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The Generation-Skipping Transfer Tax: Basics of GST Planning and Allocation of the GST Exemption

I. What is the GSTT Tax – a Brief Overview.

The current version of the generation-skipping transfer tax (GSTT) was enacted in 1986. *26 U.S. Code § 2601 et. seq.* (All statutory references in the outline are to sections of 26 US Code.) It is a tax on transfers of property that skip a generation; the tax is separate from but related to the federal estate tax. In Congress' view, the purpose of the tax was to address the perceived abuse by wealthy families who created dynasty trusts intended to pass down wealth over multiple generations without payment of estate taxes at each generation. Use of such dynasty trusts (or GST trusts) has been facilitated by repeal or extension in many states of the rule against perpetuities, allowing trusts to last many generations longer than at traditional common law.

Congress' solution was to limit the amount that an individual can transfer to GST trusts and/or to persons more than one generation below the donor. The limitation is referred to as the "GST exemption." Since 2003, the GST exemption amount has been tied to the estate tax exclusion, and similarly, it applies to transfers during lifetime and at death. In 2024, the GST exemption is \$13,610,000. In order to avoid payment of the GSTT, the transferor (or their personal representative) must allocate the transferor's GST exemption to any gift or bequest at death that could trigger a GST transfer.

Under § 2641(a), the GST tax rate is the "maximum federal estate tax rate" – currently 40%.

The GST tax in general applies to transfers after October 22, 1986, and in addition, to all lifetime irrevocable trusts created after September 25, 1985. Irrevocable trusts created before September 25, 1985 ("pre-effective date" or "grandfathered" trusts) are not subject to the tax.

Unlike the estate tax exclusion, the GST exemption is not "portable" under the rules allowing a surviving spouse to elect to use the Deceased Spouse Unused Exclusion Amount.

Key Concepts and Terms:

- A. Transferor. The transferor is the decedent, as to property transferred at death, and the donor, as to property transferred by gift. It is important to identify the transferor of a transaction for GST purposes because generational assignments are determined based on the identity of the transferor. Only the transferor can allocate GST exemption (except as to the “reverse QTIP election”, discussed below). §2652(a)
- B. A new transferor is established at the time that property is subject to estate or gift tax. §2652(a)(1) and Treas. Reg. §26.2652-1(a) and Examples. So for example, if the donor creates a trust for a child and the trust agreement grants the child a general power of appointment over the trust, the trust estate will become subject to estate tax on the child’s death. At that time, the child becomes the transferor.
- C. Reverse QTIP Election. This refers to an election made for a QTIP Marital Trust created by a decedent for the surviving spouse. If a QTIP election is made to that trust, the surviving spouse becomes the transferor of that trust because the assets are included in their estate; however, the decedent’s GST exemption still can be allocated to the QTIP Trust even though the decedent is not the “transferor.” § 2652(a)(3).
- D. Skip Person. A key concept to understand in GST planning is the “skip person.” § 2613.
- a. This is defined as a natural person who is two or more generations younger than the transferor (i.e., grandchildren, great-grandchildren and beyond), but also includes an unrelated person who is more than 37 ½ years younger than the transferor.
 - b. A trust is a “skip person” if all interests in the trust are held by skip persons.
 - c. Logically enough, a “non-skip person” means any person who is not a skip person.
 - d. Special rule for persons with predeceased parent (“move up” rule): In general, when at the time of a transfer to a grandchild, the grandchild’s parent has predeceased the transferor/grandparent (or does not survive the transferor by 90 days), the predeceased child’s children “move up” one generation, and transfers from the grandparent to the grandchild will not be treated as direct skips. §2651(e)
 - e. This special rule does not apply to transfers that occur before a child dies. Treas. Reg. §26.2651-1(c) Example 2. Note, in some cases it is possible to retroactively allocate GST exemption to such a trust in the event that a child predeceases the transferor. § 2632(d).
- E. “Interest” in a trust: A person has an interest in a trust if such person (A) has a right (other than a future right) to receive income or corpus from the trust, (B) is a permissible current recipient of income or corpus from the trust and is not a charitable organization described in section 2055(a), or (C) is a charitable remainder trust or pooled income fund. §2652(c).

- F. Inclusion Ratio: The portion of a trust's assets that will be subject to GSTT if a triggering event occurs. The inclusion ratio is determined by subtracting the "application fraction" from 1. The applicable fraction (with some exceptions) uses a numerator of the amount of GST exemption allocated to the trust, and a denominator of the value of the property transferred to the trust. [See Treas. Reg. 26.2642-1 for a more complete statement of these rules and exceptions.]

II. Three Types of Transfers Subject to GSTT.

- a. Direct skip: A gift made directly to a skip person, either outright to an individual or to a trust whose beneficiaries are all skip persons. § 2612(c)
- b. Taxable termination: termination of a trust resulting in all trust property being transferred to skip persons; basically an entire class of beneficiaries moves from one generation to a later generation. § 2612(a)
- c. Taxable distribution: distribution from a trust to a skip person (other than a taxable termination) § 2612(b).

III. Exemptions and Exclusions.

- a. GST Exemption. As noted earlier, the lifetime GST exemption is tied to the estate tax exclusion amount and is currently \$13,610,000.
- b. Annual Exclusion. The GST annual exclusion is the same amount as the gift tax annual exclusion (currently \$18,000) but is much more limited in scope. See 2642(c). It applies only to:
 - i. outright direct skips to a skip person that qualify for the gift tax annual exclusion, OR
 - ii. transfers to trusts for the benefit of a single skip person, but only if the trust will be includible in that beneficiary's estate if the trust does not terminate prior to his or her death.
 - iii. The result is that in many cases the annual exclusion that applies for gift tax purposes will not apply for GST purposes.
- c. Medical/Education Exclusion. Gifts that are non-taxable gifts under § 2503(e) are also exempt from GST tax. These are gifts of tuition payments or medical expenses paid directly to the educational institution or medical provider.

