

"Generation-Sharing" - Tax Planning That Benefits the Entire Family

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Historically, only the very wealthy engaged in generation-skipping estate planning. Families and individuals who do not think of themselves as "very wealthy," however, also can reap significant benefits from this type of planning. Some might hesitate based on the incorrect assumption that assets must pass directly to grandchildren to the exclusion of children. Proper planning, however, can allow an individual or family to achieve the desired tax benefits of generation-skipping planning and provide children with access to and control over their shares of the estate. Such planning actually results in skipping tax for a generation or more and thus is more properly called "generation-sharing."

Background

Generally speaking, the Internal Revenue Code imposes a transfer tax at each family generation. If an asset passes from a parent to a child and then from the child to a grandchild, estate tax is imposed in the estates of both the parents and the child. If a parent passes the asset directly or indirectly to the grandchild to bypass the child's estate, this transfer avoids estate tax in the estate of the child but potentially is subject to another transfer tax known as the generation-skipping transfer tax ("GST Tax"). The GST Tax is particularly onerous because it is imposed in addition to the estate tax incurred in the parent's estate and is assessed at a flat 45% rate. It also applies to lifetime gifts to grandchildren. As a result, when the GST Tax applies, it may result in more than 75% of the assets passing to the grandchild being consumed in gift or estate tax and GST tax.

Fortunately, the Internal Revenue Code provides each individual with an amount known as the "GST exemption" that can pass to grandchildren without GST Tax impact. Currently, \$10,000,000 (indexed for inflation to \$12,060,000 in 2022) can be transferred to a grandchild without GST tax. This amount is set to revert back to a \$5,000,000 base (still indexed to inflation) in the year 2026. With index and without change to the law, the GST exemption likely will be approximately \$6,000,000 in that year.

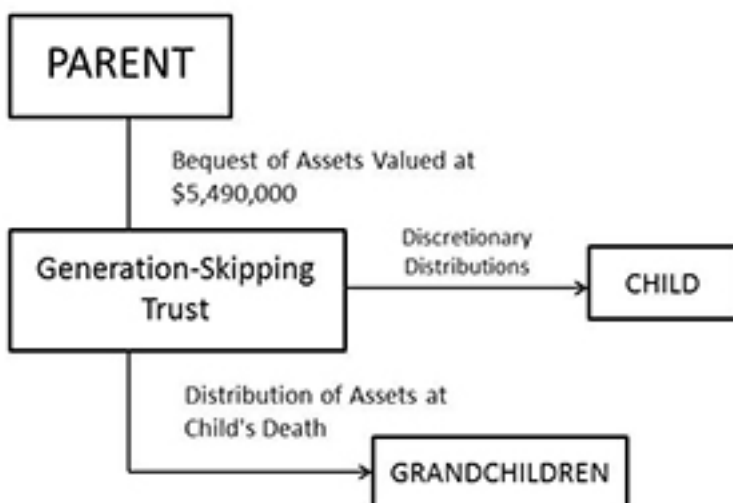
The GST exemption can be used at death or during life. Thus, in 2022, each individual may engage in generation-skipping transfers of up to \$12,060,000 without subjecting those assets to the GST Tax. With proper planning, a married couple jointly may make up to \$24,120,000 of such transfers.

Testamentary Planning

For transfers occurring after the death of an individual, good tax planning is essential. To help ensure that assets effectively and efficiently are insulated from taxation in successive generations, it is crucial that an individual's GST exemption be intentionally deployed. A smart estate plan will ensure that families receive the most GST exemption "bang" for their buck, taking care not to misapply it to assets passing to other non-generation-skipping recipients.

The simplest use of the GST exemption is to make a direct gift at death to grandchildren. Many individuals, however, do not want to "skip" their children completely. Consequently, it is common for a parent first to place assets of their estate into a generation-sharing trust that benefits the children during their lifetimes and then, ultimately, the grandchildren or more remote generations of the family. Under current law, the first \$12,060,000 (or the first \$24,120,000, for a married couple) of those assets placed in trust are exempt both from GST Tax at the parents' estate level and from estate taxes at the lower generations' level.

If a parent so desires, each child could be the trustee of his or her own generation-sharing trust. The child then could control both the investments of and distributions from the trust, including distributions to himself or herself as needed. These generation-sharing trusts also would act as a shield against potential creditors of the child, whether stemming from a lawsuit or divorce. Since this planning does not deprive the children's generation of control over or access to the funds placed in the generation-sharing trust, there is little or no disadvantage to incorporating such planning into an individual's standard estate plan.



Lifetime Transfers

Lifetime gifts are perhaps the ideal use of GST exemption, especially when the exemption is at such historical highs. These gifts may take the form of transfers to trusts that, like the testamentary trusts summarized above, are created first to benefit the donor's children during their lifetimes. The assets later can pass after that child's death in further trust for the child's own children (the grantor's grandchildren) or for more remote issue. Once the gift is made and the donor's GST exemption is applied to this type of trust, the trust will avoid estate tax or GST Tax for the remainder of the trust's existence. Thus, all post-gift income and appreciation on the gifted assets will escape further transfer

taxes, compounding the initial benefits of the parent's tax planning.

Dynasty Trusts

Several states, including Alaska and Delaware, fully repealed laws that limit the length of time a trust may last. North Carolina also has repealed its similar law, thus eliminating the requirement that trust assets must be finally distributed and again taxable within a certain time period. Simply put, as long as a trustee of a generation-sharing trust is not denied the power to sell or distribute the trust assets for longer than a certain length of time, North Carolina law will recognize and permit certain so-called "Dynasty Trusts." Where recognized, Dynasty Trusts can continue in perpetuity, thereby maximizing the utility of the GST exemption and avoiding estate tax for multiple generations.

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