

# Generation Skipping Transfer Tax

***“GST: Easy as 1-2-3”***

*presented by*  
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## Introduction:

What is the GST Tax ?  
and  
Why does it exist?



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## **What is a “generation skipping transfer?”**

- A “*generation skipping transfer*” is basically a gift that literally “*skips*” one or more generations in a family chain.
- So it is:
  - a gift from one person (“donor”) to another person (“donee”) where the recipient is *more than one generation removed* from the person making the gift;  
OR
  - a gift to a trust that benefits only persons who are more than one generation removed from the person making the gift.

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## **Purposes of the GST Tax**

- To prevent tax avoidance through multi-generational tax planning; and
- To collect federal gift and estate tax at every generational level

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## What if there were no GST Tax?

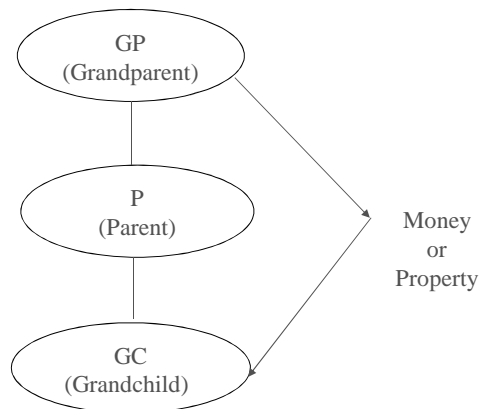
- If there were no GST tax, then a transferor could avoid a layer of federal gift and estate tax by making gifts to persons more than 1 generation below them (or to a trust that benefits such persons).
- GST transfers can be made:
  - Outright; or
  - In trust.

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## Types of GST Transfers

### *“OUTRIGHT”* GST TRANSFERS

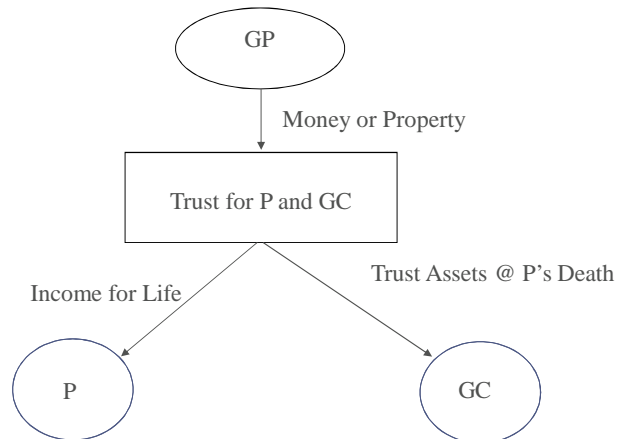


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## Types of GST Transfers (cont'd)

### GST TRANSFERS *IN TRUST*



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### Application of the GST Tax to “Skip Person” Transfers

- To *combat* avoidance of federal estate tax, the GST tax is imposed on various types of transfers to (or for the benefit of) “*skip persons*”
- “*Skip Persons*” are defined as:
  - Persons who are *2 or more generations below* the transferor; OR
  - Persons who are *more than 37-1/2 years younger* than the transferor.

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**Significance of GST Tax (from a planning standpoint)**

- The GST tax is a flat tax that is imposed at the highest federal estate tax rate on all GST transfers.
- Also, it's in addition to any federal estate tax.
- It is therefore important to *avoid* the GST Tax or *minimize* its impact whenever possible.

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**Recognizing GST Transfers**

- Who is the “*Transferor*?”
- Who is the “*Transferee*?”
- Is the transferee a “*Skip Person*?”
- If so, then does an *exclusion* apply?
- How to allocate GST exemption to the transfer?

