Generation-Skipping Transfer Tax:
Planning Considerations for 2018 and Beyond

The Florida Bar Real Property Probate and Trust Law Section

2018 Wills, Trusts & Estates Certification and Practice Review Course

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Generation-Skipping Transfer Tax – An Overview

- The origins of the Generation-Skipping Transfer [GST] Tax can be traced to a response to planning meant to escape exposure to another federal transfer tax – the federal estate tax.
- Advanced planning resulted in trusts designed to continue for several generations, while avoiding inclusion in beneficiaries' estates.
- The GST Tax was enacted as a tax on such transfers in trust (or otherwise), and perhaps more accurately, a way in which to recuperate otherwise lost estate tax revenue.

When does the GST Tax Apply?

- The GST tax applies to any transfer of property (whether directly, from a trust or a trust equivalent) to a person at least two generations younger than the transferor.
- Examples:
  - Outright lifetime gift or testamentary bequest to a grandchild;
  - Distribution from a trust to a grandchild of the settlor; and
  - Termination of a life interest resulting in remainder passing to a grandchild of the holder in interest.

Important GST-Related Terms

- Skip Person
  - In general, a transferee who is at least two generations younger than the transferor (e.g., grandchildren, great grandchildren, etc.)
  - Trusts can be skip persons if:
    - All persons having a beneficial interest in the trust are skip persons; or
    - No one holds a present beneficial interest in the trust and no distributions to non-skip Persons can ever occur.
- Trust
  - A trust, for GST purposes, is not limited to the traditional definition of trusts, but rather, is defined as any arrangement (other than an estate) that has substantially the same effect as a trust (e.g., legal term and life interests, insurance and annuity contracts, etc.)

Important GST-Related Terms

- Whether a trust is a skip person depends on whether a skip person has an interest in that trust.
  - A person will only have an interest in a trust if he or she:
    - Has a present right to receive income or principal; or
    - Is a current permissible distributee of trust assets.
- Indirect Interests in Trust
  - Nominal interests in trust given to non-skip persons for the purpose of delaying or deferring GST tax will be disregarded by the IRS.
- Support Obligations
  - A person whose legal obligations could be satisfied from payments of trust income or principal has an interest in a trust (except for where the trustee merely has discretionary authority to make distributions in satisfaction of such obligation).

Important GST-Related Terms

- Transferor
  - Identifying the transferor determines who is and is not a skip person, as well as whose GST tax exemption may be allocated to such transfer.
    - Generally, the transferor is the person who was most recently subject to federal estate or gift tax on the transferred property.
    - In the case of a gift, the donor's spouse may consents to split the gift, making each spouse a transferor of half of the gift.

Important GST-Related Terms

- Transferor (cont.)
  - Whenever a transfer is made in trust, the initial transferor will be:
    - The testator in the case of a testamentary transfer; or
    - The donor in the case of an inter vivos transfer.
  - After a transfer is completed, if the same property is subject to gift or estate tax, the transferor is redetermined, and any previously allocated GST exemption is lost.
    - Example: A trust beneficiary who holds a general power of appointment over trust property becomes the transferor upon the earlier of (a) death or (b) the exercise or release of that power).

Important GST-Related Terms

- Reverse QTIP Election
  - Normally, the surviving spouse becomes the transferor of a QTIP trust for which the estate of a deceased spouse elected to take the marital deduction.
  - However, a separate "reverse" QTIP election is available. If made, such an election results in the deceased spouse instead being treated as the transferor of the QTIP for purposes of the GST.
  - A reverse QTIP election:
    - Is made on the estate or gift tax return on which the traditional QTIP election is made.
    - Must be made as to all property in the trust; and
    - Is irrevocable.

Assigning Generations

- In order to determine the applicability of the GST Tax to a given transfer, each transferor, transferee, and each person with an interest in trust must be assigned to a generation.
  - Lineal Descendants: Assigned to generations based on simple identification.
  - Spouses and charities are always assigned to the transferor's same generation.
  - Spouses of lineal descendants are assigned to the same generation of that lineal descendant.
  - Persons whose ages are within 12.5 years of the transferor's age are assigned to the transferor's same generation.
  - Persons whose ages are more than 12.5 years but less than 37.5 years are assigned to the generation above or below the transferor. Thereafter, new generations are measured in 25 year intervals.

Assigning Generations

- Exception for Predeceased Ancestors
  - In the case of a transfer to a lineal descendant of a transferor (or the transferor’s spouse), the generation of any predeceased individual who is both a descendant of the transferor (or the transferor’s spouse) and an ancestor of the transferee is ignored in assigning generations.
  - This rule also applies to transfers where certain collateral heirs of the transferor (or the current or former spouse of the transferor) predecease if:
    - The transferor had no living descendants at the time of the transfer; and
    - The predeceased individual is a descendant of the parent of the transferor (or of the transferor’s spouse).

