

## **LIMIT DURATION OF GENERATION-SKIPPING TRANSFER (GST) TAX EXEMPTION**

### **Current Law**

Generation-skipping transfer tax is imposed on gifts and bequests to transferees who are two or more generations younger than the transferor. The GST tax was enacted to “backstop” the estate and gift tax system by preventing the avoidance of those taxes through the use of a trust that gives successive life interests to multiple generations of beneficiaries. In such a trust, no estate tax would be incurred as beneficiaries died because their respective life interests would die with them and thus would cause no inclusion of the trust assets in the deceased beneficiary’s gross estate. The GST tax is a flat tax on the value of the transfer at the highest estate tax bracket applicable in that year. Each person has a GST tax exemption (originally \$1 million, \$3.5 million in 2009, and \$5 million in 2010 and 2011), that can be allocated to transfers made by that person, whether made directly to a grandchild or other “skip person” or in trust. The allocation of GST exemption to a transfer or to a trust excludes from the GST tax not only the amount of the transfer or trust assets equal to the amount of GST exemption allocated, but also all appreciation and income on that amount during the existence of the trust.

At the time of the enactment of the GST provisions, the law of most (generally, all but about three) states included the common law Rule against Perpetuities (RAP) or some statutory enactment or version of it. The RAP generally requires that every trust terminate no later than 21 years after the death of a person who was alive (a life in being) at the time of the creation of the trust.

### **Reasons for Change**

Many states have now either repealed or limited the application of their RAP statutes, with the effect that trusts created subject to the law of those jurisdictions may continue in perpetuity. (A trust may be sited anywhere; a grantor is not limited to the jurisdiction of the grantor’s domicile for this purpose.) As a result, the transfer tax shield provided by the GST exemption effectively has been expanded from trusts funded with \$1 million and a maximum duration limited by the RAP, to trusts funded with \$5 million and continuing (and growing) in perpetuity.

### **Proposal**

This proposal would provide that, on the 90<sup>th</sup> anniversary of the creation of a trust, the GST exclusion allocated to the trust would terminate. Specifically, this would be achieved by increasing the inclusion ratio of the trust (as defined in section 2642) to one, thereby rendering no part of the trust exempt from GST tax. Because contributions to a trust from a different grantor are deemed to be held in a separate trust under section 2654(b), each such separate trust would be subject to the same 90-year rule, measured from the date of the first contribution by the grantor of that separate trust. The special rule for pour-over trusts under section 2653(b)(2) would continue to apply to pour-over trusts and to trusts created under a decanting authority, and for purposes of this rule, such trusts will be deemed to have the same date of creation as the initial trust, with one exception, as follows. If, prior to the 90<sup>th</sup> anniversary of the trust, trust property is distributed to a trust for a beneficiary of the initial trust, and the distributee trust is as

described in section 2642(c)(2), the inclusion ratio of the distributee trust will not be changed to one (with regard to the distribution from the initial trust) by reason of this rule. This exception is intended to permit an incapacitated beneficiary's distribution to continue to be held in trust without incurring GST tax on distributions to the beneficiary as long as that trust is to be used for the sole benefit of that beneficiary and any trust balance remaining on the beneficiary's death will be included in the beneficiary's gross estate for Federal estate tax purposes. The other rules of section 2653 also would continue to apply, and would be relevant in determining when a taxable distribution or taxable termination occurs after the 90<sup>th</sup> anniversary of the trust. An express grant of regulatory authority would be included to facilitate the implementation and administration of this provision.

This proposal would apply to trusts created after enactment, and to the portion of a pre-existing trust attributable to additions to such a trust made after that date (subject to rules substantially similar to the grandfather rules currently in effect for additions to trusts created prior to the effective date of the GST tax).