The Federal Estate, Gift, and Generation-Skipping Transfer Taxes

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September 18, 2013

Congressional Research Service
7-5700
www.crs.gov
95-416

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

This report contains an explanation of the major provisions of the federal estate, gift, and generation-skipping transfer taxes as they apply to transfers in 2013. The following discussion provides basic principles regarding the computation of these three transfer taxes.

The federal estate and generation-skipping transfer taxes were resurrected by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) after a hiatus of one year (2010). The American Taxpayer Relief Act of 2012 (ATRA) permanently extended the estate tax rules enacted by the 2010 Act except for the top tax rate, which increased from 35% to 40% for both the estate and gift taxes.

The federal estate tax is a tax levied on the transfer of property at death and measured by the size of the decedent's estate. The tax is computed through a series of adjustments and modifications of a tax base known as the "gross estate." Certain allowable deductions reduce the gross estate to the "taxable estate," to which is then added the total of all lifetime taxable gifts made by the decedent. The tax rates are applied and, after reduction for certain allowable credits, the amount of tax owed by the estate is reached.

The federal gift tax is a tax imposed on all gratuitous transfers of property made during life. The tax seeks to account for transfers of property that would otherwise reduce the estate and accordingly estate tax liability at death. The donor's tax liability of the gift depends upon the value of the "taxable gift." The taxable gift is determined by reducing the gross value of the gift by the available deductions and exclusions.

The unified transfer tax credit is available against both gift and estate tax liability. To the extent this credit is used to offset gift taxes, it is unavailable to offset estate taxes. The Internal Revenue Code refers to the credit as an "applicable exclusion amount," that is, the amount of taxable gifts or estate that the credit would cover. The applicable exclusion amount in 2013 is $5,250,000.

The generation-skipping transfer tax attempts to close a perceived loophole in the estate and gift tax system where property could be transferred to successive generations without intervening estate or gift tax consequences. There are two basic forms of generation-skipping transfers: the indirect skip, where the generation one level below the decedent receives some beneficial interest in the property before the property passes to the generation two or more levels below; and the direct skip, where the property passes directly to the generation two or more levels below the decedent. The generation-skipping transfer tax is imposed at a flat rate of 40% with an available exclusion of $5,250,000. While it is of the same value, this exclusion is separate from the unified transfer tax credit available for the estate and gift taxes.

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Introduction

This report contains an explanation of the major provisions of the federal estate, gift, and generation-skipping transfer taxes as they apply to transfers in 2013. The enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 phased out the estate and generation-skipping transfer taxes over a 10-year period, leaving the gift tax as the only federal transfer tax in 2010.[1] The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 temporarily (through the end of 2012) reinstated the estate and generation-skipping transfer taxes with lower top rates and larger exemptions and reunified the estate and gift taxes.[2] The American Taxpayer Relief Act of 2012 permanently extended the estate tax rules enacted by the 2010 Act except for the top tax rate, which increased from 35% to 40%.[3]

The federal estate and gift taxes are unified as they utilize the same rate structure. Federal estate and gift taxes also share a lifetime transfer credit. For 2013, this unified credit covers an applicable amount of $5,250,000 per individual.

The federal estate, gift, and generation-skipping transfer tax laws are rather lengthy and complex. This report discusses those major Internal Revenue Code (IRC) and Internal Revenue Service (IRS) regulation provisions which play the dominant role in the determination of estate, gift, and generation-skipping transfer tax liability. This discussion relates only to the taxation of United States citizens and resident aliens while different rules apply to the taxation of nonresident alien individuals.

The Federal Estate Tax

The federal estate tax is a tax on the estate of a decedent, levied against and paid by the estate. Contrastingly, the inheritance tax is imposed on and paid by the heirs of the decedent based upon the money or property that they receive. The determination of federal estate tax liability involves a series of adjustments and modifications of a tax base known as the "gross estate." Certain allowable deductions reduce the gross estate to the "taxable estate." Then, the total of all lifetime taxable gifts made by the decedent is added to the taxable estate before tax rates are applied. The result is the decedent's estate tax which, after reduction for certain allowable credits, is the amount of tax paid by the estate. This discussion will divide the federal estate tax into three components: the gross estate, deductions from the gross estate, and computation of the tax, including allowable tax credits.

