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GENERATION SKIPPING PLANNING

Clients who engage in long term estate tax planning often look at the impact of their plan upon successive generations of beneficiaries. This generational focus is due to the fact that the estate tax is confiscatory when applied repetitively to the estates of successive generations.

The Tax Problem that Prompts Generational Skips

The federal gift tax and estate tax provisions are part of a "unified" transfer tax system. For property in excess of that sheltered by the *unified credit,* federal transfer tax rates are now 45%. The state estate tax may raise the total percentage to 50% or more.

Although the unified credit is substantial—the first $2 million of property is presently sheltered from the estate tax—it is not adequate to shelter the assets of many individuals from transfer tax. For those who transfer assets above the shelter threshold, one-half of each dollar transferred is lost to tax.

If a 50% estate tax is payable on a devise of $4 million to a testator's child, the child receives a net $2 million. If later, in the child's estate, another 50% estate tax is payable on a devise of the $2 million sum to the next generation, then the grandchild receives only $1 million. The original sum of $4 million lost 75% of its value on the way to the grandchild. Of course it may have appreciated during the journey, but that appreciation would also have occurred if no tax had been payable.

For this reason, clients with significant assets have often engaged in generation skipping transfer planning. One generation skipping technique is simply to "skip over" a generation and make a gift directly to grandchildren.

A second generation skipping technique is to place assets in a trust for multiple generations. Such a trust could provide discretionary payments to the children during their lifetime, and then to the grandchildren for their lifetime, and finally a pay out to the great-grandchildren.

Congressional Response to GST planning

As more and more clients used generation skipping techniques in their estate plans to preserve wealth for future generations, Congress determined that it was important to find a way to discourage such planning. The solution was a new tax known as the generation skipping transfer (GST) tax. This tax is *in addition* to the estate tax. It comes with its own exemption amount, which is equal in amount to the property sheltered by the *unified credit.* The exclusion is *per donor* or *per testator*, so married persons may combine their GST exemption amounts to double the amount of property that may be given to a *skip* generation without incurring GST tax.

Review Your Prior Planning

Those who have incorporated GST tax planning into prior documents may want to review those documents to see if they still accomplish the intended result. The GST tax exemption amount has been a moving target in recent years. This area merits a periodic review. Our estate planning lawyers are prepared to meet with you to help you evaluate your planning choices.