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# Definitions



## Who (or what) is a “Transferor?”

- The “*transferor*” is typically the person for whom the transferred property was most recently subject to federal estate or gift tax.
  - In the case of a gift of property made during lifetime, the transferor is usually the *donor*.
  - In the case of a gift of property made at death, the transferor is usually the *decedent*.
- But there are some *exceptions*:
  - Exception #1 – Holder of a *general power of appointment*.
  - Exception #2 – QTIP Trust (surviving spouse)



## What is a “Skip Person?”

- Two types of “Skip Persons”:
  - Based on *Family Relationship*; or
  - Based on *Age*.
- “Non-Skip” Persons – anyone who is not a skip person

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### “Skip Persons” : Category #1 – based on *family relationship*

- “Skip Persons” = Any person who is 2 or more generations below the generation of the transferor.
- *Examples*:
  - Example #1: A *grandchild* (or great grandchild) is a skip person in relation to a grandparent.
  - Example #2: A *grand-nephew* or *grand-niece* is a skip person in relation to a great aunt or uncle.

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**“Skip Persons” :**  
**Category #2 – based on age**

- Persons born within 12-1/2 years of the transferor are assigned to the same generation as the transferor.
- Then there is another generation for every additional 25 years.
  - So persons who are *between 12-1/2 years and 37-1/2 years younger* than the transferor are assigned to the generation immediately below the transferor; and
  - All persons who are *more than 37-1/2 years younger* than the “transferor” are 2 or more generations below the transferor and are therefore considered “skip persons.”

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**“Skip Persons”:**  
**Special Rules for Spouses and others**

- *Spouses* are always considered of the same generation as the transferor, regardless of age.
- *Siblings* are always considered to be of the same generation as one another, regardless of age.
  - That’s true whether the siblings are full blood, half-blood or adopted.

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## Examples – Special Rule for Spouses

- Example #1: Donald Trump gives \$50,000 to a mistress who is more than 40 years younger than him. The mistress is a “skip person.”
- Example #2: Same facts, except that Donald marries the mistress before making the \$50,000 gift to her. The mistress (now spouse) is NOT a “skip person.”

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## “Skip Persons”: Special Rule – The “Predeceased Parent” Exception

- If a grandchild’s parent is deceased at the time that the grandparent makes a gift to that grandchild (or to a trust for the grandchild), then the grandchild “*moves up*” a generation and is treated as if the grandchild were a *child* of the transferor.
  - So a transfer from the grandparent to the grandchild would not be to a “skip person” and it would therefore *not* be subject to GST tax.
  - This exception does *not* apply if the grandchild’s parent dies after the gift is made to the grandchild (or to a trust for the grandchild).

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## Trusts as “Skip Persons”

- A trust can be a “skip person” and so a transfer to a trust can be subject to GST tax.
  - A trust is treated as a “skip person” if all of the interests in the trust are held by persons who are “skip persons.”
  - A trust is not treated as a skip person if there is any person holding an interest in the trust that is not a “skip person.”

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## Trusts as “Skip Persons” (cont’d)

- Example #1 – Grandparent gives property to a trust that benefits only her *grandchildren* (and/or more remote descendants).
  - The transfer to the trust **IS** a transfer to a “skip person.”
- Example #2 – Grandparent gives property to a trust that benefits her *children* and her *grandchildren*.
  - The transfer to the trust is **NOT** to a “skip person” and it is therefore NOT subject to GST tax.

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## What is a “GST Trust?”

- A “GST Trust” is any trust that *could* result in a generation skipping transfer (a “GST”) with respect to the transferor unless it falls within one of several enumerated exceptions.
- Two types of potential GSTs:
  - “*taxable termination*” or
  - “*taxable distribution*”(both of which are defined terms).

## Transfers Subject to Generation Skipping Transfer (“GST”) Tax

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**What types of Transfers are subject to GST tax?**

*3 Types of Transfers that are subject to GST Tax:*

- *“Direct Skip”*
- *“Taxable Termination”*
- *“Taxable Distribution”*

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**What is a “Direct Skip?”**

- A “direct skip” = A transfer made directly to a “*skip person*” if the transfer is subject to federal estate or gift tax.
  - Can be to a *person* or to a *trust*.
  - Can be made during *lifetime* or *at death*.
- Example #1: Grandparent during her lifetime gives \$1,000,000 directly to a grandchild.
- Example #2: Grandparent at death (through her Will) gives \$1,000,000 to her grandchildren (GC1 & GC2).