IV. **Taxation of Multiple Skips – the “Move Down” Rule – § 2653**

- a. The move down rule can alter the generational status of certain beneficiaries for GST purposes. The rule states that if there is a generation skipping transfer of any property, and immediately after the transfer, the property is held in trust, then the trust will be treated as if the transferor were assigned to the first generation above the highest generation of any person with an interest in the property.
- b. In other words, the transferor “moves down” a generation. The idea is to eliminate or reduce GSTT on subsequent transfers within the trust. Examples:
 - i. Transferor makes a direct skip to a trust for the transferor’s grandchild. For purposes of any future distributions from the trust, the transferor is treated as the beneficiary’s parent rather than their grandparent.
 - ii. Transferor creates a GST trust for child with remainder to grandchildren. A taxable termination occurs on the child’s death. The transferor moves down and is now deemed to be the child rather than the grandparent.

V. **Liability for the GST Tax. § 2603(a)**

- a. Direct skips (other than direct skip from a trust) – tax paid by transferor
- b. Taxable termination or direct skip from a trust – tax paid by the trustee
- c. Taxable distribution – tax paid by transferee
- d. Source of Tax: Unless the governing instrument states otherwise, the tax is charged to the property that was transferred. 2603(b).

VI. **Allocating the GST Exemption.** In general, there are three ways to allocate the exemption: on Form 709 for lifetime gifts, on Form 706 at death, and under the automatic allocation rules.

- a. **Gift Tax Return (Form 709).** Gift tax returns are due on April 15 of the year following the gift. A 6-month extension can be obtained by either putting the donor’s income tax return on extension or if the Form 1040 will be timely filed, then by filing a separate extension request (Form 8892). If the allocation to a lifetime gift is made on a Form 709 filed on or before the due date including extensions, then the allocation is timely filed. This is important because it means that the values used to determine the applicable fraction and hence the inclusion ratio are the values on the date of the transfer. IRC § 2642(b)(1), Treas. Reg. §26.2642-2(a). In that case, the allocation is effective as of the date of the transfer.

The regulations provide that the allocation must (i) clearly identify the trust to which the allocation is being made, (ii) disclose the amount of GST exemption allocated to it, and (3) if the allocation is late or if an inclusion other than zero is claimed, list the value of the trust principal at the time of the allocation. The allocation should also state the inclusion ratio of the trust after the allocation. Treas. Reg. § 26.2632-1(b)(2)(i).

- b. Late Allocations. If an allocation of GST exemption is made on Form 709 that is not timely filed, then the applicable fraction and inclusion ratio are based on the value of the property at the time the return is filed. A special rule allows the donor to value the property as of the first day of the month in which the return is filed. However, if the value of the gifted property has appreciated, the result is a decrease in the amount of the gift that can be protected by the GST exemption.
- c. 9100 Relief. In 2001, Congress created the ability to obtain “9100 relief” (relief under Treas. Reg. §301.9100-1, et. seq.) to make late allocations of GST exemption. This is done by filing a private letter ruling request to file an extension (beyond the automatic 6-month extension). The taxpayer must show that the transferor acted reasonably and in good faith and that the extension will not prejudice the government’s interests. See Treas. Reg. § 26.2642-7(d)(1). Proposed regulations covering such PLR requests were issued in 2008, and very recently (a mere 16 years later!) Treasury issued final regulations, which lay out in detail the criteria for obtaining 9100 relief. 89 Fed. Reg. 37116 (5-6-2024). See “Final Regs on Late GST Exemption Allocations and Late Elections,” by Howard M. Zaritsky, *Probate Practice Reporter* (June 2024). If an extension is granted, the allocation becomes effective as of the date of the transfer.

See also Rev. Proc. 2004-46 (simplified alternate method to obtain extension to allocate GST to certain inter vivos annual exclusion trusts); and Rev. Proc. 2004-47 (allows taxpayers who fail to make a reverse QTIP election on Form 706 to request relief without a PLR.)

- d. Sample Form 709 allocation. (See *Appendix 1*)
 - i. GST exemption is allocated on Schedule D, Part 2 (page 5) of Form 709.
 - ii. To correctly allocate GST, make sure you put each gift in the proper category on Schedule A, Parts 1, 2 and 3.
 - 1. Part 1: Gifts subject only to gift tax that are not currently, and cannot in the future, be subject to GST; i.e., outright gifts to non-skip persons or gifts in trust to non-GST trusts
 - 2. Part 2: Direct Skips – gifts subject to gift and GST tax, i.e., outright gifts to skip persons or to trusts for skip persons only.
 - 3. Part 3 – Indirect Skips and other transfers in trust – gifts to trusts that will or may eventually result in a taxable distribution or termination.
 - iii. Schedule D: The total allocation for direct skips shown in Part 2 will flow over to Line 4, and the total allocation for indirect skips shown in Part 3 will flow over to Line 5. Line 6 is a catch-all for allocations not shown in Part 2 or 3; an example would be

late allocations for gifts made in prior years if the gift itself had already been reported. Attach a Notice of Allocation with the detail for the basis of the allocation.

