

GST and Form 709: Fundamentals of Generation-Skipping Transfer Tax Reporting

THURSDAY, DECEMBER 20, 2018, 1:00-2:50 pm Eastern

IMPORTANT INFORMATION FOR THE LIVE PROGRAM

This program is approved for 2 CPE credit hours. To earn credit you must:

- **Participate in the program on your own computer connection (no sharing)** - if you need to register additional people, please call customer service at 1-800-926-7926 ext.1 (or 404-881-1141 ext. 1). Strafford accepts American Express, Visa, MasterCard, Discover.
- Listen on-line via your computer speakers.
- Respond to five prompts during the program plus a single verification code.
- To earn full credit, you must remain connected for the entire program.

WHO TO CONTACT DURING THE LIVE EVENT

For Additional Registrations:

-Call Strafford Customer Service 1-800-926-7926 x1 (or 404-881-1141 x1)

For Assistance During the Live Program:

-On the web, use the chat box at the bottom left of the screen

If you get disconnected during the program, you can simply log in using your original instructions and PIN.

Tips for Optimal Quality

FOR LIVE PROGRAM ONLY

Sound Quality

When listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, please e-mail sound@straffordpub.com immediately so we can address the problem.

GST and Form 709: Fundamentals of Generation-Skipping Transfer Tax Reporting

THURSDAY, DECEMBER 20, 2018

Daniel L. Daniels, Partner
Wiggin and Dana, Greenwich, Conn.
ddaniels@wiggin.com

Christiana M. Lazo, Counsel
Ropes & Gray, New York
christiana.lazo@ropesgray.com

Notice

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY THE SPEAKERS' FIRMS TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

WIGGIN AND DANA

Counsellors at Law

GST Fundamentals



Daniel L. Daniels is a partner in Wiggin and Dana LLP. Dan divides his time between the firm's Greenwich and New York offices. Dan focuses his practice representing business owners, corporate executives and other wealthy individuals and their families. Dan is included on *Worth* magazine's list of the top 100 trust lawyers in the United States. He is a Fellow of the American College of Trust and Estate Counsel and is listed in *The Best Lawyers in America*. Dan received his A.B. degree, *summa cum laude*, from Dartmouth College in 1984 and his J.D., *cum laude*, from Harvard Law School in 1987.

Wiggin and Dana LLP is a full-service law firm of approximately 135 lawyers with six offices in the Northeast, including Greenwich, Stamford, New Haven and Hartford, Connecticut, as well as New York and Philadelphia. Since its founding in 1934, the Firm has served the legal needs of entrepreneurs, corporate executives and other wealthy individuals and their families, as well as charitable and educational institutions, emerging companies, middle market business organizations and Fortune 500 corporations.

Introduction to the GST Tax

- Purpose of Tax
- Need to learn GST “vocabulary”
 - Skip person and non-skip person
 - Taxable Termination
 - Direct Skip
 - Taxable Distribution
- Tax Rate
 - Inclusion ratio
 - GST exemption

“Name That Transfer”

- T makes a gift of property to his grandchild, GC
- T transfers property to a trust to pay income his child, C, for life, with the remainder to pass to C’s children
- T makes a gift to a sprinkle trust for the benefit of his children and grandchildren
- Trustee of that trust makes distributions to grandchildren

“Name That Transfer”

- T makes a gift of property to his grandchild, GC – *Direct Skip*
- T transfers property to a trust to pay income his child, C, for life, with the remainder to pass to C’s children
- T makes a gift to a sprinkle trust for the benefit of his children and grandchildren
- Trustee of that trust makes distributions to grandchildren

“Name That Transfer”

- T makes a gift of property to his grandchild, GC
- T transfers property to a trust to pay income his child, C, for life, with the remainder to pass to C’s children – *Initial transfer not a GST event; C’s death is a taxable termination*
- T makes a gift to a sprinkle trust for the benefit of his children and grandchildren
- Trustee of that trust makes distributions to grandchildren

“Name That Transfer”

- T makes a gift of property to his grandchild, GC
- T transfers property to a trust to pay income his child, C, for life, with the remainder to pass to C’s children
- T makes a gift to a sprinkle trust for the benefit of his children and grandchildren – *No GST*
- Trustee of that trust makes distributions to grandchildren