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## “Direct Skips” to a Trust

- A transfer to a trust is a direct skip if all of the beneficiaries of the trust are “skip persons”.

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## “Direct Skips” to a Trust (Cont’d)

- Example #1: Donald Trump gives \$100 million to a trust that benefits only 3 persons, all of whom are his daughter, Ivanka Trump’s children (Donald’s grandchildren): Arabella, Joseph and Theodore.
  - The transfer to the trust is a “*direct skip*” because all of the trust beneficiaries (Donald’s grandchildren) are “skip persons.”

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## **“Direct Skips” to a Trust (Cont’d)**

- Example #2: Donald (age 75) gives \$10 million to a trust that benefits only 2 persons: his mistresses, Stormy Daniels (age 42) and Karen McDougal (age 50).
  - The transfer to the trust is NOT a “direct skip” because Stormy and Karen are NOT “*skip persons*.” (They’re not more than 37-1/2 years younger than Donald.)
  - Q: What if Stormy was only 30 years old (i.e., she is 45 years younger than Donald)?
    - The transfer to the trust would still NOT be a “direct skip” because Karen is still not more than 37-1/2 years younger than Donald.
  - Q: What if Stormy and Karen were both 30 years old (i.e., both of them are more than 45 years younger than Donald)?
    - Then the transfer to the trust would be a “direct skip” and it would therefore be subject to GST tax.

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## **What is a “Taxable Termination?”**

- A “taxable termination” = Any termination of an interest in a trust unless:
  - The transfer is subject to federal estate or gift tax;  
OR
  - A “*non-skip person*” (i.e., person other than a skip person) still has an interest in the trust after the termination; OR
  - It’s impossible for trust assets to be transferred from the trust to a “skip person.”

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**Simplified Definition of a “Taxable Termination”**

- A “*taxable termination*” is basically a termination of a person’s interest in a trust in which (immediately after the termination of that person’s interest in the trust), the only remaining persons with interests in the trust are all “*skip persons*.”

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***Examples - “Taxable Terminations”***

- Example #1: Donald Trump gives \$100 million to a trust that benefits Donald’s daughter, Ivanka, during her lifetime. When Ivanka dies, the remaining funds continue in trust for (or are paid out to) Ivanka’s 3 children: Arabella, Joseph and Theodore.
  - Ivanka’s death causes a “*taxable termination*” because:
    - Ivanka’s death *terminates* Ivanka’s interest in the trust; and
    - Immediately following the termination of Ivanka’s interest, the only remaining beneficiaries are all “*skip persons*” (i.e., Donald’s grandchildren, Arabella, Joseph and Theodore).

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**Examples - “Taxable Terminations” (Cont’d)**

- Example #2: Donald gives \$100 million to a trust. The trust is a “sprinkle trust” in which the trustee is authorized to distribute money to Donald’s oldest son, Don, Jr. or to any of Don, Jr.’s children. Don, Jr. disclaims any interest in the trust, leaving his children (Donald’s grandchildren) as the only remaining beneficiaries.
  - Don, Jr.’s disclaimer causes a “*taxable termination*.”
    - The disclaimer terminates Don, Jr.’s interest in the trust; and
    - Immediately after the disclaimer by Don, Jr., the only remaining trust beneficiaries are all “*skip persons*.”

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**Examples - “Taxable Termination” (Cont’d)**

- Example #3: Donald creates a “sprinkle trust” that benefits Donald’s oldest 3 children (Don, Jr., Ivanka and Eric) and Donald’s grandchildren. (Trustee can distribute to any of them while they are alive.) Donald’s older sons (Don, Jr. and Eric) both catch COVID and die. Does either of their deaths cause a “taxable termination?”
  - **NO**. Because Donald’s other child, Ivanka, is still living and she therefore still has an interest in the trust. So the trust does not benefit only “skip persons” (the grandchildren).

