

GENERATION-SKIPPING TRANSFER TAX

DEFINITION

The generation-skipping transfer tax (GSTT) is a federal tax imposed on transfers of assets, either by gift or inheritance, to a beneficiary who is two or more generations below that of the person making the gift. With this tax, the federal government ensures that taxes are paid when assets are transferred at each generation or when excess amounts are placed in a trust and is incurred when there is a transfer of assets to a beneficiary who is more than 37.5 years younger than the donor.

HOW IT WORKS

GENERATION SKIPPING TRANSFER (GST)

When an individual dies, their assets are subject to an estate tax. If a couple were to pass their assets to their children, those assets would first be reduced by the amount of the estate tax. If the assets were then passed to the grandchildren upon the children's death, those assets would be reduced again by the amount of the estate tax. One might think it possible to then skip a level of taxation through a generation skipping transfer. This refers to the transfer of assets to a person who is two or more generations below that of the person granting the gift. The person giving the gift is referred to as the transferor and the recipient is known as the skip person. A grandchild is usually the skip person, but it does not have to be a family member. Any individual other than a spouse or ex-spouse is eligible to receive a generation skipping transfer as long as they are at least 37.5 years younger than the transferor.

GSTT AMOUNT

A generation-skipping transfer tax is only due when a skip person receives amounts in excess of the federal estate tax exemption. Any assets transferred in excess of this exemption are subject to the highest estate tax rate. In 2015, this rate is 40%.

AVOIDANCE

While not always easy, there are ways to avoid the GSTT:

- Exemptions – Most beneficiaries will avoid the GSTT because transfers will be less than the estate tax credit provided by the government. The exemption for 2015 is \$5.43 million, and married couples can double these amounts to maximize their exemption.
- Generation-Skipping Trust – In this type of trust, the beneficiary does not have access to the trust's assets, which allows the transfer to escape the GSTT. However, he or she does have access to the income it generates.

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