

Common GST Problems

How to Avoid Them and How To Fix Them

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Denver Estate Planning Council

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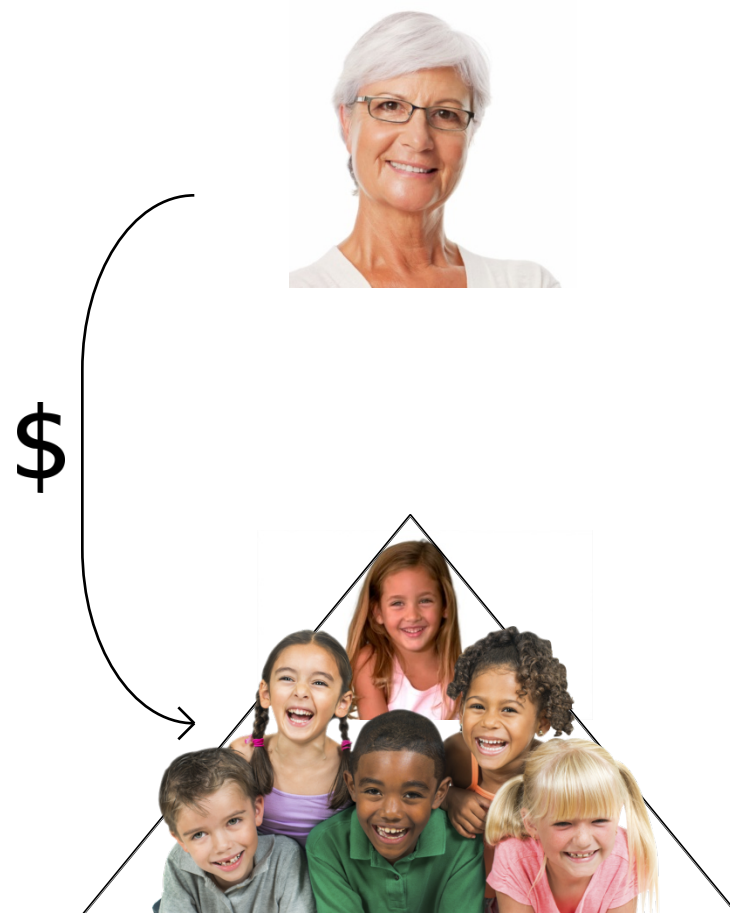
Program Outline