“Name That Transfer”

- T makes a gift of property to his grandchild, GC
- T transfers property to a trust to pay income his child, C, for life, with the remainder to pass to C’s children
- T makes a gift to a sprinkle trust for the benefit of his children and grandchildren
- Trustee of that trust makes distributions to grandchildren – *Taxable Distribution*

“Name that Transfer”- Bonus Questions (Hint: Know the transferor “move down” rule)

- T makes a gift to a sprinkle trust for the benefit of his grandchildren and great grandchildren
- Trustee later makes a distribution from the trust to a grandchild
- Trustee later makes a distribution from the trust to a great grandchild

“Name that Transfer”- Bonus Questions (Hint: Know the transferor “move down” rule)

- T makes a gift to a sprinkle trust for the benefit of his grandchildren and great grandchildren –
Direct Skip
- Trustee later makes a distribution from the trust to a grandchild
- Trustee later makes a distribution from the trust to a great grandchild

“Name that Transfer”- Bonus Questions (Hint: Know the transferor “move down” rule)

- T makes a gift to a sprinkle trust for the benefit of his grandchildren and great grandchildren –
Direct Skip
- Trustee later makes a distribution from the trust to a grandchild – *No GST (Move-down rule)*
- Trustee later makes a distribution from the trust to a great grandchild

“Name that Transfer”- Bonus Questions (Hint: Know the transferor “move down” rule)

- T makes a gift to a sprinkle trust for the benefit of his grandchildren and great grandchildren –
Direct Skip
- Trustee later makes a distribution from the trust to a grandchild – *No GST (Move Down Rule)*
- Trustee later makes a distribution from the trust to a great grandchild – *Taxable Distribution*

Transferor

- In general
 - Transferor is decedent for property transferred at death
 - Transferor is donor for property transferred by gift
- Why do we care who is the transferor?
 - Only the transferor can allocate GST exemption
 - Identity of transferor provides starting point for determining whether a transferee is a skip person or not
 - The “Reverse” QTIP election
- Identity of transferor can change over time
 - Transferor is person who transfers property and with respect to whom the property was most recently subject to estate or gift tax

Interest

- Why do we care about the term “interest”?
 - Integral part of the definition of certain generation skipping events
 - A taxable termination occurs when there is
 - A termination of an “interest” in property held in trust
 - Unless immediately thereafter a non-skip person has an **interest** in the property
 - A transfer to a trust will be not be a direct skip as long as a non-skip person has an **interest** in the trust

Interest – Special Rule for Charities

- A charity may have an interest in a trust for GST tax purposes in two situations:
 - Charity has a present non-discretionary right to receive income or principal from the trust
 - Charity is the remainderman of a CRAT, CRUT or pooled income fund
 - Example: T transfers property to a CRT to pay a unitrust percentage to GC for life, remainder to charity. T's transfer is not a direct skip. Distributions to GC are taxable distributions.

Skip Person/Non-Skip Person

- A skip person may be a natural person or a trust
- A natural person is a skip person if she is assigned to the second or lower generation below the transferor
- A trust is a skip person if either:
 - all interests in the trust are held by skip persons; or
 - no person holds an interest in the trust and at no time after the transfer may a distribution be made to a non-skip person
- A non-skip person is a natural person or trust that is not a skip

Skip Person Quiz

- T creates a trust naming his grandchild, GC, as the only permissible income and principal beneficiary, remainder to great-grandchildren
- T creates a trust for GC. Trustee directed to accumulate income until GC is 21 then pay income to GC for life, remainder to GGC
- T creates a sprinkle trust for C and GC for the life of C, remainder to GC

Skip Person Quiz

- T creates a trust naming his grandchild, GC, as the only permissible income and principal beneficiary, remainder to great-grandchildren - **Skip Person**
- T creates a trust for GC. Trustee directed to accumulate income until GC is 21 then pay income to GC for life, remainder to GGC
- T creates a sprinkle trust for C and GC for the life of C, remainder to GC