Assigning Generations

- Multiple Skips
  - Where property that is held in trust is subjected to a GST tax and thereafter remains in trust, the generation of the transferor is redetermined as the generation immediately above any person holding an interest in the trust.
    - Example: Settlor creates a trust to pay income to Child for life, then to Grandchild for life, then to Great-Grandchild for life. If Child dies after the trust is created, the trust property is subjected to GST tax. As Grandchild is now in the highest generation of any person holding an interest in the trust, Settlor's generation is redetermined as Child's generation.

Triggering Events

- There are three types of triggering events under the GST tax:
  - Direct Skips
  - Taxable Terminations
  - Taxable Distributions.

Triggering Events

- Direct Skips
  - A direct skip occurs when a transfer that is subject either to the estate tax or the gift tax is made by the transferor to a skip person.
  - A simple example is an outright bequest by a transferor to a grandchild.
  - A transfer to a trust that is itself a skip person is also a direct skip.

Triggering Events

- Taxable Terminations
  - Taxable terminations generally occur at the termination of an interest in a trust (e.g., the death of an owner of an interest, the failure of a contingency).
  - Taxable terminations can also be the result of certain distributions from a trust (e.g., a partial distribution of trust property to a skip person upon the death of the transferor or a lineal descendant, a transfer of all trust property to a skip person).

Triggering Events

- Terminations that are not GST Events
  - Trusts which cannot benefit skip persons
    - No taxable termination occurs at the termination of an interest if at no time thereafter distributions (including a terminating distribution) may be made to a skip person.
  - Terminations where non-skip persons hold an interest
    - A taxable termination will not occur if one or more non-skip persons continue to hold an interest in the trust (greater than a nominal interest).
  - Terminations subject to estate or gift tax
    - Generally, if a termination of an interest is subject to gift tax or estate tax, no taxable termination occurs. Instead, the transferor is redetermined.
    - Exception in the case of a QTIP trust for which an election is made to treat the first spouse as the transferor pursuant to IRC § 2652.

Triggering Events

- Taxable Distributions
  - A taxable distribution occurs when a distribution of trust income or principal, which is neither a direct skip nor a taxable termination is made to a skip person.
    - Example: Trustee of a trust settled by Parent for the benefit of Child, which allows distributions of income to Grandchild, making such a distribution to Grandchild.

GST Tax Exemptions and Exclusions

- The GST tax has its own set of exclusions and exemptions. These include exclusions for medical and tuition payments, an exclusion similar to the gift tax annual exclusion and of course the per transferor GST exemption.

GST Tax Exemptions and Exclusions

- Section 2503(e) Equivalents
  - Transfers or distributions which, if made inter vivos, would otherwise qualify for the IRC § 2503(e) gift tax exclusion are also excluded from the GST tax.
- Section 2503(b) Exclusion
  - An inter vivos direct skip is exempt from the GST tax to the extent it qualifies for the IRC § 2503(b) gift tax annual exclusion.
  - In order for this exemption to apply to a gift in trust, it must vest, for tax purposes, in a single beneficiary. Such a trust must exclusively benefit a single beneficiary during life, and the trust's property must be includible in that beneficiary's estate if the beneficiary were to die before termination of the trust.

GST Tax Exemptions and Exclusions

- The GST Exemption
  - Every person, including non-U.S. persons, has a cumulative lifetime exemption that may be used to shelter transfers from the GST tax.
  - The GST Exemption was recently doubled by the Tax Cuts and Jobs Act of 2017 to $11,200,000 for 2018.
    - Note however, that pending final guidance from the IRS, this number may in fact be $11,180,000

Computing the GST Tax

- The GST tax due as a result of a particular taxable event is calculated by multiplying the taxable amount by the applicable taxable rate. As such, these figures must in turn first be determined.

Computing the GST Tax

- Taxable Amount
  - The taxable amount is the fair market value of the property subject to the direct skip, taxable distribution or taxable termination.
  - For direct skips, the taxable amount is limited to the value of the property transferred.
  - For taxable terminations and distributions, the taxable amount also includes the money that will ultimately be used to pay the gift tax.
    - For example, the taxable amount in the case of a residuary bequest to a skip person is the portion of the residue which, when subjected to the GST tax, leaves enough residue to pay the tax due.

Computing the GST Tax

- Applicable Rate
  - The applicable rate is equal to the maximum estate tax rate (40% for 2018) multiplied by the inclusion ratio.
  - Where the inclusion ration is 0, the applicable rate is also 0. Where the inclusion ratio is 1, the applicable rate is the maximum estate tax rate.
  - Any inclusion ratio between 0 and 1 will result in an applicable rate greater than 0, but lower than the maximum estate tax rate.

Computing the GST Tax

- Inclusion Ratio and Applicable Fraction
  - The inclusion ratio is determined by subtracting the applicable fraction from 1.
  - The numerator of the applicable fraction is the GST exemption allocated to the trust or direct skip.
  - The denominator is equal to the GST value of the property transferred, reduced by any federal or state estate tax charged and actually recovered and any charitable deductions allowed with respect to the property.
  - In the case of a direct skip, the denominator is also reduced by any portion of the transfer that is a nontaxable gift.