- ▶ Background
- ▶ Common problems
- ▶ How to Avoid Them
- ▶ How to Fix Them

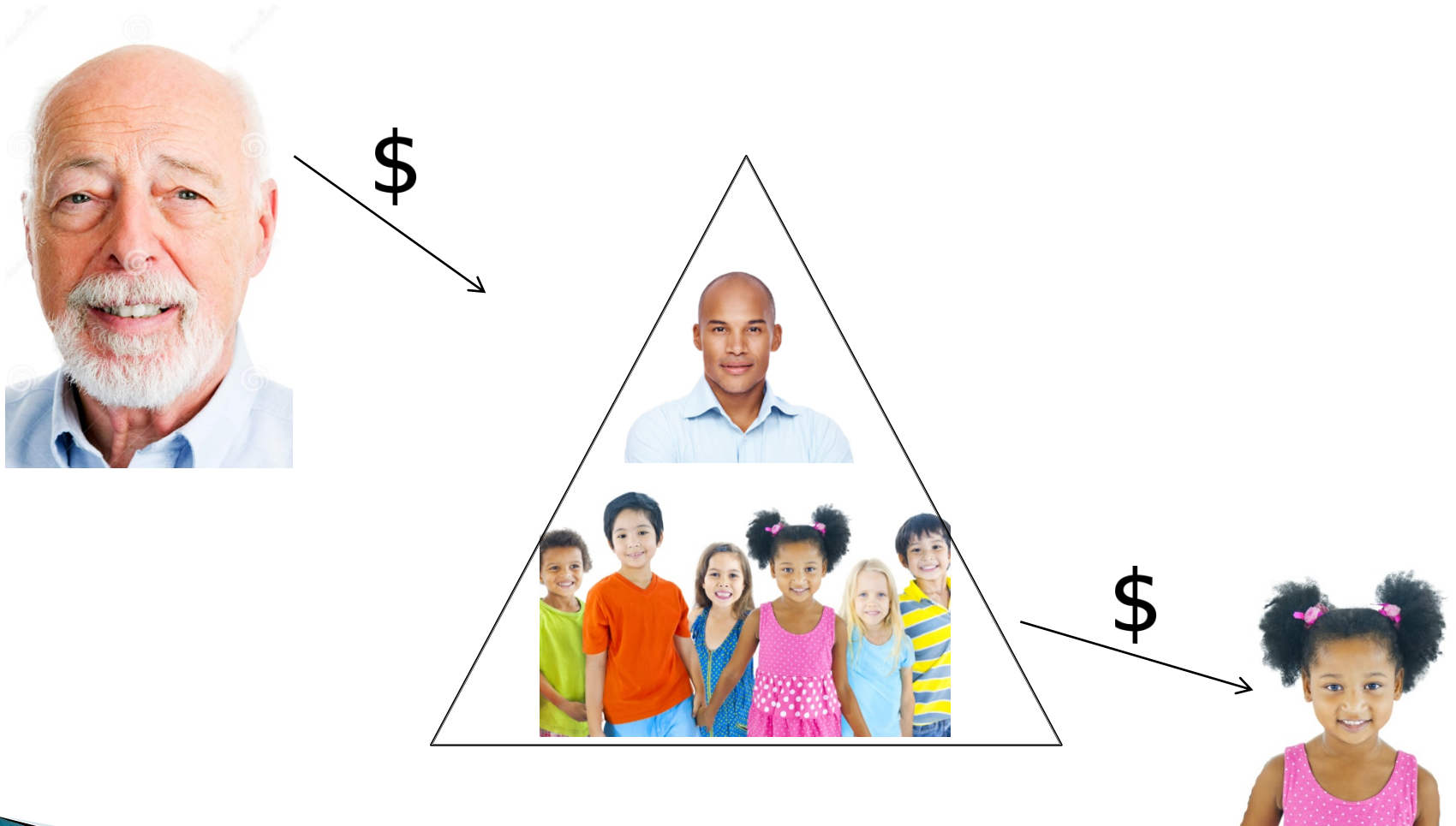
Direct Skip



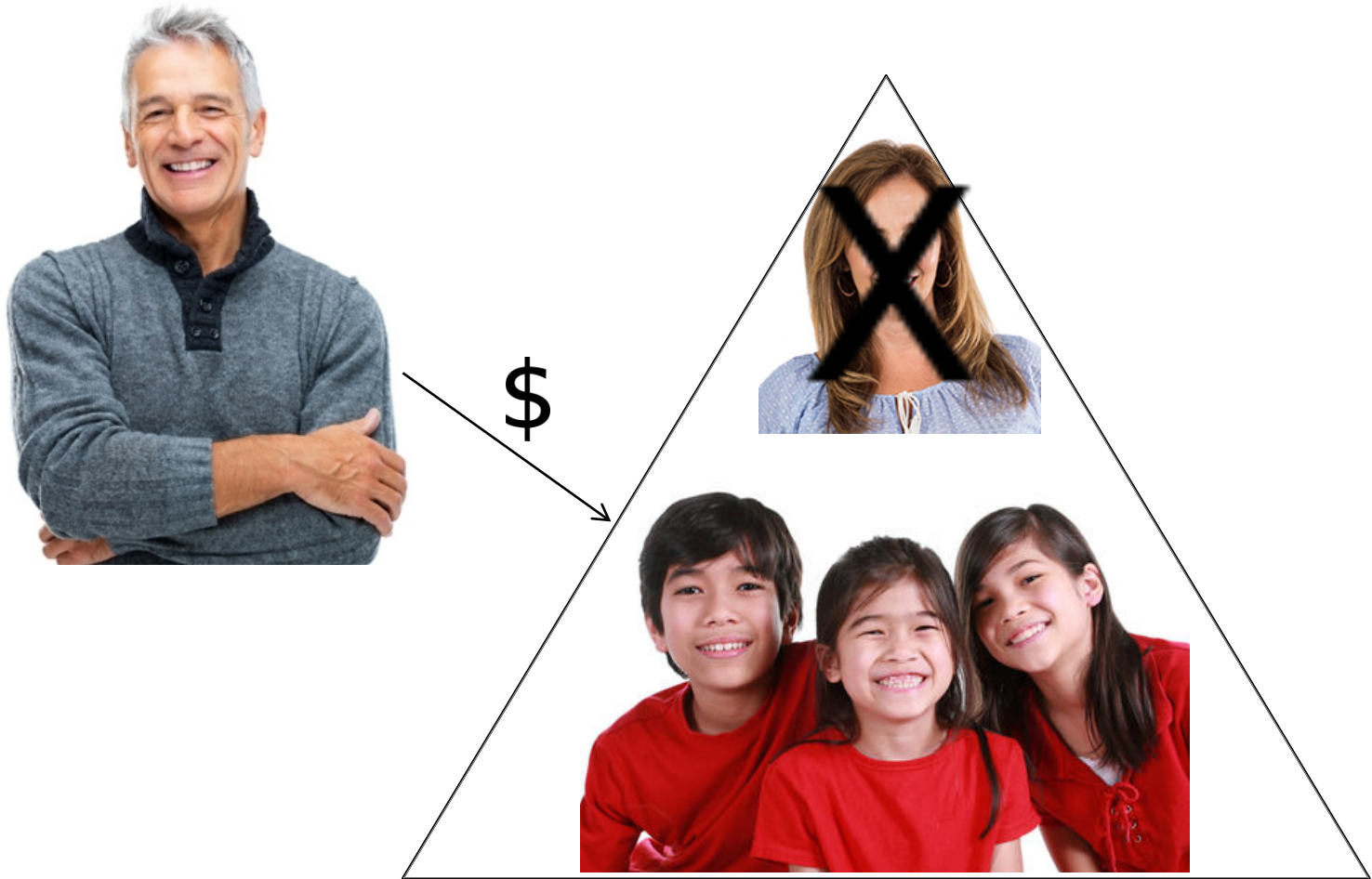
OR



Taxable Distribution



Taxable Termination



Background: Pre-2001 Deemed Allocation

- ▶ Lifetime Direct Skips
- ▶ Unused exemption at death
 - First, to direct skips at death
 - Second, to trusts from which a TD or TT might occur at or after the transferor's death
 - Within categories, proportional

Background: 2001 Changes in Law

- ▶ More deemed allocations:
 - Deemed allocation to lifetime gifts to “GST Trusts” (Code section 2632(c))
- ▶ Created avenues of relief:
 - 9100 –type relief made available for late GST elections (Code section 2642(g)(1); Notice 2001-50
 - Added substantial compliance (Code section 2642(g)(2))

Misplaced Reliance on Deemed Allocation

- ▶ Deemed allocation rules *usually* work as we would like
- ▶ Notable exceptions:
 - Insurance trusts
 - ETIPs
- ▶ The arguments for not relying on deemed allocation
 - Preparer should be thinking about each allocation
 - Correct answer may depend on wealth of the taxpayer

Improperly Categorizing Gifts

- ▶ Direct skip defined
 - An outright gift to a skip person
 - A gift in trust, where the trust has only skip persons as current beneficiaries
 - A gift in trust that has no current beneficiary and no permitted distributions to non-skip persons
- ▶ Indirect skip defined
 - A transfer of property to a GST trust
 - Trust is not a skip person
 - The trust has “GST potential” (could have TD or TT in the future)