The Gross Estate: The Federal Estate Tax Base

The gross estate of a decedent includes the value of all property, real or personal, tangible or intangible, wherever situated, in which the decedent owned an interest on the date of the

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[1] P.L. 107-16, 107th Cong., 1st Sess. (2001).

[2] P.L. 111-312, 111th Cong., 2nd Sess. (2010).

[3] P.L. 112-240, 112th Cong., 2nd Sess. (2012).

decedent's death. The gross estate may also include certain interests in property which the decedent had transferred to another person at some time prior to the date of death.[4]

Certain types of property may be included in the decedent's gross estate if specific IRC conditions are met. Proceeds from a life insurance policy on the life of the deceased may qualify as part of the gross estate if either the proceeds are payable to or for the use of the estate's executor, or if the decedent held any "incidents of ownership" in the policy on the date of death or gave away such incidents of ownership within three years of the date of death.[5] An incident of ownership is an economic right in the policy, such as the right to cancel the policy, change the beneficiary, or borrow against its cash surrender value.[6] Similarly, the value of a survivor's annuity payable because of the death of the decedent is included in the decedent's gross estate if the deceased had the right to receive a lifetime annuity under the same contract.[7]

The value of property owned by the decedent jointly with a right of survivorship in another person, other than the decedent's spouse, may also qualify as part of the gross estate. The contribution of money or money's worth of consideration towards the cost of acquiring the property by someone other than the decedent subsequently reduces the contribution of that property to the gross estate.[8] However, only one-half of the value of property owned jointly with a right of survivorship by a decedent and the surviving spouse, regardless of the relative contributions of the decedent and the surviving spouse, may qualify as part of the gross estate.[9]

In a number of instances, the value of a decedent's gross estate encompasses the value of property not owned by the decedent on the date of death.[10] For example, a decedent's gross estate can include the value of lifetime gifts over which the decedent retained a life interest[11] or the power to alter, amend, terminate, or destroy the beneficial enjoyment of the property.[12] Lifetime gifts that do not take effect until the date of death, irrespective of the number of years that have elapsed between the date of the gift and the date of the donor's death, are also included in the donor's gross estate.[13] However, the gross estate does not include property sold during the decedent's lifetime for full and adequate consideration.

The decedent's gross estate also includes all property subject to a general power of appointment held by the decedent on the date of death, even if the decedent died without exercising that

[4] 26 U.S.C. §2031(a).

[5] 26 U.S.C. §2042.

[6] Treas. Regs. (26 C.F.R.) §20.2042-1(c)(2).

[7] 26 U.S.C. §2039(a). Annuities are valued according to the actuarial life expectancy of the annuitant, the frequency of the payments, and the size of the payments. Treas. Regs. (26 C.F.R.) §20.2039-1.

[8] 26 U.S.C. §2040(a). The right of survivorship is the power of the successor of a deceased individual to acquire that individual's property upon his/her death.

[9] 26 U.S.C. §2040(b).

[10] Because the gross estate may include property given away during the decedent's life, the gross estate for tax purposes is not the equivalent of the probate estate. See 26 U.S.C. §§2035, 2037.

[11] 26 U.S.C. §2036. A life interest in property is an interest which ceases upon the interest-holder's death. The retention of an estate, the duration of which is not ascertainable except with reference to the lifetime of the donor, is treated as a retained life interest. The retention of the right to vote shares of stock of certain closely-held corporations is also a retained life interest. 26 U.S.C. §2036(b); *see also, United States v. Byrum*, 408 U.S. 125 (1972).

[12] 26 U.S.C. §2038. These transfers are also known as "revocable transfers" because the retained power allowed the deceased donor to revoke the transfer and return to himself or herself the enjoyment of the transferred property.