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**Examples - “Taxable Termination” (Cont’d)**

- Example #4: Donald creates a trust for his son, Eric and transfers \$100 million to the trust. Under the trust agreement, the beneficiaries are Eric and each of Eric’s two children, Luke and Carolina. Eric also holds a testamentary *general power of appointment* over the trust assets. Eric then dies. Does Eric’s death cause a “taxable termination?”
- **NO**, because Eric held a testamentary power of appointment over the trust, which causes the trust assets to be includable in Eric’s estate for tax purposes. It therefore falls under one of the exceptions to the definition of a “taxable termination.”

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**What is a “Taxable Distribution?”**

- A “*taxable distribution*” = Any distribution from a trust (of income or principal) to a skip person (unless it also meets the definition of a direct skip or taxable termination).

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## Example – “Taxable Distribution”

- Example #1: Donald’s father (Fred Trump) transfers \$10 million to a trust that benefits each of Fred’s children and grandchildren. (Trustee can make distributions to any of them.) The Trustee then distributes \$9 million to Donald’s daughter (and favorite child), Ivanka.
  - The \$9 million distribution from the trust to Ivanka (a “skip person”) is a “*taxable distribution*”.

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## Example – “Taxable Distribution” (Cont’d)

- Example #2: Assume the exact same set of facts as the last example, *except* that the Trustee instead distributed the money to *Donald* rather than to Ivanka.
  - The distribution to Donald would not be a “taxable distribution” because *Donald* is not a “skip person” in relation to his father, Fred.

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# Other Types of Transfers

(NOT Subject to GST Tax)

***“Indirect Skips”***

## What is an “*Indirect Skip*?”

- An *indirect skip* is a transfer to a trust that benefits a mix of beneficiaries, some of whom are “*skip persons*” (e.g., grandchildren) and some of whom are “*non-skip persons*” (e.g., spouse or children).
- An indirect skip is NOT a GST and it is therefore NOT subject to GST tax.
- BUT an indirect skip creates the potential for a future GST, because following the transfer to the trust, there could be either (1) a “*taxable termination*” or (2) a “*taxable distribution*.”

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## Example – “Indirect Skip”

- Example: Donald transfers \$100 million to a trust that benefits his daughter, Ivanka, and her three children (Arabella, Joseph and Theodore).
  - The transfer to the trust is NOT a GST because one of the beneficiaries (Ivanka) is NOT a “skip person”.
  - **BUT**: If the trustee distributes money (or property) from the trust to one of the grandchildren, then that distribution to a grandchild would be a “*taxable distribution*.”
  - **ALSO**: If Ivanka’s interest in the trust is terminated (due to death, disclaimer, etc.), then it would be a “*taxable termination*,” because immediately after Ivanka’s interest is terminated, all of the remaining trust beneficiaries are “skip persons” (i.e., Ivanka’s children, all of whom are grandchildren in relation to Donald).

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# Non-Taxable (Gift) Transfers



## Two Types of Non-Taxable (Gift )Transfers

- Gifts made directly to an *Individual* that qualify for the annual gift tax exclusion [IRC §2503(b)] (currently \$15,000 per year per donee).
- Payments of *Medical or Educational* Expenses that are made directly to the medical or educational institution and would therefore qualify for exclusion from gift tax on that basis [IRC §2503(e)].



# Previously Taxed Transfers



## Exclusion - for “Previously Taxed Transfers”

- The concept: If property was already subject to GST tax once in an earlier transfer, then that same property should not get hit with GST tax again unless the property is transferred to a *lower* generation than last time.
- Requirements (for the exclusion):
  - The transferred property was *already subject* to GST tax in an earlier transfer; and
  - The transferee (in the current transfer) is *not in a lower generation* than the transferee in the earlier transfer (that was subject to GST tax); and
  - The transfers do not have the effect of avoiding GST tax.



