

CHAPTER 11 GST & DYNASTY TRUSTS

Objectives of “Dynasty Trusts”:

- 1) Preserve assets for multiple generations.
- 2) Maintain family solidarity.
- 3) Avoid the “rule against perpetuities.”
- 4) Reduce multiple transfer tax costs (reject the assumption that a transfer tax liability is to be incurred at each generational level).

Multi-generational Transfer Example

Property transfer to:

(1) child for life, &

(2) remainder to grandchildren (or even younger generations, subject to the RAP).

Applicability of the federal estate tax on the death of the initial transferor (or gift tax);

however, no estate tax exposure applies upon the subsequent death of the child (i.e., the next, intermediate generation). Why?

Non-Transfer Tax Structuring Matters

Flexibility for future generations.

Trustee discretion re distributions (i.e., no general P/A to any beneficiary).

Advice is provided to the trustees through an advisory committee of family members and advisors (or a private trust company).

Protection from creditors of the beneficiaries (including former spouses seeking assets).

Use a “trust protector” to change the trustee if necessary in future. Who is the “protector”?

Imposition of Generation Skipping Transfer Tax

P.2 GST tax is imposed (as a substitute for estate or gift tax) on a GST – see §2611:

- 1) Taxable distribution
- 2) Taxable termination
- 3) Direct skip

This tax imposition question concerns the “timing,” i.e., completion for GST tax purposes.

Note: No limit on the number of generations skipped! (Note: 2005 JCT Options paper)

What Planning During 2010/now for 2018? p.5

- 1) GSTT was repealed during 2010 (until December 17, 2010).
 - 2) Restored in 2011 (with \$5 million exemption level). Could create a GST trust thereafter and fund (at least) to extent of the \$5/\$10 million (pre-index) GST exclusion amount? Also, a gift tax event (but exclusion?). Outright transfer to a GC? Purchase an annuity for the GC?
 - 3) P. 5-6 Obama proposal: 90 year limit. Cf., “grandfathered” (pre-1986) dynasty trusts.
- Consider repeal of RAP in many jurisdictions.**

“Direct Skip” Identified

Code §2612(c)(1)

p.6

A transfer subject to Ch. 11 or 12 tax is made to a “skip person.”

Examples (where the GST is also applicable):

- 1) Gift is directly to GC
- 2) Bequest is made to GC
- 3) Gift/bequest into trust (solely) for GC

See PLR 200215001, p. 7 (slide 9) re transfers from a revocable trust to GC trusts at death of the grantor. These are “direct skips.”

“Taxable Termination”

Code §2612(a)(1) p.7

Termination by death or lapse of time of an interest held in trust by an intermediate generation member (and property goes to a lower generation member).

Example: Trust from Parent to Child for life, remainder to GC; Child dies & GC then receives the remainder outright.

The GST transfer occurs as of the death of the Child.

“Taxable Distribution”

Code §2612(b)

p.7

Distribution from a trust to a skip person when the trust status is to be continued.

Example: Trust created by Parent (1) for Child for life, remainder to GC, and (2) discretion to make income or corpus distributions to Child and GC.

Trustee does make a discretionary trust distribution (income or corpus) to GC while Child is alive. This transfer is treated as a “taxable distribution.”

PLR 200215001

p.7

Separate trusts created for each living grandchild – to continue until a grandchild is then 45 and then terminate. Discretionary income and corpus distribution in the interim.

When GST transfer: (1) when funded, or (2) when distributions occur, since beneficiary may die before trust termination? Here: when funded. All interests treated as held by skip persons. Alternative: Transfer to 1st generation which then transfers to second.

Defining “Skip Persons”

Code §2613

p.10

Skip person as: (1) individual two or more generations below transferor, or (2) a trust with all the beneficial interests held by skip persons.

Move-up rule for the orphaned CG – Code §2651(e). See PLR 199907015, p.10.

Similar rule for “collaterals.” p. 12.

Transfers to Non-Relatives

p.13

Generation assignments when transfers to persons who are not lineal descendants:
Every 25 years, 1st skipped generation when recipient is 37 1/2 years younger – See §2651(d).
See PLR 9105006, p. 12, where life tenant was 40 years younger, remainder then to child. All trust value is includible in the GST transfer.

Exemption and Exclusions

p.15

GST Exemption - \$5.0 million in 2011/2?

No GST in 2010; 11.400 million in 2019.

Exclusions:

- 1) Annual donee exclusions – only for “direct skips” – §2642(c)(3)(A); including trusts with a “sole skip beneficiary.” PLR 200114026, p.16.**
- 2) Medical and tuition exclusion - §2611(b)(1) & §2642(c)(3)(B).**

Reverse QTIP GST Election

p.20

Code §2652(a)(3) – election to treat property in trust as if a QTIP election was not made. PLR 20054007, p. 20.

Objective: decedent (first spouse to die) remains the transferor of the QTIP trust for GST purposes. The GST exemption is then allocated to the QTIP trust.

GST Tax Computation

p.25

Tax base varies, dependent upon the type of property transfer:

GST tax base for a taxable termination includes the property subject to the termination. §2622. Cf., estate tax.

Direct skip – amount received is the amount subject to tax - §2623. Cf., gift tax (re non-inclusionary transfer).

GST Exemption Allocation – Inclusion Ratio p.26

§2631(a) & §2632 re allocation of the GST exemption.

What is the purpose of the “inclusion ratio” (or exclusion ratio)? I.e., to get an exclusion for current transfer, with post transfer appreciation attributable to the excluded portion protected at time of the future GST transfer.

PLR 200608004, p.27, re allocation of exemption when making lifetime gifts.

Indirect Skips

p.31

A deemed allocation rule (for the GST exemption) applies to lifetime “indirect skips.”
Code §2632(c).

Income Tax Deduction for GST Tax p.31

Code §164(a)(4) provides for an income tax deduction for GST tax imposed on income distributions.

Announcement 91-43

Obtaining a GST Private Letter Ruling p.32

**Possible to obtain a “prospective ruling” re
GST?**

**Most PLR requests concerning protecting the
continuing “grandfathered status” of a GST
exempt trust.**

Grandfathered Trusts

p. 33

Query: How assure continued status of a trust as “grandfathered” for GST purposes?