[13] 26 U.S.C. §2037.

power.[14] A power of appointment is a right, held by a person other than the owner of property, to determine who will enjoy the ownership of or benefit of the property. A power of appointment is "general" if it may be exercised by its holder in favor of the holder, the holder's estate, the holder's creditors, or the creditors of the holder's estate. If a power cannot be exercised in favor of these classes of persons, it is not a general power of appointment, regardless of the size of the classes of beneficiaries in whose favor the power can be exercised.[15]

The property and interests included in the decedent's gross estate are valued at their fair market value on the date of death or, if elected by the executor at his/her discretion, the alternate valuation date. The alternate valuation date is the earlier of either the date of distribution or disposition of the property by the estate or the date six months after the date of death.[16] The "fair market value" of property is the price at which the estate property would change hands between a willing buyer and seller.[17] In such a sale, the buyer and seller should not be compelled to buy or sell. Additionally, both parties should have reasonable knowledge of the relevant facts. The fair market value price does not reflect a forced sale price but the sale price in a market in which the item is most commonly sold to the public.[18] The IRS regulations outline valuation rules for certain types of property such as stocks and bonds, family farms, and closely held businesses where the estate must determine the fair market value under specific conditions.[19]

Deductions from the Gross Estate: Reaching the Taxable Estate

A decedent's taxable estate is determined by reducing the gross estate with allowable deductions, including estate administration expenses, certain debts and losses, the amount of qualified transfers to a surviving spouse, charitable bequests, and state death taxes.

The first deduction to which an estate is entitled is for the funeral expenses, administration expenses, claims against the estate, and unpaid mortgages paid by the estate (to the extent not reflected in the reduced value of estate assets). The estate may deduct these payments if they are paid by the estate and are permitted under the laws of the applicable jurisdiction in which the estate is administered.[20] Additionally, the estate may deduct the amount of any casualty or theft losses sustained by the estate during the settlement of the estate, to the extent such losses are not compensated by insurance.[21]

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[14] 26 U.S.C. §2041.

[15] 26 U.S.C. §2041. Certain other powers are statutorily classified as limited or non-special powers of appointment, including the right to invade the corpus (principal) subject only to an ascertainable standard relating to health, education, support or maintenance; or the non-cumulative right to withdraw up to the greater of $5,000 or 5% of corpus annually.

[16] 26 U.S.C. §2032(a). The alternate valuation date is useful when the value of the property contained in the gross estate has decreased following the death of the decedent, such as might be the case when the estate holds a substantial quantity of stock in a corporation in which the decedent was a dominant figure.

[17] Treas. Regs. (26 C.F.R.) §20.2031-1(b).

[18] *Id.*

[19] See Treas. Regs. (26 C.F.R.) §§20.2031-1 – 20.2031-10.

[20] 26 U.S.C. §2053.

[21] 26 U.S.C. §2054.

The estate may also claim a "marital deduction" for the value of all property passing to the decedent's surviving spouse.[22] Only non-terminable interests passing to the surviving spouse qualify for this marital deduction. Interests that may terminate in favor of another person upon the lapse of time, the occurrence of an event or contingency, or the failure of an event or contingency to occur, generally do not qualify for the estate tax marital deduction.[23] Special exceptions to the terminable interest rule are made for certain transfers in trust of a lifetime income interest if the executor elects to include the value of the trust property in the surviving spouse's gross estate and for certain life estates coupled with a general power of appointment.[24] Certain life insurance settlement options and certain interests conditioned upon survivorship for a reasonable period not exceeding six months also serve as exceptions to the terminable interest rule.[25]

A deduction for certain charitable bequests and devises to qualified charitable organizations also reduce the value of the gross estate.[26] Although the rules are not identical, the estate tax charitable deduction functions similarly to its income tax counterpart with the purpose of encouraging charitable contributions.[27]

The gross estate is also reduced by the amount of any estate, inheritance, legacy, or succession taxes actually paid to any state or the District of Columbia in respect to property included in the gross estate.[28]