Skip Person Quiz

- T creates a trust naming his grandchild, GC, as the only permissible income and principal beneficiary, remainder to great-grandchildren
- T creates a trust for GC. Trustee directed to accumulate income until GC is 21 then pay income to GC for life, remainder to GGC – **Skip Person**
- T creates a sprinkle trust for C and GC for the life of C, remainder to GC

Skip Person Quiz

- T creates a trust naming his grandchild, GC, as the only permissible income and principal beneficiary, remainder to great-grandchildren
- T creates a trust for GC. Trustee directed to accumulate income until GC is 21 then pay income to GC for life, remainder to GGC
- T creates a sprinkle trust for C and GC for the life of C, remainder to GC – **Skip Person**

Skip Person Quiz – Advanced Questions

- T creates a CRT to pay an annuity interest to GC, remainder to charity
- T creates a sprinkle trust for C and his five GCs for the life of C, remainder to GC; Crummey rights are given to all six beneficiaries

Skip Person Quiz – Advanced Questions

- T creates a CRT to pay an annuity interest to GC, remainder to charity – **Nonskip Person**
- T creates a sprinkle trust for C and his five GCs for the life of C, remainder to GC; Crummey rights are given to all six beneficiaries

Skip Person Quiz – Advanced Questions

- T creates a CRT to pay an annuity interest to GC, remainder to charity
- T creates a sprinkle trust for C and his five GCs for the life of C, remainder to GC; Crummey rights are given to all six beneficiaries
 - Nonskip Person
 - Crummey rights are ignored

Contact Information

Daniel L. Daniels
Wiggin and Dana LLP
30 Milbank Avenue
Greenwich, CT 06830
203.363.7665
ddaniels@wiggin.com
www.wiggin.com

III. GST Exemption and Allocation Rules

- GST Exemption amount equals the estate tax exemption (basic exclusion amount)
 - \$11.4 million in 2019, but sunsets 12/31/25
- *May* allocate GST Exemption to reduce the rate of tax on a generation-skipping transfer
 - Rate can be reduced to 0 if sufficient GST Exemption allocated

III. GST Exemption and Allocation Rules

Tax rate on a generation-skipping transfer =
Maximum federal estate tax rate
X
Inclusion Ratio

III. GST Exemption and Allocation Rules

- **Inclusion Ratio**
 - Practically, proportion of a trust subject to GSTT
 - Technically, 1- Applicable Fraction
- **Applicable Fraction**
 - Numerator: Amount of GST Exemption allocated to trust/direct skip
 - Denominator: Value of property transferred (with some reductions)

III. GST Exemption and Allocation Rules

- In 2017, T gives \$500,000 to GC and allocates \$300,000 of her GST Exemption to gift.
- Applicable fraction =
 - Numerator (\$300,000)/Denominator (\$500,000) = $3/5$
- Inclusion ratio =
 - $1 - 3/5 = 2/5$
- GST applicable rate of tax =
 - $40\% \times 2/5 = 16\%$
- GST tax on T's direct skip =
 - $\$500,000 \times 16\% = \$80,000$

III. GST Exemption and Allocation Rules

- Only a few events will change an inclusion ratio:
 - Changes to trust principal
 - Allocation of additional GST Exemption
 - Payment of GSTT from trust

III. GST Exemption and Allocation Rules

- Planning goal is to have an inclusion ratio of either zero or one
- Allocation of GST Exemption can achieve that goal
- Qualified severances may be used to correct

III. GST Exemption and Allocation Rules

- Practice pointer: Effective date of any allocation of GST Exemption critical –
Determines the value of property transferred for purposes of calculating the Applicable Fraction

III. GST Exemption and Allocation Rules

- Allocation of GST Exemption at Death:
 - Manual allocations made on a timely filed FET return, effective as of date of death
 - Manual allocations not made on a timely filed FET return, generally not effective → automatic allocation rules apply
 - Automatic allocation rules:
 - First, to direct skips occurring at death
 - Second, to trusts from which generation-skipping transfer might occur

III. GST Exemption and Allocation Rules

- Allocation of GST Exemption During Life:
 - Automatic Allocation rules apply to any lifetime direct skip and to “indirect skips”
 - **Indirect skip** is a transfer of property that is:
 - Not a direct skip
 - Subject to gift tax
 - Made to a GST Trust
 - **GST Trust** is any trust that could have a generation-skipping transfer, BUT subject to 6 exceptions:

III. GST Exemption and Allocation Rules

- **Exceptions to GST Trust Definition:**
 - More than 25% of corpus must be distributed or may be withdrawn by non-skip persons before they attain age 46
 - More than 25% of corpus must be distributed or may be withdrawn by non-skip persons who are living on the date of death of a person identified in the trust agreement who is more than 10 years older than such non-skip persons
 - Under the trust agreement, if a non-skip person dies on or before an event described in Exception 1 or Exception 2, more than 25% of the trust corpus must be distributed to such person's estate is subject to a GPA held by such person
 - The trust is a trust any portion of which would be included in the estate of a non-skip person if such person died immediately after the transfer to the trust
 - The trust is a CLAT, CRAT or CRUT
 - The trust is a CLUT and is required to pay the remainder interest to a non-skip person if the person is alive at the termination of the lead interest

III. GST Exemption and Allocation Rules

- Practice pointer:
 - Elect out of automatic allocation rules and affirmatively allocate GST Exemption when desired
 - **Many** common trusts will be ‘pitfalls’

III. GST Exemption and Allocation Rules

- Timing of Manual Allocations During Life:
 - Effective date depends on whether timely or not
 - If timely, then relates back to date of gift
 - If late, then relates back to date return actually was filed, with one exception:
 - May elect to value trust property on 1st day of month on which election made (unless life insurance and it has matured)

III. GST Exemption and Allocation Rules

- ETIP and Spousal ETIP prevent allocation of GST Exemption (or, rather, delay effective date until end of the ETIP/Spousal ETIP)
 - Generally will not want to allocate GST Exemption to ETIP/Spousal ETIP
 - Both ETIP and Spousal ETIP = all or nothing proposition. Any \$1 of inclusion → ETIP/Spousal ETIP applies to 100%
 - Two small exceptions to spousal ETIP
 - QTIP for which made reverse QTIP election
 - **Withdrawal power** limited to 5&5 and ends within 60 days

III. GST Exemption and Allocation Rules

- **Late Allocation Relief:**
 - Narrow ‘retroactive allocation’ rule under IRC Section 2632(d)
 - Notice 2001-50 and proposed regulations under IRC Section 2642(g)

III. GST Exemption and Allocation Rules

- **Select Exclusions:**
 - Annual exclusion
 - Gift qualifying for annual exclusion, outright to a skip person individual, has a 0 inclusion ratio
 - Special rule for trusts:
 - Must be for the benefit of a single individual, and no distribution may be made to anyone other than that individual during individual's lifetime
 - Assets must be includible in individual's gross estate
 - Medical/Education exclusion

IV. Intro to Form 709

- Report gifts in appropriate Part of Schedule A:
 - Part 1 – Gifts Subject Only to Gift Tax
 - Part 2 – Direct Skips
 - Direct skips subject to both gift tax and GSTT
 - Part 3 – Indirect Skips
 - Gifts to trusts currently subject to gift tax and may later be subject to GSTT

IV. Intro to Form 709

- **Automatic Allocation Rules**
 - For a direct skip, opt out by checking column c on Schedule A, part 2 and pay the GSTT (or simply pay GSTT on a timely filed Form 709)
 - For an indirect skip, opt out by checking column c on Schedule A, part 2 or 3 and attach a statement with the explanation:
 - Opt out once
 - Opt out forever
 - Opt in

• Election Out Statement should:

- Identify the trust by its name and tax ID number (unless the trust is not in existence at the time of the election out);
- Identify the transfers to which the election out shall apply;
- State that the taxpayer is electing out of the automatic allocation rules with respect to the transfer(s) described therein.
- Identify any prior year transfer subject to an ETIP.
- Unless the election out is made for all transfers made to the trust in the current year and/or in all future transfers to which the election out is to apply, the transfers must be specifically described or otherwise identified in the election out statement.



Christiana M. Lazo
Ropes & Gray LLP
1211 Avenue of the Americas
New York, New York 10036
Christiana.lazo@ropesgray.com
212-596-9506