Computing the GST Tax

- GST Value of Lifetime Transfers
  - The value of property transferred subject to a lifetime gift is its fair market value on the effective date of the allocation of GST exemption.
  - Where such allocation is made on a timely filed gift tax return, the value is determined by the fair market value as finally determined for purposes of the gift tax.
  - If, however, such allocation is made after the due date of the gift tax return, this value will be determined on the date on which the allocation is actually made.
    - Note that the transferor may elect to treat the allocation as having been made on the first day of the month during which the late allocation is made. However, this election is not effective with respect to a life insurance policy or a trust holding a life insurance policy if the insured has died.

Computing the GST Tax

- GST Value of Testamentary Transfers
  - The estate tax value, subject to any special valuation methods elected, is used to value the denominator of the applicable fraction of property included in a decedent's gross estate.

Computing the GST Tax

- Charitable Lead Annuity Trusts
  - In determining the applicable fraction with respect to a charitable lead annuity trust:
    - The denominator of the fraction is the value of the property immediately after the termination of the charitable interest; and
    - The numerator is the adjusted GST exemption.

Redetermination of the Applicable Fraction

- After a transfer to a trust is made, the occurrence of certain events may require that the applicable fraction be redetermined. Examples include:
  - The subsequent allocation of additional GST exemption to the trust.
  - The addition of more property to the trust.
  - A consolidation of two or more trusts with the same transferor.
- In each case:
  - The denominator of the new applicable fraction will equal the value of the property in the trust after the event causing the redetermination.
  - The numerator of the new applicable fraction will equal the sum of the value of the nontax portion of the trust and any additional exemption allocated at the time of the event.

Transfers by Nonresident Aliens Subject to GST Tax

- GST Tax applies to transfers by nonresident aliens (NRAs) only with respect to transfers that are also subject to the federal gift tax or the federal estate tax.
  - In the case of transfers in trust consisting only partly of property subject to the gift tax or the estate tax, the numerator of the applicable fraction is equal to the sum of the GST exemption allocated to the trust plus the value of the nontax portion of the trust.
  - The ETIP rules apply to transfers by NRAs only if the property transferred is subsequently included in the transferor's gross estate. Otherwise, the nontax portion of the trust and the applicable fraction are determined as of the date of the initial transfer.

Effective Date of the GST Tax

- In general, the GST tax applies to testamentary transfers after October 22, 1986, and to lifetime transfers after September 25, 1985. Conversely, it does not apply to irrevocable transfers made on or before those dates.
  - Beneficial from a tax standpoint to keep grandfathered trusts in existence as long as possible.
  - One method for doing so is to avoid scheduled terminations by exercising a special power of appointment to appoint the trust property in continuing trust. However, care must be exercised to ensure compliance with the Rule Against Perpetuities.

Planning for the GST Tax

- The primary consideration in planning for the GST tax is to insure that the GST tax exemption is effectively utilized.
- Doing so requires consideration of how the exemption is allocated and the rules relating to when a single trust may be split into (or be treated as) two or more separate trusts.
- Consideration of reverse QTIP for married persons.

The GST Exemption

- GST Exemption Basics
  - Every person has a cumulative lifetime exemption ($11,200,000 for 2018) that may be used to shelter transfers from the GST tax.
  - Critical to understand that no GST tax occurs on distributions from or terminations of interests in a trust having an inclusion ratio of 0.
  - An inclusion ratio of 0 is only achieved when the exemption allocated to the trust equals the GST value of the property transferred to it.
  - Where this is the case, the allocation applies to the trust itself rather than to any particular assets in the trust. As a result, careful use of the exemption allocation can be used to shelter GSTs with values far greater value than the exemption itself.

The GST Exemption

- Allocating the Exemption
  - The GST tax exemption may be allocated to a GST by a transferor, with respect to an inter vivos transfer, or by the transferor’s executor, at any time from the date of the transfer to the due date of the transferor's estate tax return (including extensions granted).
  - The procedures for making the allocation and its impact if made, vary with the type of transfer and the timing of the allocation.

Allocations During the Transferor's Life

- Allocations during the Estate Tax Inclusionary Period
  - Except in the case of a QTIP where a reverse QTIP election is made, an elective or automatic allocation of GST exemption during an ETIP does not become effective until the ETIP terminates.
  - The ETIP, or estate tax inclusionary period, is that period of time after a lifetime transfer when any portion of the transfer would be includible in the gross estate of the transferor or the transferor's spouse other than by reason of IRC § 2035.

Allocations During the Transferor's Life

- Automatic Allocations
  - If a direct skip occurs during the life of the transferor, unused GST exemption is automatically allocated to the transfer. However, the transferor may prevent this by indicating that intent on a Form 709 or by reporting the transfer and paying the GST tax.
  - The same scenario applies in the event of an indirect skip.
  - An indirect skip is any transfer of property (other than a direct skip) to a GST trust that is subject to the gift tax. A GST trust is any trust that could have a GST event with respect to the transferor.