- iv. It is recommended to use a formula allocation clause to cover the possibility that the values are changed on audit (sample included in Appendix 1).
- e. **Estate Tax Returns - Form 706.** Estate tax returns are due 9 months from date of death; a 6-month automatic extension may be obtained by filing Form 4768.
- i. The allocation of GST exemption to transfers at death is made on Schedule R of the Form 706. A late allocation may also be made on Form 706. Treas. Reg. §26.2632-1(d). Any GST exemption not affirmatively allocated as of the due date for the transferor's federal estate tax return is automatically allocated under §2632(c) under the automatic allocation rules discussed below.
 - ii. Sample Form 706 Allocation – Schedule R. (See Appendix 2)
 1. Lines 2 and 3 are for lifetime allocations by the decedent, and by the executor, respectively
 2. Line 4- GST allocation to Direct Skips where the property transferred bears the GST tax (from Part 2, Line 6). This is the default rule so direct skips will be listed here unless the governing instrument specifically directs otherwise.
 3. Line 5 – GST allocation to Direct Skips where the property transferred does not bear the GST tax (Part 3, Line 6)- use only if the instrument directs that GST tax is not to be paid from the transferred interest.
 4. Line 6 – GST allocated on Schedule R-1, which is used for payment of the GSTT on direct skips from a trust where GST tax is owed. [Schedule R-1 is filed separately from the 706 along with payment of tax owed.]
 5. Line 7 – total of all allocations described above
 6. Line 8 – total remaining GST that can be allocated to GST trusts.
 7. In Section 9, you will identify the trusts to which you are allocated the remaining GST exemption and the amount allocated to each.
- f. **Automatic Allocation (Deemed Allocation) Rules- Lifetime Transfers**
- i. Deemed Allocation to Direct Skips. Code § 2632(b)(2) automatically allocates GST exemption to lifetime direct skips to the extent necessary to make the inclusion ratio zero for each direct skip, or to make the inclusion ratio as small as possible if zero is not possible.

The transferor can elect out of an automatic allocation on Form 709. § 2632(b)(3). In addition, a timely-filed Form 709 along with payment of GST tax with respect to a direct skip is sufficient to elect out. Treas. Reg. §26.2632-1(b)(1)(i).

- ii. Indirect Skips. The automatic allocation rules were expanded in 2001 to apply to indirect skips – gifts to “GST Trusts” as defined in the statute. The goal of these rules is to prevent practitioner errors by automatically allocating GST exemption to transfers that the IRS considered the most likely to result in a GST event. The automatic allocation of GST exemption to indirect skips applies to the extent necessary to make the inclusion ratio zero for each indirect skip, or to make the inclusion ratio as small as possible if zero is not possible. § 2632(c)(1).

However, the automatic allocation rules can be confusing and difficult to apply. The definition of a GST trust in § 2632(c)(3)(B) is complex and ambiguous in several common situations. For that reason, relying on the definitions is not generally recommended when instead a transferor can achieve certainty by electing in or out of the automatic allocation rule on the first gift tax return reporting a gift to the trust. However, if no return was filed, or a return preparer failed to elect in or out, the definition of GST trust should be examined to see if it has resulted in a default allocation consistent with the transferor's wishes.

- iii. Definition of GST Trust. An indirect skip is defined as a lifetime transfer (other than a direct skip) to a “GST trust” as defined in § 2632(c)(3)(B). A GST trust is “any trust that could have a generation-skipping transfer occur with respect to the transferor”, with six exceptions which are listed in § 2632(c)(3)(B). A GST trust is also any trust that the transferor has elected to be treated as a GST trust, even if it falls within an exception. Thus the transferor may elect in or out of the automatic allocation of GST exemption for lifetime transfers in 2001 and thereafter. The expanded automatic allocation rules in § 2632(c) apply only to lifetime transfers.
- iv. Exceptions: The following trusts are not “GST Trusts” for purposes of the automatic allocation rules:
 1. The trust instrument provides that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more non-skip persons before that non-skip person reaches 46 years of age, or on or before one or more dates specified in the trust instrument that will occur before that non-skip person attains 46 years of age, or on the occurrence of an event that, in accordance with regulations, may reasonably be expected to occur before that non-skip person attains age 46.
 2. The trust instrument provides that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more non-skip persons who are living on the date of death of another person identified in the instrument (by name or by class) who is more than ten years older than such non-skip persons.

3. The trust instrument provides that on the death of one or more non-skip persons on or before a date or event described in (i) or (ii) above, more than 25% of the trust principal is distributed to the estate or estates of such non-skip persons, or the trust principal is subject to a general power of appointment exercisable by one or more of such non-skip persons.
 4. Any portion of the trust estate would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer. However, to prevent all Crummey trusts from falling outside the definition of a GST trust, an “exception to the exception” provides that the value of transferred property is not considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the annual exclusion amount
 5. Charitable lead annuity trusts, charitable remainder annuity trusts, and charitable remainder unitrusts.
 6. Charitable lead unitrusts with a non-skip person as the remainder beneficiary if living at the end of the lead period.
- v. Opting In or Opting Out. An election in or out of the automatic allocation rules must be made on a timely-filed gift tax return for the year in which the transfer was made. The regulations provide that a transferor may elect out of the automatic allocation of GST exemption for an indirect skip making an election as described, but also by making an affirmative allocation of GST exemption that is less than (but not equal to) the value of the property transferred as reported on that return. §26.2632-1(b)(2)(ii). Elections out of the automatic allocation rules for lifetime transfers to a trust have no effect on the automatic allocation rules applicable at the transferor's death.
1. To elect out of automatic allocation to a direct skip, check the box in column (C) in Schedule A, Part 2.
 2. To elect in OR out of automatic allocation to an indirect skip, check the box in column (C) in Schedule A, Part 3. You may elect out of automatic allocation as to a particular transfer or as to all transfers made to a trust.
 3. Electing in: § 2632(C)(5) allows you to elect into GST treatment for any trust which will then apply to all transfers to the trust from that transferor (regardless of the automatic rules). This is best practice to ensure that GST is properly allocated to a trust. Relying on the automatic allocation rules is risky, as noted above.