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**Example – Exclusion for Previously Taxed Transfers**

- Example: Donald transfers money to a trust for the benefit of his son, Don, Jr. (“Junior”) and Junior’s four (4) children, Chloe, Tristan, Donald III and Spencer. Under the terms of the trust agreement, (a) the trustee is authorized to distribute income or principal to Junior or to any of Junior’s children (Donald’s grandchildren) during Junior’s lifetime, and (b) when Junior dies, the trust will be administered for the benefit of Junior’s children. Junior then dies.
  - Junior’s death causes a “*taxable termination*” with respect to the trust. Therefore, the entire trust balance is subject to GST tax at Junior’s death.
  - If the trustee later distributes money out of the trust to one of Junior’s children (Donald’s grandchildren), that distribution (to a grandchild) is NOT a “*taxable distribution*.” It is excluded as a *previously taxed transfer* and is therefore not subject to GST tax a second time.

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# The GST Exemption



## GST Exemption – What *is* it?

- The “*GST exemption*” is an amount that can be allocated to a GST to minimize GST Tax.
  - If GST exemption is allocated to a GST, it will *reduce or avoid* imposition of GST tax to the transfer.
- (From a purely mechanical standpoint, allocated GST exemption is applied to the tax rate that would otherwise apply to a GST.)

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## Significance of the GST Exemption

- If property is transferred (directly or indirectly) to a “skip person,” then the transfer will generally be subject to GST tax unless GST exemption is allocated to the transfer.
- If GST exemption is allocated to a GST, and if the amount of exemption allocated equals the amount transferred to the skip person, then the transfer will not be subject to GST tax.

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**Examples – Allocation of GST Exemption (Direct Skips)**

- Example #1 – (*Direct Skip to a Person*): Grandparent (“GP”) gives \$1 million to her grandchild (“GC”). GP allocates \$1 million of GST exemption to the transfer. The transfer is *not* subject to GST tax.
- Example #2 – (*Direct Skip to a Trust*): GP gives \$1,000,000 to a *trust* that benefits her two grandchildren (GC1 & GC2). (The grandchildren are the only beneficiaries of the trust.) GP allocates \$1,000,000 of GST exemption to the trust. The transfer to the trust (which is a “direct skip”) is not subject to GST tax.

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**Allocation of GST Exemption (Indirect Skips)**

- If GST exemption is allocated to a trust, it will also reduce (or possibly even eliminate) GST tax on other types of GSTs such as “*taxable distributions*” and “*taxable terminations*.”
  - If the GST exemption allocated to the trust equals the amount transferred to the trust, then there will be no GST tax imposed on a taxable distribution or taxable termination.
- So even if a transfer to a trust is NOT a GST, a transferor might still want to allocate GST exemption to the trust in order to minimize potential GST tax in the *future*.

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**Examples – Allocation of GST Exemption (cont'd)**

- Example #3 – (*Taxable Distribution*): Grandparent (Donald) gives \$1 million to a trust that benefits one of his children (Ivanka) and one of her children (Arabella). Donald allocates \$1,000,000 of GST exemption to the trust. The trustee then distributes \$250,000 to the grandchild (Arabella).
  - The distribution to the grandchild (Arabella) is a “taxable distribution” that would normally be subject to GST tax.
  - However, because the amount of GST exemption allocated to the trust equals the amount transferred to the trust, the distribution of money from the trust to the grandchild (Arabella) is completely sheltered from GST tax. So there is no GST tax on the \$250,000 distribution to the grandchild.