Exceptions to GST Trusts

- The term GST Trust does not include any of the following trusts:
  - A trust which provides that more than 25% of trust principal must be distributed to (or may be withdrawn by) one or more non-skip persons:
    - Before they attain the age of 46; or
    - On or before one or more dates specified in the instrument (or the regulations) that will reasonably be expected to occur before the non-skip persons attain the age of 46.
  - A trust which provides that more than 25% of the trust principal must be distributed to (or may be withdrawn by) one or more non-skip persons who survive the death of a person specified in the instrument by name or class description who is more than 10 years older than the non-skip person(s).
  - A trust which provides that more than 25% of the trust principal must be distributed to the estate(s) of (or is subject to a general power of appointment held by) one or more non-skip persons if one or more of them dies on or before a date or event described above.
  - A trust any portion of which would be included in the gross estate of a non-skip person other than the transferor if such person died immediately after the transfer to the trust
  - A charitable lead annuity trust, a charitable remainder annuity trust, or a charitable remainder unitrust.
  - A charitable lead unitrust the noncharitable beneficiary of which is a non-skip person.

Allocations During the Transferor's Life

- IRC § 2632(c)(5)(A) provides that an individual may elect not to have the automatic allocation rules apply to a GST trust where:
  - They otherwise would apply or to elect to have rules apply; or
  - They would otherwise not apply
- Either election may be made as to a specific transfer, or if preferred, as to all transfers made to a particular trust.

Allocations During the Transferor’s Life

- Retroactive Allocations
  - IRC § 2632(d) provides that a transferor may make a retroactive allocation of his or her unused GST exemption to a previous transfer in trust if:
    - A current or future beneficial interest is held by a non-skip person who is a child, niece, nephew, or child of a first cousin of either the transferor or of the transferor’s current or former spouse; and
    - The non-skip person dies before the transferor.

Allocations after the Death of the Transferor

- A transferor's personal representative may allocate any of the transferor’s unused GST exemption at the transferor’s death.
- However, if the deadline for filing a transferor’s estate tax return passes without the transferor’s personal representative having allocated all of the exemption, any unused exemption is automatically allocated:
  - First to testamentary direct skips; and
  - Then to transfers in trust that have a potential for subsequent GST tax exposure, other than a QTIP trust for which no reverse QTIP election is made.
  - In either case, the allocation is made pro rata on the basis of the values of the nonexempt portion of each transfer.

Single Trust Treated as Separate Trusts

- Where a single trust has more than one transferor, the portion of the trust attributable to each transferor is treated as a separate trust.
- Each share of a single trust that consists substantially of separate and independent shares for different beneficiaries is treated as a separate trust.
- Where a single trust is treated as separate trusts, the inclusion ratio for each such trust is determined separately. However, unless the governing instrument provides otherwise:
  - Additions to and distributions from the trust are allocated pro rata among the separate trusts; and
  - Any automatic allocation of GST exemption is allocated prorata among the separate trusts.

Division of Single Trust into Separate Trusts

- Regulatory Severances
  - Regulations provide that a division of one trust into separate trusts will be recognized for GST tax purposes only if the trust was included in the transferor's gross estate (or was created under the transferor's Will) and:
    - The trust is severed pursuant to a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor; or
    - The governing instrument does not direct or require severance but such severance occurs pursuant to a discretionary authority granted under either the instrument itself or local law; and
      - The resulting trusts are severed on a fractional basis; or
      - In the case of a severance on the basis of a pecuniary amount, the severance by that method is required by the terms of the governing instrument and the pecuniary payment meets the requirements for a pecuniary payment from a trust to be treated as a separate share.

Division of Single Trust into Separate Trusts

- Qualified Severances
  - IRC § 2642(a)(3) provides that a trust severance will be recognized for GST tax purposes if it is a "qualified severance". A qualified severance means the division of a trust and the creation of two or more trusts by any means available under the governing instrument or local law if:
    - the severance is effective under local law;
    - the original trust is divided on a fractional basis;
    - funding of the severed trust commences immediately and is completed within a reasonable time not to exceed 90 days after the date of the severance;
    - the terms of the resulting trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust; and
    - if the trust to be severed has an inclusion ratio of either 0 or 1, the resulting trusts must have the same inclusion ratio as the original trust.

Planning for Married Persons

- Where the combined estates of both spouses are less than a single GST exemption, their estates may be planned without much concern for the GST tax, as automatic GST exemption allocation will eliminate all potential GST exposure.
- However, for marital estates larger than at least one GST exemption, the primary planning objective is to fully utilize the GST exemption of both spouses through the creation of one or more trusts that are totally exempt.

Planning for Married Persons

- Planning for the Death of the Less Wealthy Spouse
  - There is a risk, if the less wealthy spouse is the first to die, that part of that spouse's GST exemption may be wasted if that spouse did not have an estate in excess of the GST exemption amount.
  - Such a risk may be avoided or mitigated by splitting gifts, as well as by making inter-spousal gifts.