GST Trust Defined

- ▶ A trust that could have a GST with respect to the transferor UNLESS:
 - More than 25% of corpus distributable to non-skip persons
 - before age 46 OR
 - upon the death of someone >10 years older than the non-skip person OR
 - If non-skip person dies, distributable to estate or subject to GPOA
 - Recipient is trust
 - any portion included in non-skip person's estate
 - that is a CLAT, CRAT, CRUT or certain CLUTs

The Form 709 – Schedule A

- ▶ Part 1: Gifts subject only to gift tax
- ▶ Part 2: Direct skips – list in chronological order
 - Including at the end of an ETIP
- ▶ Part 3: Indirect skips (“may later be subject to GST”) – list in chronological order
 - Includes both “GST Trusts” and
 - Non GST Trusts

The Form 709 – Schedule D

From Schedule A	To Schedule D
Part 1 – Gifts Not Subject to GST	Doesn't go on Schedule D
Part 2 – Direct Skips	Schedule D, Part 1
Part 3 – Indirect Skips	Schedule D, Part 2 <ul style="list-style-type: none">•Line 5 if automatic allocation•Line 6 if manually allocating (must attach Notice of Allocation)•Don't list if not allocating exemption

Elections on the Return

- ▶ Schedule A, Part 2 (direct skips)
 - Election out of deemed allocation under section 2632(b)
- ▶ Schedule A, Part 3 (indirect skips)
 - Section 2632(c) election
 - This could be for this gift or
 - For all future gifts to this trust or
 - Both

Annual Exclusion Gifts

- ▶ Gift tax annual exclusion (Code section 2503(b))
 - Transfer
 - To any person
 - Of a present interest
- ▶ GST counterpart to the annual exclusion (Code section 2642(c))
 - Is a direct skip which is a non-taxable gift for gift tax purposes
 - Only applies to a gift in trust if
 - For the benefit of one skip person beneficiary
 - Only the one beneficiary can receive any income or principal during the life of the beneficiary
 - If the trust does not terminate before the beneficiary's death, the assets of the trust will be included in the gross estate of the beneficiary

Annual Exclusion Gifts: To Allocate or Not?

- ▶ If given a zero inclusion ratio under 2642(c), no issue
- ▶ Was gift pre-2001?
 - See Rev Proc 2004-46 for simplified relief
- ▶ Was gift in 2001 or later:
 - Is trust a GST trust?
 - If yes, deemed allocation
 - Should you opt out?
 - If no, should you manually allocate?

Gift Splitting – A Related Problem

- ▶ Beware of gifts that can't be split
- ▶ And gifts you don't want to split
- ▶ Rules operate differently for gift and GST purposes
- ▶ Rules in Code section 2652(a)
 - Usually transferor is the donor
 - If any portion is treated as gift by spouse, spouse is also the transferor of that portion
 - Treas. Reg. 26.2652-1(a)(4): even if electing spouse has an interest in the transferred property
- ▶ What if election is made but trust is wholly ineligible for gift splitting? PLRs 201523003, 201108010

How To Avoid Problems with Annual Exclusion Gifts

- ▶ Be aware of the difference between gift and GST rules
- ▶ File a gift tax return even for annual exclusion gifts
- ▶ Question whether or not allocation is appropriate
- ▶ What is the best way to implement – deemed or manual?
- ▶ Properly account for all deemed and manual allocations

How to Avoid Mistakes

- ▶ Categorize gifts correctly on Schedule A
- ▶ Figure out whether or not Part 3 gift are to GST trusts
- ▶ Consider the column C checkboxes carefully
 - Include an opt out statement where required
- ▶ Carry forward the Schedule A items to Schedule D
- ▶ Include a Notice of Allocation for all indirect skips to which you are manually allocating exemption
- ▶ Regard prior returns with a healthy skepticism
- ▶ Put helpful language in your trust instrument

ETIPs

- ▶ Allocation to a trust with an ETIP not valid until ETIP ends
 - An ETIP postpones a direct skip
- ▶ Automatic allocation rules may apply at end of ETIP
- ▶ Examples
 - GRAT
 - Certain UGMA accounts
- ▶ In year of gift: elect out
- ▶ In year of ETIP termination: consider manual allocation of exemption

How to Prevent ETIP Mistakes

- ▶ Create tickler for year ETIP ends
- ▶ Look out for use of GST exemption for other transfers during ETIP
- ▶ Should you allocate in year ETIP ends?
 - Is it a postponed direct skip?
 - How likely are distributions to skip persons?
 - Is there something better to do with the exemption?