For any election in or out, always attach a separate statement to Form 709 explaining the election, as just “checking the box” will not necessarily provide enough information.

- g. **Automatic Allocation Rules at Death.** Section 2632(e) automatically allocates GST exemption at the transferor’s death to the extent not actually allocated before the due date for the transferor’s estate tax return. Automatic allocations are irrevocable and cannot be amended.
- i. The unused GST exemption is first automatically allocated to direct skips occurring at the transferor’s death. § 2632(e)(1)(A).
 - ii. Any remaining GST exemption is automatically allocated pro rata to trusts from which a taxable termination or taxable distribution may occur at or after the transferor’s death. § 2632(e)(1)(B). The proration is made on the basis of the value of the property as finally determined for estate tax purposes of the nonexempt portion of the transferred property.
 - iii. No automatic allocation of GST exemption will occur with respect to a trust that will have a new transferor prior to the occurrence of any generation-skipping transfer with respect to the trust; e.g., a trust for which the beneficiary holds a general power of appointment causing inclusion in his or her estate.
 - iv. In addition, no automatic allocation of GST exemption will be made to a trust if during the nine-month period immediately following the death of the transferor, no generation-skipping transfer has occurred and no future generation-skipping transfer can occur with respect to the trust. Treas. Reg. § 26.2632-1(d)(2). For example, a beneficiary could disclaim an interest during the nine-month period after the transferor’s death, so that thereafter no generation-skipping could occur with respect to the trust, in which case no GST exemption would be automatically allocated to the trust.

- VII. **Severances: Dividing a Trust into GST Exempt and Non-Exempt Shares.** Recall earlier in the outline the definition of “inclusion ratio,” an important concept in GST planning.
- a. A GST exempt trust should have an inclusion ratio of zero. A governing instrument that creates GST trusts should include language requiring division into a separate GST exempt share and a non-GST exempt share. [*Sample language is attached at Appendix 3*]. Sufficient GST exemption should be allocated to the GST exempt share to create an inclusion ratio of zero so that no GSTT is ever owed on distributions from the trust. The non-GST exempt share should be held in a separate trust which gives the beneficiary a general power of appointment; or some drafters prefer to have the non-exempt share distributed outright.
 - b. If a trust is severed or divided pursuant to language in the instrument, it will be treated as a separate trust for GST purposes and GST may be allocated to the trust.
 - c. Qualified Severance. Prior to the enactment of EGTRRA in 2001, the IRS did not permit a trust with an inclusion ratio between zero and one to be severed into separate GST and non-exempt trusts. This could happen if the trust instrument did not contain language authorizing a division, or if the division was not properly done. As an example, if a trust were funded in the amount of \$2,000,000 but GST exemption of only \$1,000,000 was allocated to it, the trust would have an inclusion ratio of .500. The government would not permit the trust to be divided subsequently into a trust of 50% of the trust’s assets with a zero inclusion ratio and a trust of 50% with an inclusion ratio of one, even though it was clear that that would have been the result if the division had occurred before the effective date of the allocation. This placed a heavy penalty on the taxpayer who failed to divide a trust properly as of the time the GST exemption allocation would be effective.
 - d. Code § 2642(a)(3) as amended under EGTRRA changed that and provides that if a trust is severed in a “qualified severance,” the trusts resulting from the severance will be treated as separate trusts for GST purposes.
 - e. A qualified severance is defined as the division of a single trust (either under the governing instrument or under local law, e.g., by court order) in two or more trusts if the division is done on a fractional basis and the terms of the new trusts in the aggregate provide for the “same succession of interests” of beneficiaries as provided for in the original trust. § 2642(a)(3)(B). If a trust has an inclusion ratio of between zero and one, a severance is qualified only if it is divided into two trusts, one with an inclusion ratio of zero and the other with an inclusion ratio of one.
 - i. Same succession of interests: This requirement is satisfied if the beneficiaries of the separate resulting trusts, when viewed collectively, are the same as the beneficiaries and their respective interests in the original trust, before severance. As an example,

if the original trust provides for income to spouse, remainder to child, then both of the successor trusts must have the identical structure. They cannot, for example, provide for income to spouse, remainder to grandchild.

- ii. A formula fraction may be used for the severance. (*Sample language provided in Appendix 3*)
- iii. Date of the Severance. The date of the severance must be either the date selected by the trustee for valuation of the assets to determine the funding of the resulting trusts, or the court-imposed date of funding, in the case of funding pursuant to an order of the local court with jurisdiction over the trust. However, the funding must begin immediately and funding must occur within a reasonable time (but in no event more than 90 days after the selected valuation date). Treas. Reg. § 26.2642-6(d)(3).
- iv. Reporting a Qualified Severance. The regulations provide that while not required, a qualified severance should be reported to the IRS by filing form 706-GS(T) by April 15 of the year immediately following the year in which the severance occurred (or by the extended due date if an extension of time is granted). The regulations request that the words "Qualified Severance" be written at the top of the return and a Notice of Qualified Severance be attached to the return. The Notice should identify the name of the transferor, the date the trust was created, the taxpayer ID number for the original trust, and the inclusion ratio of the trust before the severance. §26.2642-6(e).

As to the new trusts, the Notice should include the name and tax ID number for each new trust that was created, the date of the severance, the fraction of the total assets of the original trust received by the new trust, other details explaining the basis for the funding of the new trust, such as whether the funding is a fraction of each asset or a fraction of the total fair market value of the assets at the date of severance, and the inclusion ratio.