Planning for Married Persons

- Planning for the Death of the Less Wealthy Spouse (cont.)
  - In the case of inter-spousal gifting, the gift to the spouse may be made to an inter vivos QTIP trust for which no IRC § 2652(a)(3) election is made
  - A spouse's personal representative will have to allocate the spouse's GST exemption to a trust. The authority to make such an allocation to a trust created by the first spouse should be included in the governing instrument.
  - However, for marital estates larger than at least one GST exemption, the primary planning objective is to fully utilize the GST exemption of both spouses through the creation of one or more trusts that are totally exempt.

Planning for Married Persons

- Integrating the GST Exemption and the Marital Deduction
  - Other effective techniques for fully utilizing the GST exemption include:
    - Using a QTIP trust for the marital gift.
    - Including a clause giving the personal representative the authority to allocate a decedent's GST exemption to any trust for which the decedent is the transferor for GST purposes.
    - Providing the trustee of the QTIP with the authority to split the QTIP trust into two trusts prior to making the estate tax and IRC § 2652(a)(3) QTIP elections.
    - Drafting QTIP trusts to provide that to the extent practical, distributions of principal to the surviving spouse should be made out of trusts whose inclusion ratio is greater than zero.
    - Ensuring that the trusts and surviving spouse's Will provide that any taxes attributable to QTIP property at the death of the spouse be paid by a QTIP trust whose inclusion ratio for GST purposes is greater than zero
    - Including a clause in the QTIP directing where QTIP property is to go in the event the spouse makes a qualified disclaimer of some or all of her interest in the QTIP trust
    - Including a clause in the QTIP directing where QTIP property is to go in the event the spouse makes a qualified disclaimer of some or all of her interest in the QTIP trust

Planning for Married Persons

- Using a Partial Disclaimer as an Alternative
  - An alternative to a reverse QTIP election that may be used is a partial disclaimer of the QTIP trust.
  - Doing so removes the disclaimed property from the strictures of the QTIP trust. Said property could be added to the credit shelter trust. Alternatively, decedent's Will could direct that a separate "disclaimer trust" be created to hold the property.
  - Property disclaimed from the QTIP trust will no longer qualify for the estate tax marital deduction. Thus, a disclaimer should only be used where it is otherwise contemplated that some taxes should be paid at the death of the first spouse.

GST Case Study – John and Mary Client

- John and Mary Client have estates of $30,000,000 and $3,000,000 respectively.
- John has used $400,000 of his applicable exclusion amount for gifts to his children.
- John and Mary have reciprocal estate plans.
- Each leaves $400,000 outright to the survivor with the residue going to a revocable inter vivos trust.
- The trust is also named beneficiary of any insurance policies on the life of the decedent.
- For illustration purposes, all numbers generated assume that John and Mary each die in a year when the applicable exclusion amount is $10,000,000.

GST Case Study – John and Mary Client

- The Marital Deduction Plan
  - John’s pour over Will devises his probate estate to his revocable Living Trust.
  - If Mary predeceases John, the property in the revocable trust is to be held in continuing trust for John's surviving descendants from time to time living.
  - If Mary survives John, the trust contains a formula gift under which John’s $29,600,000 trust is divided into a $9,600,000 Family Trust and a $20,000,000 Marital Trust.
  - It is anticipated that both trusts will continue after the death of John and Mary for the benefit of their descendants from time to time living.

GST Case Study – John and Mary Client

- The Marital Deduction Plan (cont.)

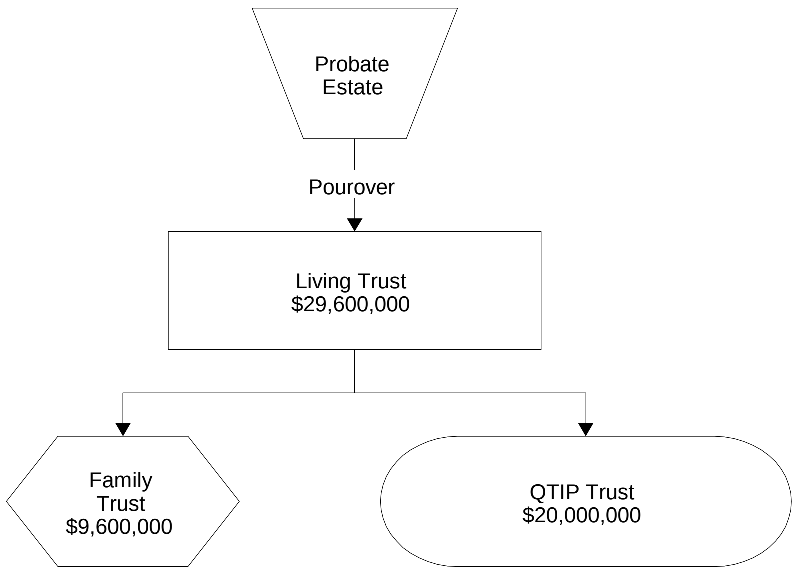

Fig. 1 At death, John's revocable trust splits into marital and nonmarital shares. John has used $400,000 of his applicable exclusion amount for gifts to children.