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**Examples – Allocation of GST Exemption (cont'd)**

- Example #4 – (*Taxable Termination*): Grandparent (Donald) gives \$1,000,000 to a trust that benefits his son (Eric), and Eric's 2 children (Luke and Carolina). (Under the terms of the trust agreement, the trustee is authorized to distribute money to Eric or to either of Eric's children (Luke or Carolina) while Eric is still living and at Eric's death, the remaining principal will continue to be administered in trust for the benefit of Eric's children.) Donald allocates \$1,000,000 of GST exemption to the trust. Eric then dies.
  - Eric's death terminates Eric's interest in the trust and is a “*taxable termination*” which would normally subject the entire trust balance to GST tax.
  - However, because Donald allocated GST exemption equal to the amount transferred to the trust, the termination of Eric's interest in the trust does *not* trigger GST tax. (The GST exemption allocated to the trust shelters the entire amount in the trust.)

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**GST Exemption also covers future appreciation in trust assets**

- If GST exemption is allocated to a transfer of money or property to a trust, then the allocated GST exemption applies not only to the value that was transferred to the trust but also to:
  - Any future appreciation in the value of the trust assets;  
AND
  - Any earnings generated on the assets in the trust.
- The GST exemption can therefore be extremely valuable because it can be “*leveraged*” to also shelter future growth in the trust assets and/or earnings from the trust assets.

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**Example – Application of GST Exemption to future appreciation**

- Example – (*Appreciated Trust Assets*) Donald transfers \$1,000,000 to a trust that benefits his daughter, Ivanka, and each of Ivanka’s 3 children (Arabella, Joseph & Theodore). Donald allocates \$1,000,000 of GST exemption to the trust. The trust thereafter grows to \$15,000,000. Ivanka then dies, so that the only remaining beneficiaries are her children (Donald’s grandchildren, Arabella, Joseph & Theodore).
  - Ivanka’s death triggers a “*taxable termination*” that would normally subject the value of the entire trust (\$15,000,000) to GST tax.
  - However, because Donald allocated GST exemption (\$1,000,000) *equal* to the amount *transferred* to the trust (\$1,000,000), *NO GST tax* is imposed on the termination of Ivanka’s interest in the trust, even though the trust is now worth much more than the amount that was originally transferred to it.

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## WHO can allocate GST Exemption

- The only person who can allocate GST exemption to a transfer is:
  - The “transferor” (in the case of a transfer made during *lifetime*); or
  - The transferor’s executor (in the case of a transfer from an estate following a person’s *death*).

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## WHO is the “*transferor*?”

- It is therefore critically important to understand to know WHO the transferor is.
- However, it is also important to understand that who the “*transferor*” is can change under certain circumstances.
- A change in the identity of the transferor with respect to a trust changes:
  - Who can *allocate* GST exemption to the trust; and
  - Whether GST exemption that has *already* been allocated to a trust by a particular person can *continue* to protect the trust from GST tax.
- In other words, once a new “transferor” is determined with respect to any property in trust, then:
  - Any GST exemption already allocated to the trust by a previous transferor is lost; and
  - Only the new transferor can allocate GST exemption to the property.

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## Example – New “Transferor”

- Example – (*New “Transferor”*): Donald creates a trust for the benefit of his wife, Melania, and their son, Barron. Melania is given the power during her lifetime to withdraw the entire trust balance. When both Melania and Barron are deceased, the remaining trust balance passes to Barron’s children (Donald’s grandchildren). Donald transfers \$1,000,000 to the trust and allocates \$1,000,000 of GST exemption to the trust.
  - Melania’s power of withdrawal over the trust during her lifetime is a *general power of appointment* for tax purposes, and causes her to be treated as the (new) “transferor” of property to the trust.
  - The \$1,000,000 of GST exemption that Donald already allocated to the trust is “wasted”.
  - Going forward, only *Melania* can allocate GST exemption to the trust. (Donald cannot allocate anything to it.)

## Computing the GST Tax

## The “Applicable Rate”

- When a transfer is subject to GST tax, it’s taxed at a rate called the “*applicable rate*.”
- “*Applicable Rate*” = The maximum federal estate tax rate (45% in 2021) multiplied by the “*inclusion ratio*.”
- The “*inclusion ratio*” is a number that measures *how much GST exemption was allocated* to the transfer, and thus the extent to which the transfer is subject to GST tax.