VIII. Pre-effective Date (“Grandfathered”) GST Trusts.

- a. Effective Date. Trusts that were irrevocable as of **September 25, 1985**, are exempt from GST tax. In addition, a trust created under a will or revocable trust in existence on October 22, 1986, which became irrevocable because of the death of the maker before January 1, 1987, is also exempt from the GST tax.
- b. Loss of Grandfathered Status by Addition or Modification. The effective date provisions of the GST tax state that a trust is not subject to GST tax if it was irrevocable on September 25, 1985, “but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income treatable to corpus).”
 - i. Limited Powers of Appointment. The exercise of a limited power of appointment over a pre-effective date trust will NOT be treated as an “addition” if the exercise does not postpone or suspend the vesting period, i.e., the rule against perpetuities period that applied at the creation of the trust. Treas. Reg. § 26.2601-1(b)(1)(v)(B)(2). Thus if drafting any such exercise of a power of appointment, practitioners are advised to include language specifying that the original perpetuities period shall continue to apply to interests created by the exercise of the power.
 - ii. Modifications – Safe Harbor. A reformation, modification, merger, decanting, or any other act affecting the terms of a grandfathered trust could potentially subject the trust to loss of its exempt status, if the change is considered an addition to the trust or creates a new trust. Fortunately, the regulations at Treas. Reg. § 26.2601-1(b)(4) provide four safe harbors for determining when a “modification, judicial construction, settlement agreement or trustee action” will not affect the exempt status:
 1. **Discretionary Power to Distribute to New Trust**. An exercise of a discretionary power to distribute to a new trust will not cause a loss of status if the terms of the instrument authorize the distributions, without consent or approval of any beneficiary or court; or if at the time the trust became irrevocable, state law authorized the distributions, without consent or approval of any beneficiary or court.
 2. **Settlement**. A court-approved settlement of a bona fide issue regarding the administration of the trust or construction of its terms will not cause loss of exempt status if the settlement is the product of arm’s length negotiations and is within the range of reasonable outcomes under the instrument and applicable state law.

3. **Judicial Construction.** A judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause loss of exempt status if the action involves a bona fide issue and is consistent with state law that would be applied by the highest court of the state.

4. **Other Changes.** A modification that does not fall within one of the above categories will still not cause loss of exempt status if (A) the modification does not shift a beneficial interest in the trust to any beneficiary of a lower generation than those beneficiaries who held the interest prior to the change; AND (B) the change does not extend the perpetuities period that applied to the original trust.

Example 4 in the reg deals with a change of trustee that resulted in a change of trust situs from a state with the traditional common law rule against perpetuities to a state that has abolished that rule. The example suggests that this could potentially trigger loss of exempt status. However, the terms of the trust in the example provide for it to terminate at the same time regardless of the change in perpetuities rules. So no loss of exempt status occurred.

The takeaway is that if you are modifying, decanting, or making any change to a pre-effective date trust, be aware of the safe harbor rules and if necessary include language in the new trust instrument that preserves the original perpetuities period.

-END-

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APPENDIX 1

United States Gift (and Generation-Skipping Transfer) Tax Return

2023

Department of the Treasury Internal Revenue Service

Go to www.irs.gov/Form709 for instructions and the latest information. (For gifts made during calendar year 2023)

1 Donor's first name and middle initial Jane; 2 Donor's last name Smith; 3 Donor's social security number 999-99-9999; 4 Address (number, street, and apartment number) 2200 E River Road; 5 Legal residence (domicile) Tucson, AZ 85718; 6 City or town, state or province, country, and ZIP or foreign postal code Tucson, AZ 85718; 7 Citizenship (see instructions)

8 If the donor died during the year, check here [X] and enter date of death 12/05/2023; 9 If you extended the time to file this Form 709, check here []; 10 Enter the total number of donees listed on Schedule A. Count each person only once 2; 11a Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If 'No,' skip line 11b. X; 11b Has your address changed since you last filed Form 709 (or 709-A)? X; 12 Gifts by husband or wife to third parties. Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? See instructions. (If the answer is 'Yes,' the following information must be furnished and your spouse must sign the consent shown below. If the answer is 'No,' skip lines 13-18.) N/A; 13 Name of consenting spouse; 14 SSN; 15 Were you married to one another during the entire calendar year? See instructions; 16 If line 15 is 'No,' check whether [] married [] divorced or [] widowed/deceased, and give date. See instructions; 17 Will a gift tax return for this year be filed by your spouse? If 'Yes,' mail both returns in the same envelope; 18 Consent of Spouse. I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.

Consenting spouse's signature; Date; 19 Have you applied a DSUE amount received from a predeceased spouse to a gift or gifts reported on this or a previous Form 709? If 'Yes,' complete Schedule C. X; 20 Does any gift or other transfer reported on this Form 709 include a digital asset (or a financial interest in a digital asset)? See instructions. X

Table with 20 rows for gift tax computation. Includes columns for line number and amount. Total tax is 0. Amount to be refunded is 0.

Sign Here: Signature of donor, Date; Paid Preparer Use Only: Firm's name GADARIAN & CACY, P.L.L.C., Firm's address 2200 E. River Rd. #123, Tucson, AZ 85718, Firm's EIN, Phone no. 520-529-2242; Declaration: Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than donor) is based on all information of which preparer has any knowledge. May the IRS discuss this return with the preparer shown below? See instructions. [X] Yes [] No

SCHEDULE A Computation of Taxable Gifts (including transfers in trust) (see instrs)

A Does the value of any item listed on Schedule A reflect any valuation discount? If 'Yes,' attach explanation. Yes No

B Check here if you elect under section 529(c)(2)(B) to treat any contributions made this year to a qualified tuition program as made ratably over a 5-year period beginning this year. See instructions. Attach explanation.