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GST Case Study – John and Mary Client

- Ensuring Recognition of the Marital/Family Share Split
  - The initial concern with this plan is whether the split of the revocable trust into two trusts will be honored for GST tax purposes. If it isn't, an automatic or directed allocation of $9,600,000 of exemption to the Family Trust will not result in a zero inclusion ratio since the Family and QTIP trusts would be treated as a single trust for GST purposes.
  - Severance into family and marital shares must be done in accordance with the regulatory requirements for when a split of a trust included in the transferor's gross estate will be recognized for GST purposes.
  - This requires that pecuniary gifts carry appropriate interest under applicable state law or the terms of the governing instrument. Thus, the instrument should be drafted to insure compliance with the appropriate interest requirement.

GST Case Study – John and Mary Client

- Reverse QTIP Election
  - Before filing John's estate tax return, his personal representative must decide how to allocate his GST exemption. Two approaches are considered: One that allocates exemption to the Family trust, and one that does not.
  - Under both options, John's personal representative will split his QTIP Eligible trust into an Exempt QTIP trust and a Nonexempt QTIP trust.
  - Using the reverse QTIP election to make John the transferor, John's personal representative will then allocate John's GST exemption to the Exempt QTIP trust giving it an inclusion ratio of zero.

GST Case Study – John and Mary Client

- Reverse QTIP Election (cont.)
  - Option 1 – Nonexempt Family Trust
    - Under the first approach, John's personal representative splits the trust so that the Exempt QTIP trust will be sufficiently large to use all of John's GST exemption.
    - Assuming no exemption has been used previously, this will require a trust of $10,000,000.
    - This approach leaves the property in the Family trust available for the use of non-skip persons without wasting John's GST exemption.
      - Particularly useful if John's spouse was not a US citizen. In that case, it may be better to use the Family trust to provide for the spouse during life because distributions of principal from either of the QTIP trusts would be subject to a QDOT-estate tax

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GST Case Study – John and Mary Client

- Reverse QTIP Election (cont.)
  - Option 1 – Nonexempt Family Trust

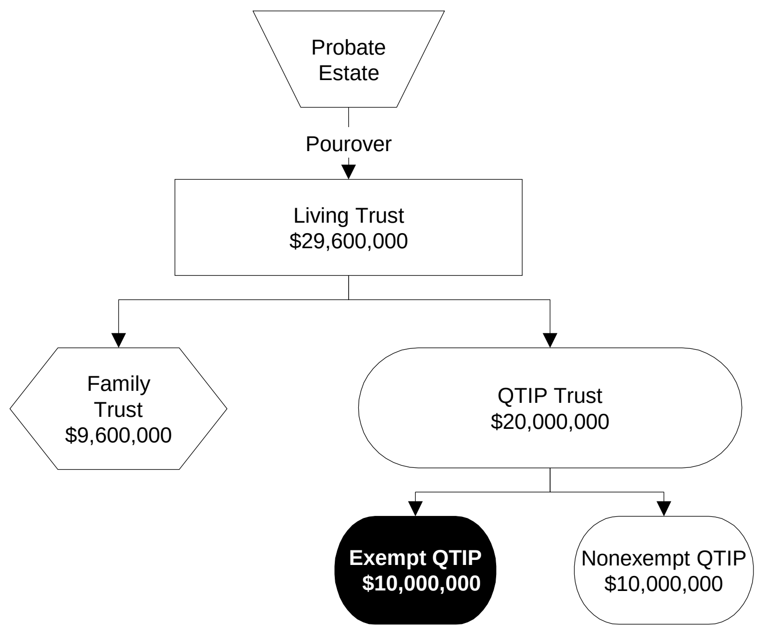

Fig. 2 Reverse QTIP with no GST exemption allocated to Family trust

GST Case Study – John and Mary Client

- Reverse QTIP Election (cont.)
  - Option 2 – Exempt Family Trust
    - Under the second approach, $9,600,000 of John's $10,000,000 exemption would be allocated to the Family trust and the reverse QTIP election would be used to create an Exempt QTIP trust equal to the remaining $400,000 of John's exemption.