Computation of the Estate Tax

Under the unified estate and gift tax system, computation of a decedent's estate tax liability requires a "grossed-up," or a combination, of the decedent's lifetime taxable gifts and the decedent's taxable estate to which the tax rate schedule is then applied. Any available credits are subsequently taken to obtain the decedent's actual estate tax liability (the amount of tax to be paid by the estate).[29]

[22] 26 U.S.C. §2056. Generally, the unlimited marital deduction is not allowed for transfers to a surviving spouse who is not a citizen of the United States and does not become a citizen before the estate tax return is filed unless the transfer utilizes a qualified domestic trust. See 26 U.S.C. §2056(d). A qualified domestic trust is defined in 26 U.S.C. §2056A to be a trust that has at least one trustee who is a United States citizen and such citizen trustee has veto power over distributions from the trust.

[23] 26 U.S.C. §2056(b). Known as the "terminable interest rule."

[24] *Id.*

[25] *Id.*

[26] 26 U.S.C. §2055.

[27] *Compare* 26 U.S.C. §§2055(a) and 170(c).

[28] 26 U.S.C. §2058.

[29] 26 U.S.C. §2001(b).

The estate rate schedule[30] is as follows:

Taxable Estate	Tentative Tax
not over $10,000	18% of such amount
$10,000-$20,000	$1,800 + 20% of excess over $10,000
$20,000-$40,000	$3,800 + 22% of excess over $20,000
$40,000-$60,000	$8,200 + 24% of excess over $40,000
$60,000-$80,000	$13,000 + 26% of excess over $60,000
$80,000-$100,000	$18,200 + 28% of excess over $80,000
$100,000-$150,000	$23,800 + 30% of excess over $100,000
$150,000-$250,000	$38,800 + 32% of excess over $150,000
$250,000-$500,000	$70,800 + 34% of excess over $250,000
$500,000 -$750,000	$155,800 + 37% of excess over $500,000
$750,000 -$1,000,000	$248,300 + 39% of excess over $750,000
Over $1,000,000	$345,800 + 40% of excess over $1,000,000

There are three major estate tax credits presently in effect: the unified transfer tax credit, the credit for foreign death taxes, and the credit for federal estate taxes paid by previous estates. Each credit is a dollar-for-dollar offset against an estate's federal estate tax liability.

The unified transfer tax credit is available against both lifetime gift tax liabilities and the estate tax liability. To the extent this credit is used to offset gift taxes, it is unavailable to offset estate taxes. The IRC refers to the credit as an "applicable exclusion amount," that is, the amount of taxable gifts or estate that the credit would cover. [31] The applicable exclusion amount in 2013 is $5,250,000.

Each estate may also use credits for foreign death taxes, including estate, inheritance, legacy, or succession taxes actually paid by the estate or any heir with respect to property included in the federal gross estate. This credit is limited to the amount of U.S. estate taxes paid on the same property. The credit is computed as the same proportionate share of the total U.S. estate taxes as the value of the foreign taxed property bears to the total of the U.S. taxable estate.[32]

The credit for previously taxed property (PTP credit) is provided to relieve some of the harshness that could otherwise result when an individual dies soon after inheriting property upon which a federal estate tax has already been imposed. The PTP credit is allowed for all or some portion of the federal estate taxes paid on property transferred to the decedent within the past ten years. The PTP credit is graduated according to the amount of time that has elapsed between the date the

[30] 26 U.S.C. §2001(c). The taxable estate is the gross estate less any relevant deductions. The tax rate is then applied to the taxable estate resulting in the tentative tax. Any available credits are then taken from the tentative tax to arrive at the estate's actual tax liability.

[31] 26 U.S.C. §2010.

[32] 26 U.S.C. §2014.

property was transferred to the decedent and the date of death. The maximum PTP credit is 100% of the previously paid taxes, when the decedent received the property within two years prior to the date of death. The minimum PTP credit is 20% of the previously paid taxes, when the decedent received the property during the ninth or tenth years preceding the date of death.[33]

The Federal Gift Tax

The federal gift tax is a tax imposed on an annual basis on all gratuitous transfers of property made during life. The tax seeks to account for transfers of property that would otherwise reduce the estate and accordingly estate tax liability at death.[34] The donor's tax liability on the gift depends upon the value of the "taxable gift." The taxable gift is determined by reducing the gross value of the gift by the available deductions and exclusions. The gift tax liability created on the basis of the donor's taxable gifts may be reduced by the available unified transfer tax credit. This discussion will divide the federal gift tax into two components: the taxable gift and the computation of the gift tax.