Part 1 – Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions. See instructions.

A Item no.	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP number • If closely held entity, give EIN	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)

Gifts made by spouse – complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

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Total of Part 1. Add amounts from Part 1, column H.

Part 2 – Direct Skips. Gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item no.	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP number • If closely held entity, give EIN	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
	See Attachment		100,000.		100,000.	0.	100,000.

DO NOT FILE

Gifts made by spouse – complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

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Total of Part 2. Add amounts from Part 2, column H. 100,000.

Part 3 – Indirect Skips and Other Transfers in Trust. Gifts to trusts that are indirect skips as defined under section 2632(c) or to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item no.	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP number • If closely held entity, give EIN	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
	See Attachment	✓	5,000,000.		5,000,000.	0.	5,000,000.

Gifts made by spouse – complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

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Total of Part 3. Add amounts from Part 3, column H. 5,000,000.

(If more space is needed, attach additional statements.)

Part 4 – Taxable Gift Reconciliation

1	Total value of gifts of donor. Add totals from column H of Parts 1, 2, and 3.	1	5,100,000.
2	Total annual exclusions for gifts listed on line 1 (see instructions).	2	17,000.
3	Total included amount of gifts. Subtract line 2 from line 1.	3	5,083,000.
Deductions (see instructions)			
4	Gifts of interests to spouse for which a marital deduction will be claimed, based on item numbers _____ of Schedule A	4	
5	Exclusions attributable to gifts on line 4.	5	
6	Marital deduction. Subtract line 5 from line 4.	6	
7	Charitable deduction, based on item numbers _____ less exclusions	7	
8	Total deductions. Add lines 6 and 7.	8	
9	Subtract line 8 from line 3.	9	5,083,000.
10	Generation-skipping transfer taxes payable with this Form 709 (from Schedule D, Part 3, col. G, total)	10	0.
11	Taxable gifts. Add lines 9 and 10. Enter here and on page 1, Part 2 – Tax Computation, line 1.	11	5,083,000.

Terminable Interest (QTIP) Marital Deduction. (See instructions for Schedule A, Part 4, line 4.)

If a trust (or other property) meets the requirements of qualified terminable interest property under section 2523(f), and:

a The trust (or other property) is listed on Schedule A; and

b The value of the trust (or other property) is entered in whole or in part as a deduction on Schedule A, Part 4, line 4, then the donor shall be deemed to have made an election to have such trust (or other property) treated as qualified terminable interest property under section 2523(f).

If less than the entire value of the trust (or other property) that the donor has included in Parts 1 and 3 of Schedule A is entered as a deduction on line 4, the donor shall be considered to have made an election only as to a fraction of the trust (or other property). The numerator of this fraction is equal to the amount of the trust (or other property) deducted on Schedule A, Part 4, line 6. The denominator is equal to the total value of the trust (or other property) listed in Parts 1 and 3 of Schedule A.

If you make the QTIP election, the terminable interest property involved will be included in your spouse's gross estate upon his or her death (section 2044). See instructions for line 4 of Schedule A. If your spouse disposes (by gift or otherwise) of all or part of the qualifying life income interest, he or she will be considered to have made a transfer of the entire property that is subject to the gift tax. See *Transfer of Certain Life Estates Received From Spouse* in the instructions.

12 Election Out of QTIP Treatment of Annuities

Check here if you elect under section 2523(f)(6) not to treat as qualified terminable interest property any joint and survivor annuities that are reported on Schedule A and would otherwise be treated as qualified terminable interest property under section 2523(f). See instructions. Enter the item numbers from Schedule A for the annuities for which you are making this election

SCHEDULE B Gifts From Prior Periods

If you answered 'Yes' on line 11a of page 1, Part 1, see the instructions for completing Schedule B. If you answered 'No,' skip to the Tax Computation on page 1 (or Schedule C or D, if applicable). Complete Schedule A before beginning Schedule B. See instructions for recalculation of the column C amounts. Attach calculations.

A Calendar year or calendar quarter (see instructions)	B Internal Revenue office where prior return was filed See Worksheet	C Amount of applicable credit (unified credit) against gift tax for periods after December 31, 1976	D Amount of specific exemption for prior periods ending before January 1, 1977	E Amount of taxable gifts	
2022	Kansas City, MO	1,945,800.	0.	5,000,000.	
1	Totals for prior periods	1	1,945,800.	0.	5,000,000.
2	Amount, if any, by which total specific exemption, line 1, column D, is more than \$30,000.	2			
3	Total amount of taxable gifts for prior periods. Add amount on line 1, column E, and amount, if any, on line 2. Enter here and on page 1, Part 2 – Tax Computation, line 2.	3			5,000,000.

(If more space is needed, attach additional statements.)

SCHEDULE C Deceased Spousal Unused Exclusion (DSUE) Amount and Restored Exclusion

Provide the following information to determine the DSUE amount and applicable credit received from prior spouses. Complete Schedule A before beginning Schedule C.

A Name of deceased spouse (dates of death after December 31, 2010, only)	B Date of death	C Portability election made?		D If 'Yes,' DSUE amount received from spouse	E DSUE amount applied by donor to lifetime gifts (list current and prior gifts)	F Date of gift(s) (enter as mm/dd/yy for Part 1 and as yyyy for Part 2)
		Yes	No			
Part 1 – DSUE RECEIVED FROM LAST DECEASED SPOUSE						
Part 2 – DSUE RECEIVED FROM PREDECEASED SPOUSE(S)						
TOTAL (for all DSUE amounts applied from column E for Part 1 and Part 2).....						
1 Donor's basic exclusion amount (see instructions).....					1	
2 Total from column E, Parts 1 and 2.....					2	
3 Restored Exclusion Amount (see instructions).....					3	
4 Add lines 1, 2, and 3.....					4	
5 Applicable credit on amount in line 4 (see <i>Table for Computing Gift Tax</i> in the instructions). Enter here and on line 7, Part 2 – Tax Computation.....					5	

SCHEDULE D Computation of Generation-Skipping Transfer Tax

Note: Inter vivos direct skips that are completely excluded by the GST exemption must still be fully reported (including value and exemptions claimed) on Schedule D.