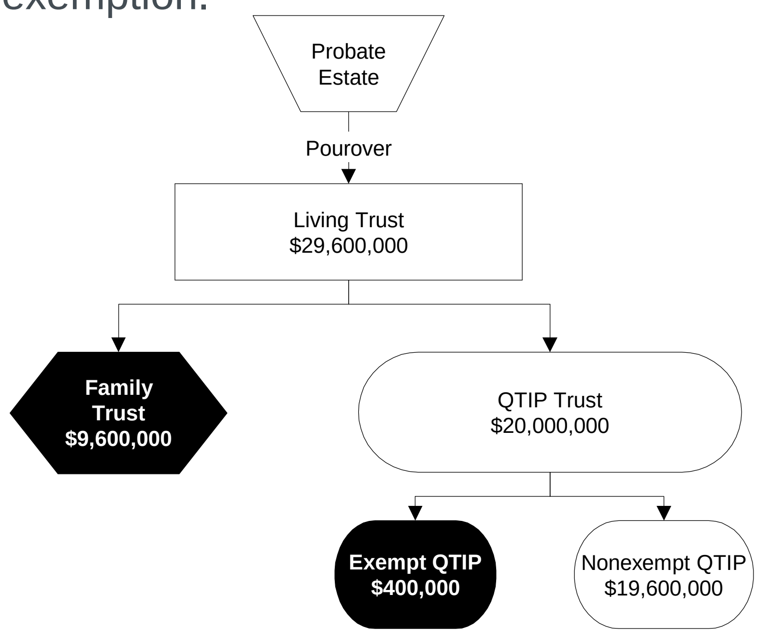

Fig. 3 Reverse QTIP with exempt Family trust

GST Case Study – John and Mary Client

- Reverse QTIP Election (cont.)
  - Between the two approaches presented for using John's GST exemption, the second will generally be preferable because:
    - Distributions to skip persons from the Family Trust during the life of the surviving spouse may be necessary or desirable. If the Family Trust is exempt, those distributions may be made tax free.
    - Exempting the Family Trust makes greater use of the exemption because both the principal and the trust income can be used for skip persons. The income of a QTIP trust must be distributed to the surviving spouse

GST Case Study – John and Mary Client

- Unification of GST Exemption and Unified Credit
  - Beginning in 2004, the amount of the GST exemption has been tied to the amount of the estate tax applicable exclusion amount. In some cases, this leads to the value of the Family Trust being exactly equal the amount of GST exemption, making it unnecessary to make any reverse QTIP election to avoid wasting GST exemption.
    - In some cases, however, taxable gifts to non-skip persons during the decedent's life may consume unified credit resulting in a Family Trust that is smaller than the remaining GST exemption.
    - In addition, it is possible for the Family Trust to exceed the remaining GST exemption. This could occur, for example, if the decedent allocated GST exemption to nontaxable gifts to a Crummey trust created during life.
      - In that event, it may be necessary to split the Family Trust in anticipation of an allocation of GST exemption at the decedent's death.

GST Case Study – John and Mary Client

- Formulating the Split
  - Since a reverse QTIP election may only be made with respect to all assets under trust, instead of a portion of a trust, if the chosen plan is to be properly implemented, the QTIP trust must be severed into exempt and nonexempt portions prior to the making of the reverse QTIP election.
  - It is advisable for the document to include a provision directing the severance of any trust where the GST exemption to be allocated to the trust exceeds the value of the property in the trust.
  - One advantage of providing for the severance prior to allocation of the GST Exemption is the ability to also provide for whether the severance will be effectuated on a fractional or pecuniary basis.
  - It is critical that the instrument provide for a valid funding method for the severance. In absence of a valid funding method, the severance will not be recognized for GST tax purposes and the allocation of exemption to the "exempt" portion will not result in a 0 inclusion ratio.

GST Case Study – John and Mary Client

- Integrating Mary’s Exemption
  - At Mary's death, her revocable inter vivos trust will begin with a balance of $3,400,000 representing the $3,000,000 with which she started plus the $400,000 outright bequest she received from John.
  - At that point, it may be necessary or advisable for Mary’s personal representative to allocate some of her GST exemption to John’s nonexempt QTIP trust.

GST Case Study – John and Mary Client

- Integrating Mary's Exemption (cont.)