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## “Inclusion Ratio”

- “*Inclusion Ratio*” = 1 minus the “*applicable fraction*.”
- “*Applicable Fraction*” = Amount of GST exemption allocated to the transfer divided by the value of the transferred property.

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## Inclusion Ratio (cont'd)

- What does the inclusion ratio mean?
  - The inclusion ratio effectively determines the tax rate imposed on a transfer subject to GST tax.
    - An inclusion ratio of “0” means that the tax rate will be zero percent.
    - An inclusion ratio of “1” means that the transfer will be subject to GST tax at the highest tax rate.
    - An inclusion ratio between “0” and “1” means that the transfer will be taxed at a rate between zero and the highest tax rate.

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## “Inclusion Ratio” – Examples:

### Example #1 – (Inclusion Ratio of “Zero”):

- Grandparent (“GP”) give \$1 Million to her grandchild (“GC”). GP allocates \$1 Million of GST exemption to the transfer.
  - “*Inclusion Ratio*”
    - = 1 – “*Applicable Fraction*”
    - = 1 – (\$1 Million / \$ 1 Million)
    - = 1 – 1 = 0.
  - The “*Applicable Rate*” = Inclusion Ratio multiplied by the Maximum Federal Estate Tax Rate (45%)
    - = 0 x 45% = 0%

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## “Inclusion Ratio” – Examples (cont’d)

Example #2 – (Inclusion Ratio of “**ONE**”):

- Grandparent (“GP”) give \$1 Million to her grandchild (“GC”). GP allocates NONE of her GST exemption to the transfer.
  - “*Inclusion Ratio*”       $= 1 - \text{“Applicable Fraction”}$   
                                  $= 1 - (\$0 / \$1 \text{ Million})$   
                                  $= 1 - 0 = 1.$
  - The “*Applicable Rate*” = Inclusion Ratio multiplied by the Maximum Federal Estate Tax Rate (45%)  
                                  $= 1 \times 45\% = \underline{\mathbf{45\%}}.$

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## “Inclusion Ratio” – Examples (cont’d)

Example #3 – (Inclusion Ratio **Between Zero and One**):

- Grandparent (“GP”) give \$600,000 to her grandchild (“GC”). GP allocates \$200,000 of her GST exemption to the transfer.
  - Inclusion Ratio       $= 1 - (\$200,000 / \$600,000)$   
                                  $= 1 - 1/3 = 2/3.$
  - The “*Applicable Rate*” =  $2/3 \times 45\% = \underline{\mathbf{30\%}}$

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## **Inclusion Ratio - Planning**

- The Goal: To allocate GST exemption to trusts in such a way that all trusts have an inclusion ratio of **EITHER** “0” OR “1.”
- WHY? Because it *simplifies* planning – e.g., when trusts distribute money to beneficiaries.

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## **Example – Planning for GST Trust Distributions**

- Example: Donald creates two different trusts (Trusts #1 and #2), each of which benefit his children and his grandchildren. Donald contributes \$1,000,000 to *both* of the two trusts, but he has only \$1,000,000 GST exemption left to allocate. So Donald allocates all \$1,000,000 of his GST exemption to Trust #1 and none of his GST exemption to Trust #2.
  - Following the allocation of Donald’s GST exemption, Trust #1 has an inclusion ratio of “0” (i.e., totally *exempt*) and Trust #2 has an inclusion ratio of “1” (i.e., totally *non-exempt*)
  - All distributions to Donald’s *grandchildren* (skip persons) should be made from Trust #1 and all distributions to Donald’s *children* (non-skip persons) should be made from Trust #2.

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# Allocating GST Exemption



## When GST exemption is allocated

- GST exemption can be allocated:
  - During the transferor's lifetime (by the transferor);  
OR
  - Following the transferor's death (by the executor of the transferor's estate).



