an unintended waste of the lifetime exemption or even worse, trigger substantial GST tax costs to beneficiaries of trusts when distributions are made. Also, many GST elections are irrevocable and cannot be changed when a mistake is discovered in future years. For example, an amended return, which is

often filed to correct errors on prior income tax returns, is not an option to prevent allocation of GST exemption once the deadline to file the original return has passed.

If you wish to make substantial gifts, either outright or in trust, to your grandchildren or other skip persons, be sure to carefully review your GST tax exemption options. Contact your Anchin Relationship Partner or Josh Shapin of Anchin's Private Client Group at [josh.shapin@anchin.com](mailto:josh.shapin@anchin.com) to devise a strategy that leverages the exemption while minimizing your GST tax liability.