Part 1 – Generation-Skipping Transfers. List items from Schedule A first, then items to be reported on Schedule D, including any transfers subject to an Estate Tax Inclusion Period (ETIP).

A Item number (from Schedule A, Part 2, col. A, then ETIP transfers, if any)	B Description (only for ETIP transfers)	C Value (from Schedule A, Part 2, col. H, or close of ETIP described in col. B)	D Nontaxable portion of transfer	E Net transfer (subtract col. D from col. C)
1		100,000.	17,000.	83,000.
Gifts made by spouse (for gift splitting only)				

(If more space is needed, attach additional statements.)

Part 2 – GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election

Check here if you are making a section 2652(a)(3) (special QTIP) election. See instructions.

Enter the item numbers from Schedule A of the gifts for which you are making this election _____

1	Maximum allowable exemption (see instructions).....	1	12,920,000.
2	Total exemption used for periods before filing this return	2	5,000,000.
3	Exemption available for this return. Subtract line 2 from line 1	3	7,920,000.
4	Exemption claimed on this return from Part 3, column C, total below	4	83,000.
5	Automatic allocation of exemption to transfers reported on Schedule A, Part 3. To opt out of the automatic allocation rules, you must attach an "Election Out" statement. See instructions	5	5,000,000.
6	Exemption allocated to transfers not shown on line 4 or line 5 above. You must attach a "Notice of Allocation." See instructions	6	
7	Add lines 4, 5, and 6.....	7	5,083,000.
8	Exemption available for future transfers. Subtract line 7 from line 3	8	2,837,000.

Part 3 – Tax Computation

A Item number (from Schedule D, Part 1)	B Net transfer (from Schedule D, Part 1, col. E)	C GST exemption allocated	D Divide col. C by col. B	E Inclusion ratio (Subtract col. D from 1.000)	F Applicable rate (multiply col. E by 40% (0.40))	G Generation-skipping transfer tax (multiply col. B by col. F)
1	83,000.	83,000.	1.000	0.000	0.000	0.
Gifts made by spouse (for gift splitting only)						
Total exemption claimed. Enter here and on Part 2, line 4, above. May not exceed Part 2, line 3, above.....		83,000.	Total generation-skipping transfer tax. Enter here; on page 3, Schedule A, Part 4, line 10; and on page 1, Part 2 – Tax Computation, line 16.....			0.

DO NOT FILE

(If more space is needed, attach additional statements.)

Donor's name **Jane Smith** Social security number **999-99-9999**

SCHEDULE A Computation of Taxable Gifts

FDGL0112L 06/24/21

Part 2 – Direct skips – gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B ● Donee's name and address ● Relationship to donor (if any) ● Description of gift ● If the gift was of securities, give CUSIP number	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Susie Smith GRANDDAUGHTER Cash		100,000.	6/01/23	100,000.	0.	100,000.
Total Schedule A, Part 2			\$ 100,000.		\$ 100,000.	\$ 0.	\$ 100,000.

DO NOT FILE

Donor's name

Social security number

Jane Smith

999-99-9999

SCHEDULE A Computation of Taxable Gifts

FDGL0189L 06/24/21

Part 3 – Indirect skips – gifts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B ● Donee's name and address ● Relationship to donor (if any) ● Description of gift ● If the gift was of securities, give CUSIP number	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	John Smith GST Exempt Trust TRUST Cash Total Schedule A, Part 3	X	5,000,000.	6/01/23	5,000,000.	0.	5,000,000.
			<u>\$ 5,000,000.</u>		<u>\$ 5,000,000.</u>	<u>\$ 0.</u>	<u>\$ 5,000,000.</u>

DO NOT FILE

7/09/24

02:28PM

NOTICE OF ELECTION UNDER SECTION 2632 (C) .

The Taxpayer hereby makes the election under Code Section 2632(c) to treat the John Smith GST Exempt Trust as a GST Trust and elect that all gifts to the John Smith GST Exempt Trust shall be treated as indirect skips and allocated the Taxpayer's GST exemption.

FORMULA ALLOCATION OF GST EXEMPTION TO TRUST

The generation skipping transfer tax (GST) exemption allocated to the John Smith GST Exempt Trust is based on values as returned. The Taxpayer allocated to this gift the smallest amount of GST exemption necessary to produce an inclusion ratio [as defined in Code Section 2642(a)] which is closest to or if possible zero. This is a formula allocation that will change if values are changed on audit.

If changes made on audit were to change the allocation such that there was not enough exemption available to result in zero inclusion ratio for the trust shown on Schedule A, Part 3, then the GST exemption for such trust should be adjusted in order for it to remain fully exempt.

DO NOT FILE

Southern Arizona Estate Planning Council
Summer Session II
July 12, 2024

APPENDIX 2

Estate of: Jane Smith

Decedent's social security number
999 99 9999

SCHEDULE R—Generation-Skipping Transfer Tax

Note: To avoid application of the deemed allocation rules, Form 706 and Schedule R should be filed to allocate the GST exemption to trusts that may later have taxable terminations or distributions under section 2612 even if the form is not required to be filed to report estate or GST tax.

The GST tax is imposed on taxable transfers of interests in property located outside the United States as well as property located inside the United States. See instructions.