The Taxable Gift

The donor calculates the gift tax liability by first determining the amount of the taxable gift. The amount of the taxable gift is the fair market value of the gift at the time it was made, less certain exclusions and deductions.[35] The major deductions and exclusions are the annual per donee exclusion, the gift tax marital deduction, and the gift tax charitable deduction.

Through the annual exclusion, every donor may exclude from his/her federal gift tax base the first $14,000 of cash or property given to each donee annually.[36] An unlimited exclusion is available for gifts of direct payments to the donee's educational institution for tuition expenses or to the donee's medical provider for health care expenses.[37] Under the present interest rule, the annual exclusion is unavailable, however, for gifts of future interests which vest in the donee only upon some future date. The present interest rule often requires complicated drafting techniques to obtain the annual exclusion for the value of a gift of a life insurance policy made in trust, or a gift to a minor, to be held in trust until the minor reaches a certain age.[38]

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[33] 26 U.S.C. §2013.

[34] The word "gift" is not defined in the IRC, but the statute does state that the amount of a gift is ascertained when "property is transferred for less than an adequate and full consideration in money or money's worth." 26 U.S.C. §2512(b). Generally, IRS regulations state that a gift is made, for gift tax purposes, when there is a transfer for inadequate consideration and the transaction does not take place in a business context. Treas. Regs. (26 C.F.R.) §25.2511. This should be distinguished from the definition of a "gift" for income tax purposes, which requires that the transfer be made from "detached and disinterested generosity." *Comm'r v. Duberstein*, 363 U.S. 278 (1960). A transfer may, therefore, be a gift for gift tax purposes, because there was no legally sufficient consideration, but not constitute a gift for income tax purposes, because it was not motivated by detached and disinterested generosity.

[35] 26 U.S.C. §2512. Special valuation rules for valuation freezing transactions are set forth in 26 U.S.C. §2701 through 2704.

[36] 26 U.S.C. §2503. This figure is indexed for inflation.

[37] 26 U.S.C. §2503(e).

[38] But see 26 U.S.C. §2503(c), for a special rule granting the annual exclusion for gifts to certain trusts created for the benefit of minors that permit the income to be expended for the benefit of the minor until the minor attains age 21 and require the minor to be given outright ownership of the trust assets at that age or, if the minor should die prior to (continued...)

Married couples may double the annual exclusion through "gift-splitting," an arrangement in which one spouse consents to being treated as having made one-half of the gifts made by his or her spouse in that taxable year.[39] The election is made by a notation on the gift tax return, and results in each spouse receiving a $14,000 per donee exclusion for one-half of the value of the same gift. Therefore, married couples may annually exclude $28,000 per donee from their tax liability by gift-splitting.

Several deductions are also available for the donor to reduce his/her tax liability. A donor may deduct the value of certain interspousal gifts.[40] Like its estate tax counterpart, the gift tax marital deduction is not allowed for most gifts of terminable interests.[41] A donor may also deduct the value of certain charitable gifts. The value of the gift may be deducted only if the charity is of a type described in the applicable statutory provision, which describes most, but not all, of the charities for which deductible income tax contributions may be made.[42]

The division of property incident to a divorce or separation agreement may result in the interspousal transfer of property for consideration which is not adequate for gift tax purposes. Consequently, the IRC provides that interspousal transfers pursuant to a written agreement dividing the property of the spouses and occurring within one year before and two years after a decree of divorce will not be treated as taxable gifts. However, in order to meet this provision, the agreement must settle the marital rights of the spouses or provide for a reasonable allowance for the support of minor children.[43]

The renunciation of property given one by another person might be viewed as either the negation of the initial gift, resulting in no gift tax liability, or as a reciprocal gift, resulting in two gift tax liabilities. The gift will be ignored for gift tax purposes if a disclaimer is made in writing before the donee has accepted any benefits of the property and within nine months of the gift's date.[44]

Computation of the Gift Tax

The tax liability of a taxable gift is measured initially by the value of the transferred property.[45] The gift tax follows the same progressive rates as the estate tax.[46] The tax is then applied cumulatively to taxable gifts made over the donor's lifetime.