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**Lifetime allocation of GST exemption – Voluntary & Automatic**

- During the transferor's lifetime, the transferor may "voluntarily" (i.e., affirmatively) allocate GST exemption to a transfer.
- Also, in certain circumstances, the transferor's GST exemption can be allocated "automatically" (without action on the part of the transferor) during the transferor's lifetime to a transfer that would otherwise be subject to GST tax (or that could give rise to GST tax in the future). **[VERY IMPORTANT BUT ALSO VERY COMPLEX AND THEREFORE NOT DISCUSSED IN DEPTH.]**

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**Lifetime (Voluntary) Allocation – HOW to do it?**

- A transferor can voluntarily allocate GST exemption to a transfer made during his/her lifetime by making the allocation on a federal *gift tax* return.
  - In the case of a gift to a trust that is not a “skip person,” (i.e., an “indirect gift”), the allocation is made by attaching a “Notice of Allocation” form to the gift tax return.
- While it's possible to allocate a specific dollar amount, it's normally advisable to allocate by formula (e.g., language indicating that the transferor intends to allocate an “amount of exemption [that is] necessary to produce an inclusion ratio of “0” or as close to “0” as possible”).

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## Timely Allocation (during lifetime)

- If a transferor allocates GST exemption on a timely filed gift tax return (for the year of the gift), then the transferred property will be valued as of the *date of the transfer*.
- That's generally preferable because the transferor will not need to use as much GST exemption to produce a "0" inclusion ratio (that is, if the property *appreciates* in value after the transfer).

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## Example – *Timely* Allocation (during lifetime)

- Example: Donald transfers \$2,000,000 to a trust for his children and grandchildren on December 1 of year 1. Donald allocates \$2,000,000 of GST exemption to the trust on April 1 of year 2.
  - The property is valued at \$2,000,000 for GST tax purposes – even if the property is actually worth \$3,000,000 by the time the allocation is made on April 1 of year 2.
  - Donald is therefore able to exempt the entire trust value (\$3,000,000) from GST tax even though he only allocated \$2,000,000 of GST exemption to the transfer.
  - If Donald allocates on a late filed return (let's say, on November 1 of year 2), then the property would be valued as of the date of filing. Therefore, Donald would need to allocate \$3 million of GST exemption to get that same result.

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### **Automatic Allocation (during lifetime)**

- There are rules under which a transferor's GST exemption can be allocated "*automatically*" during his/her lifetime.
  - In (very) general terms, GST exemption will be automatically allocated to all "*direct skip*" transfers and to most types of "*indirect skip*" transfers made to a "GST trust."
  - **BUT** there are a number of *exceptions*, which are very important but too complicated to cover here.
  - **NOTE:** The rules and exceptions are covered in the outline.

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### **Allocation of GST exemption – after transferor's death**

- After a transferor dies, the executor of the transferor's estate can "*voluntarily*" allocate GST exemption that would (or might) otherwise be subject to GST tax.
- A deceased transferor's GST exemption can also under certain circumstances be "*automatically*" allocated to transfers that would (or might) otherwise be subject to GST tax. **[THIS IS IMPORTANT BUT ALSO COMPLEX AND THEREFORE NOT DISCUSSED IN DEPTH.]**

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## Voluntary Allocations (after death)

- When a transferor dies, the executor of the transferor's estate can allocate the transferor's unused GST exemption to property that was included as part of the deceased transferor's estate (or that was transferred during the transferor's lifetime) by making a voluntary allocation on a timely filed *federal estate tax return* (IRS Form 706).
- Voluntary allocations are made on *Schedule R* of the IRS Form 706.
- If the allocation is made on a timely filed estate tax return, then the allocation will be effective as of the decedent's *date of death*.

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## Voluntary Allocations (after death)

- NOTE: That would be advantageous if, for example, the property appreciates in value between the date of the decedent's death and the date that the tax return is filed.

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## **Thank You!**

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