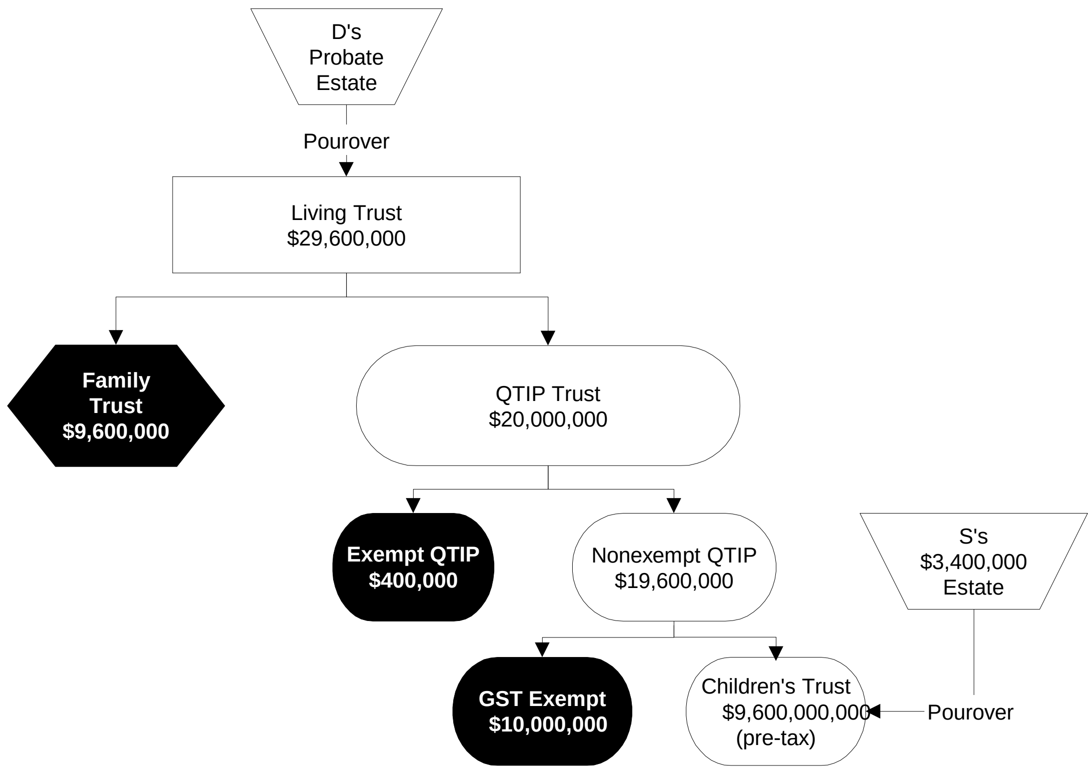

Fig. 4 At Mary's death before taxes are apportioned

Proskauer

GST Case Study – John and Mary Client

- Planning for Mary’s Taxes
  - Upon her death, Mary will be taxable on her own estate and all of the bottom line trusts in Fig. 4 above except for the Family Trust. She will have an estate of $23,400,000 on which she will owe taxes of $4,690,000, none of which is attributable (on a marginal basis) to Mary’s own property.

Proskauer

GST Case Study – John and Mary Client

- Mary's Planning
  - Unless Mary waives the right of contribution provided in IRC § 2207A, her estate can seek contribution for the taxes attributable to John's QTIP trusts from the trustees of those trusts.
  - So Mary's Will should expressly instruct her personal representative to exercise the right of contribution.
  - Mary's Will should also provide that any taxes attributable to her own property should be paid from the nonexempt portion of her estate.

GST Case Study – John and Mary Client

- John's Planning
  - John's plan can facilitate Mary's right of contribution for the taxes attributable to his QTIP trusts by directing the trustee of the trusts to either pay the taxes directly or to distribute property to Mary's personal representative for the purpose of paying the taxes.
  - To avoid wasting GST exemption, however, John should direct that the taxes are to be paid from his nonexempt QTIP trust rather than from one to which his exemption has been allocated.

GST Case Study – John and Mary Client

- Because it is generally impossible to predict which spouse will die first, the following clauses should appear in both spouses' Wills and / or revocable trusts:
  - Direction to Sever Nonexempt QTIP
  - Authority to Allocate GST Exemption to Trust Created by Spouse
  - Establishment of the order in which different trusts make discretionary distributions
  - Distributions to non-spouse beneficiaries to be made from nonexempt trust, unless such distribution would trigger GST tax
  - Merger of Similar Trusts

GST Case Study – John and Mary Client

- Other Planning Considerations
  - Minimizing Order of Death Risk
    - This risk can be eliminated by having the wealthy spouse create an inter vivos QTIP trust for the less wealthy spouse.
    - As long as no reverse QTIP election is made, this will allow the less wealthy spouse to allocate exemption to the QTIP trust in the event he or she were to die first.
  - Integrating a Partial QTIP Election
    - This can be useful if, for instance, Mary dies shortly after John, in which case combined taxes can be reduced if John’s estate eschews the marital deduction in favor of the IRC § 2013 credit for prior transfers.
  - Integrating a Partial Disclaimer
    - If the decision to utilize the IRC § 2013 credit is made within 9 months of John's death, a partial disclaimer may be used instead of a partial QTIP election.

Unmarried Persons

- Where an unmarried person's estate is certain to be less than the GST exemption, the estate may be planned without any consideration for the GST.
- In such a case, any trusts created are not likely to last for several generations and the automatic GST exemption allocation rules will exempt any that do.

Unmarried Persons

- In the case of larger estates, however, a significant concern is planning for the effective use of the GST exemption. The considerations will be similar to those facing Mary in the preceding case study, including:
- The estate should be divided into two shares: an exempt share and a nonexempt share.
- Such division may be effectuated by way of formula, although much care must be exercised in drafting an appropriate formula.
- Such formula must take into account the possibility that the decedent may have made inter vivos gifts to which she or her personal representative will allocate some of the GST exemption.

Unmarried Persons

- In selecting between a pecuniary and fractional share formula, keep in mind that the funding of a pecuniary bequest is a sale or exchange. All things considered, the fractional share formula may be the best choice. There is no gain on funding and post death appreciation and depreciation are shared ratably by the exempt and nonexempt portions.
- If a fractional share formula is used, the instrument should authorize the executor or trustee to select the assets to be distributed to the exempt and nonexempt funds, subject to the requirement that the fiduciary select assets that are fairly representative of the net appreciation of depreciation of the fund as a whole.

Generation-Skipping Transfer Tax:
Planning Considerations for 2018 and Beyond

The Florida Bar Real Property Probate and Trust Law Section

2018 Wills, Trusts & Estates Certification and Practice Review Course

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