Part 1. GST Exemption Reconciliation (Section 2631) and Special QTIP Election (Section 2652(a)(3))

You no longer need to check a box to make a section 2652(a)(3) (special QTIP) election. If you list qualifying property in Part 1, line 9, below, you will be considered to have made this election. See instructions for details.

1	Maximum allowable GST exemption	1	12,920,000
2	Total GST exemption allocated by the decedent against decedent's lifetime transfers	2	5,000,000
3	Total GST exemption allocated by the executor, using Form 709, against decedent's lifetime transfers	3	5,083,000
4	GST exemption allocated on line 6 of Schedule R, Part 2	4	
5	GST exemption allocated on line 6 of Schedule R, Part 3	5	
6	Total GST exemption allocated on line 4 of Schedule(s) R-1	6	
7	Total GST exemption allocated to inter vivos transfers and direct skips (add lines 2–6)	7	10,083,000
8	GST exemption available to allocate to trusts and section 2032A interests (subtract line 7 from line 1)	8	2,837,000
9	Allocation of GST exemption to trusts (as defined for GST tax purposes):		

A Name of trust	B Trust's EIN (if any)	C GST exemption allocated on lines 2–6 above (see instructions)	D Additional GST exemption allocated (see instructions)	E Trust's inclusion ratio (optional) (see instructions)
John Smith GST Exempt Trust		0	1,418,500	0
Anne Smith GST Exempt Trust		0	1,418,500	0

9D Total. May not exceed line 8 above	9D	2,837,000
10 GST exemption available to allocate to section 2032A interests received by individual beneficiaries (subtract line 9D from line 8). You must attach special-use allocation statement. See instructions	10	

APPENDIX 3

SAMPLE LANGUAGE: Division into GST Exempt and Non-Exempt Shares

Provisions Relating to Generation-Skipping Tax.

(1) **Division of Trusts.** If a trust hereunder would be partially exempt from generation-skipping tax by reason of an allocation of generation-skipping tax exemption to it, before the allocation, the Trustee shall divide the trust into two separate trusts of equal or unequal value that shall be funded fractionally out of the available property, to permit allocation of the exemption solely to one trust that will be entirely exempt from generation-skipping tax. In addition, if a trust hereunder is entirely exempt or nonexempt from generation-skipping tax and adding property to the trust would partially subject it to generation-skipping tax, the Trustee shall hold that property as a separate trust in lieu of making the addition. Except as otherwise provided in this Agreement, the two trusts shall have the same terms and conditions, but the Trustee shall not make discretionary distributions from the income or principal of the exempt trust to beneficiaries who are non-skip persons so long as any readily marketable assets remain in the nonexempt trust.

(2) **Allocation of Assets.** Upon division or distribution of an exempt trust and a nonexempt trust held hereunder, the Trustee, in the Trustee's discretion, may allocate or distribute property from the exempt trust first to a distributive share from which a generation-skipping transfer is more likely to occur. The purpose of this provision is to enable the Trustee to take advantage of the opportunities provided by the creation of such related trusts to avoid or delay federal generation-skipping transfer tax when making discretionary distributions.

(3) **Taxable Distributions.** If the Trustee considers that any distribution from a trust hereunder other than pursuant to a power to withdraw or appoint is a taxable distribution subject to a generation-skipping tax payable by the distributee, the Trustee shall augment the distribution by an amount that the Trustee estimates to be sufficient to pay the tax and shall charge the same against the trust to which the tax relates.

(4) **Taxable Terminations.** If the Trustee considers that any termination of an interest in trust property hereunder is a taxable termination subject to a generation-skipping tax, the Trustee shall pay the tax from the portion of the trust property to which the tax relates, without adjustment of the relative interests of the beneficiaries.

(5) **Conditional/General Testamentary Power of Appointment.** Upon a beneficiary's death:

- (a) if the death would be deemed to result in a taxable termination of a trust or portion thereof because of the absence of a general power of appointment; and
- (b) if that trust or portion thereof would be subject to generation-skipping transfer taxes; and
- (c) if the combined federal generation-skipping transfer tax and, if applicable, state generation-skipping transfer tax would exceed the combined federal estate tax, state estate tax, and inheritance tax that would otherwise be payable if the beneficiary were to have a testamentary general power of appointment:

APPENDIX 3

then in addition to any other power of appointment granted to that beneficiary under this Agreement, the beneficiary may appoint the portion that would be subject to generation-skipping transfer taxes to the creditors of his or her estate by will, by making specific reference to this power of appointment. To the extent that the foregoing general power of appointment is in existence on the beneficiary's death, then unless the beneficiary directs otherwise by will, the Trustee shall pay to the personal representative of the beneficiary's estate, from the portion of the trust to which the power pertains, the amount, if any, by which the estate and inheritance taxes payable in any jurisdiction by reason of the beneficiary's death shall be increased as a result of the inclusion of that portion in the beneficiary's estate for such tax purposes, as certified in writing by that personal representative.

SAMPLE LANGUAGE: Fractional Funding Formula

The Trustee shall allocate to the Exempt Trust a fractional share of the transferred property determined by reference to the fraction described below in effect at the time of the transfer of the transferred property. The numerator of the fraction shall consist of the amount of the transferor's generation-skipping tax exemption (provided under Section 2631(a) of the Internal Revenue Code) allocated to the transfer to this trust or the amount of the transferor's remaining generation-skipping tax exemption if lower. The denominator of the fraction shall be the value of the transferred property as finally determined for federal gift or estate tax purposes, whichever is applicable for the transferred property. It is the Grantor's intention that the Exempt Trust always have a GST inclusion ratio of zero (0:1).