The actual computation of the gift tax for each calendar year is completed in three steps. First, the donor's taxable gifts for the calendar year and any preceding calendar periods are totaled and the tentative tax determined. Second, the tentative tax is again calculated using the total taxable gifts

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attaining age 21, to designate by will or otherwise the disposition of the property.

[39] 26 U.S.C. §2513. Gift-splitting also permits use of both spouses' unified transfer tax credits to eliminate present tax on lifetime taxable gifts.

[40] 26 U.S.C. §2523(a).

[41] 26 U.S.C. §2523(b), (f).

[42] *Compare* 26 U.S.C. §2522 and §170(c).

[43] 26 U.S.C. §2516.

[44] 26 U.S.C. §2518.

[45] 26 U.S.C. §2501.

[46] 26 U.S.C. §2001(c).

for preceding calendar periods. Third, the result from step two is subtracted from the result of step one, and the donor's unused unified tax credit is applied to the remaining amount.[47] The combination of the progressive tax rates and the cumulative computation of the gift tax generates the tax liability of larger gifts at progressively higher rates.

The Generation-Skipping Transfer Tax

The Tax Reform Act of 1986 repealed the original generation-skipping transfer (GST) tax, enacted in 1976, because of its complexity and replaced it with a simplified flat-rate tax.[48] The purpose of the resulting GST tax is the same as its predecessor, to close a loophole in the estate and gift tax system where property could be transferred to successive generations without paying multiple estate or gift taxes. The traditional generation-skipping transfers were trusts established by a parent for the lifetime benefit of the children with the remainder passing to the grandchildren. If properly drafted, an estate or gift tax would not be imposed when the trust corpus passed from the settlor's children to the settlor's grandchildren because the estate tax is not imposed on interests that terminate at death. This discussion will divide the generation-skipping transfer tax into two components: generation-skipping transfers and the computation of the tax.

Generation-Skipping Transfers

The GST tax is a flat-rate tax. The rate is set at the highest estate tax rate, currently 40%.[49] This tax rate is applied to three different transfer events: a direct skip, a taxable termination, or a taxable distribution.

A direct skip is a transfer to a skip person. A skip person is a person assigned to a generation two or more generations below the transferor's.[50] A transfer to a trust is a direct skip if all the interests in the trust are held by skip persons.[51] A taxable termination is a termination by death, lapse of time, release of power, or otherwise of an interest in property held in trust. A taxable termination does not occur if immediately after the termination a non-skip person has an interest in the property or if after the termination, the trust makes a distribution to a skip person.[52] A taxable distribution is a distribution from a trust, other than a taxable termination or direct skip, to a skip person.[53]

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[47] 26 U.S.C. §§2502, 2001(c), 2505. P.L. 111-312 restored the total unification of the unified credit so that the full applicable exclusion amount is available to offset gifts. The 40% top rate must be used for computing the amount of credit used when grossing up any previously made gifts where a higher rate was used.

[48] Staff of the Joint Committee on Taxation, 100th Cong., 1st Sess., *General Explanation of the Tax Reform Act of 1986*, 1263 (1987). P.L. 11-312 brought back the generation-skipping transfer tax after a hiatus for 2010.

[49] 26 U.S.C. §2641(a).

[50] 26 U.S.C. §2613.

[51] 26 U.S.C. §2612.

[52] 26 U.S.C. §2612.

[53] 26 U.S.C. §2612.

