

Gifts To Grandchildren In 2010

Making gifts to grandchildren and more remote descendants in any year is challenging because of the need to comply with complex rules about the generation skipping transfer (GST) tax application and exemptions. In 2010, this complexity has been compounded by the repeal of the estate tax and its return in 2011 with uncertainty as to Congress's intervening action or inaction.

Normally, a grandchild or more remote descendant is considered a "skip person" under Section 2613 of the Internal Revenue Code (the "Code"). Unrelated individuals and trusts can also be skip persons under the Code. Any transfer to a skip person is subject to the GST tax unless exempted. Unfortunately, the GST tax was repealed along with the estate tax for 2010, leaving us with no GST exemption to protect transfers for 2010 (unless Congress changes the law). This is both good news and bad.

For "direct transfers" made to a skip person this year, there is no need to allocate any GST exemption because there is no GST tax. This means that any person can make outright gifts of any amount of money or assets under current law, to their grandchild or more remote descendant, or any other individual assigned to that generation, and not incur a GST tax. They might, however, incur gift taxes since the gift tax was not repealed with the estate and GST tax. Deathbed gifts outright to skip persons are a very good idea now because any gift tax incurred will be less than an estate tax on the same amounts bequeathed and there is currently no GST tax. Testamentary trusts funded when there is no estate or GST tax should be forever exempt from the GST tax under a technicality in the estate tax repeal law.

These direct transfers work when the "skip person" is an individual and not a trust whose beneficiaries are all skip persons, even though such a trust is also a "skip person" under the Code. The problem with a trust is that while no GST tax applies to any transfer to the trust this year, no GST exemption can be allocated to the transfer. Therefore, the trust will not be wholly exempt from the GST tax for distributions made after the GST tax is reinstated. This means that it is risky to make any gifts to a trust that benefits skip persons while there is no GST tax or GST exemption. Gifts to a 529 Plan for a grandchild may have the same problem as a trust. It is advisable to wait until we have some clarity on the law to plan for the tax consequences of any such gift.

The repeal also creates an opportunity. A trust that was created before 2010 to which no GST exemption was allocated (and thus all distributions to skip persons would have been GST taxable), may currently distribute assets to skip person beneficiaries and not incur a GST tax... unless Congress passes a retroactive GST tax. This means that now might be a very good time to get assets down a few generations, provided that the recipient is a legal adult and no further trust or GST tax protection is warranted.

Gifts that are not affected by the GST tax uncertainty include payments directly to health care and educational providers. By statute, these are not considered gifts for GST tax purposes.