Severances

- ▶ Separate trusts – Code Section 2654(b)
 - Different transferors
 - Substantially separate and independent shares of different beneficiaries
- ▶ Severance of a trust included in the gross estate (Treas. Reg. Section 26.2654-1(b))
 - Pursuant to governing instrument or state law
 - Prior to due date (including extension) for estate tax return
 - Severed on a fractional basis
 - Retroactive to date of death

Severances (continued)

- ▶ Qualified Severance (Treas. Reg. Section 26.2642-6)
 - Pursuant to governing instrument or state law
 - Must be effective under local law
 - Severed on a fractional basis
 - Terms must provide in the aggregate for the same succession of interests
 - Cannot shift a beneficial interest to a lower generation or extend the time for vesting
 - After severance, resulting trusts must have an inclusion ratio of zero or one
 - Must be reported by filing a Form 706-GS(T)
 - Can be done at any time, but has prospective effect only

Reverse QTIP Election

- ▶ Code Section 2652(a)(3) - Election to treat donor/decedent as the transferor of QTIP property
 - Made on same return on which QTIP election is made
 - Must apply to all of the property in the trust
 - Can sever under regulation section 26.2654-1(b) to comply
 - Election irrevocable once made

How to Fix GST Problems

- ▶ Ask for section 9100 relief
- ▶ Argue for substantial compliance
- ▶ Make a late allocation
- ▶ Modify , decant, merge, or sever the trust

Section 9100 Relief

- ▶ Section 9100 relief available for missed elections
 - Available for all GST elections
 - But not where you made the election and should not have
- ▶ 301.9100-2 makes relief available for statutory or regulatory elections, but only for 6 months after deadline
- ▶ 301.9100-3 makes relief available for regulatory elections
 - Notice 2001-50 makes this applicable to GST elections, until final regulations are issued
- ▶ Simplified relief for failure to allocate to annual exclusion gifts, Rev Proc 2004-46

Section 9100 Relief

- ▶ General regulations for regulatory deadlines under 301.9100-3
- ▶ GST specific proposed regulations 26.2642-7 (2008)
- ▶ Must demonstrate that
 - Taxpayer acted reasonably and in good faith
 - There is no prejudice to the interests of the government
- ▶ Support application with evidence of intent, affidavits from all involved
- ▶ Alternative: Ruling request re substantial compliance

Late Allocations

- ▶ If the problem is that you failed to allocate exemption, consider a late allocation
 - Late allocations are effective as of the day made, but can elect to use the value as of the first day of the month. Code section 2642(b)(3) and regulations under 26.2632-1
 - Allocation is made on a Notice of Allocation attached to a Form 709 for the current year
- ▶ If the asset value has declined (or not appreciated very much), late allocation is a good solution
- ▶ If trust too large, consider distributions to non-skip persons first

Modify, Decant, Merge or Sever Trust

- ▶ Modify , decant, or merge the trust
- ▶ Needs to be allowed by state law or the governing instrument and satisfy the “grandfathering” regulations
- ▶ Types of modifications that might help
 - Add a non-skip person beneficiary of future additions
 - Add a GPOA
 - Change distribution standard
- ▶ IRS will not rule on decanting (no rule area); ruling on merger or modification may be available
- ▶ Sever the trust into an exempt trust and a non-exempt trust

Using Indexed Exemption

- ▶ As soon as new year starts, indexed exemption is available for use
- ▶ Don't need to wait for new version of 709
- ▶ Use current version and allocate as a late allocation
- ▶ Effective date of allocation most likely date of allocation

Questions?

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