An important step in determining the GST tax is to assign all persons involved to a specific generation level, as outlined in the IRC.[54] Persons related to the transferor or spouse are assigned along family lines. For example, the transferor, spouse, and brothers and sisters are in one generation, their children in the next, and grandchildren in the next. Lineal descendants of a grandparent of the transferor or spouse are assigned to generations on the same basis. Anyone ever married to a lineal descendant of the transferor's grandparent or the spouse's grandparent are assigned to the level of their spouse who was a lineal descendant. Non-relatives of the transferor are assigned generations measured from the birth of the transferor. Persons not more than 12½ years younger are treated as members of the same generation as the transferor. Each 25-year period thereafter is treated as a new generation. A grandchild of the transferor or spouse is moved up one generation if his parents are deceased at the time of the transfer.[55]

Computation of the Generation-Skipping Transfer Tax

The first step in calculating the GST tax is to determine the taxable amount. For direct skips, the taxable amount is the value of the property received by the transferee.[56] The GST tax on direct skips is tax-exclusive, meaning that the amount of tax paid is proportional to the pretax value of the transferred property. Contrastingly, the taxable amount for taxable terminations and distributions is tax-inclusive. The taxable amount for these property transfers is determined by including the tax value with the value of the property before applying the tax rate.

The second step in calculating the GST tax is to apply the applicable rate. The applicable rate is the maximum Federal estate tax rate (40% for 2013) and the inclusion ratio of the transfer.[57] The inclusion ratio is figured by subtracting from one ("1") the following fraction: the portion of the GST exemption allocated to the transfer as the numerator and the value of the property transferred as the denominator.[58] To compute the generation-skipping tax, the value of the transfer is multiplied by the tax rate (40%) and by the inclusion ratio.[59]

The IRC provides several exemptions and exclusions for the GST tax.[60] Unlike the estate and gift taxes, the GST tax does not use the unified credit. Instead, a $5,250,000 GST exemption is allowed to each individual for generation-skipping transfers during life or at death.[61] The exemption is doubled for married individuals who elect to treat the transfers as made one-half by each spouse.[62] An indirect skip property transfer automatically triggers the GST exemption.[63] An

[54] 26 U.S.C. §2651.

[55] 26 U.S.C. §2651.

[56] 26 U.S.C. §2623.

[57] 26 U.S.C. §2641.

[58] 26 U.S.C. §2642.

[59] 26 U.S.C. §2641.

[60] *See e.g.,* P.L. 99-514, §1433(b)(3) provided that for transfers made prior to January 1, 1990, each grantor could exempt $2,000,000 in direct skips per grandchild ($4,000,000 for married individuals who elect to treat the transfers as made one-half by each spouse).

[61] 26 U.S.C. §2631(a). The GST exemption is equal to the estate tax unified credit amount, with both indexed for inflation. The GST exemption may be allocated by the transferor or the executor to any generation-skipping transfer. The allocation is irrevocable once made. Unless a contrary election is made, all or any portion of the exclusion not previously allocated is deemed allocated to a lifetime direct skip to the extent necessary to make the inclusion ratio for the transfer zero. 26 U.S.C. §2632.

[62] 26 U.S.C. §2652(a).

indirect skip occurs when the generation one level below the decedent (e.g., children) receives some beneficial interest in the property before the property passes to the generation two or more levels below (e.g., grandchildren).

The exclusions for tuition and medical expense payments from the gift tax[64] also apply to the generation-skipping tax.[65] Additionally, the $14,000 per donee annual exclusion from the gift tax is recognized against taxation of direct skips only (i.e., where the property passes directly to the generation two or more levels below the decedent).[66]

The liability for the tax is determined by the type of transfer. In the case of a taxable distribution, the tax is paid by the transferee. The tax on taxable terminations or direct skips from a trust is paid by the trustee. Direct skips, other than those from a trust, are taxed to the transferor.[67]

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Acknowledgments

This report was originally written by John R. Luckey, former Legislative Attorney.

(...continued)

63 26 U.S.C. §2632(c).

64 26 U.S.C. §2503(e).

65 26 U.S.C. §2611(b).

66 26 U.S.C. §2642(c).

67 26 U.S.C. §2603.