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A STRATEGY SPOTLIGHT

Generation-Skipping Transfer Tax and Dynasty Trusts: A Primer on Multi-Generational Wealth Transfer Planning

Transferring family wealth across multiple generations is often the dream of many American families. However, without careful planning the generation-skipping transfer tax (GSTT) assessed at a rate equal to the highest federal estate tax rate (currently 40%) can substantially reduce the net wealth transferred outright or in trust to individuals more than one generation below that of the transferor.

The GSTT is a separate and distinct tax system that applies in addition to the estate or gift tax. Each taxpayer has a federal estate and gift tax exemption of $11,580,000 (2020) as well as an exemption from the GSTT equal to $11,580,000 (2020). Unlike the federal estate and gift tax exemption, a taxpayer must fully allocate his or her GSTT exemption during life or at death. The GSTT exemption is not “portable” between spouses. The balance is not available to the surviving spouse or surviving spouse’s estate for later generation-skipping transfers. With proper planning and allocation of the transfer tax exemption and generation-skipping exemption, a dynasty trust can be created to transfer significant wealth through multiple generations without the imposition of either GSTT or federal estate taxes. The assets held by the dynasty trust are sheltered from any future transfer taxation for as long as the trust lasts. Even when the inheritance is relatively small, the ability to protect the assets from taxes, creditors, and predators through multiple generations can be valuable.

Gifts into an irrevocable dynasty trust using the grantor's (and spouse's) lifetime gift exemption and GSTT exemption can be leveraged with the use of whole life insurance. A survivorship policy on the life of the grantor and spouse can provide an opportunity to minimize taxes and maximize family wealth over many generations. The exemptions (gift and GSTT) are allocated to contributions to the trust used to pay the premiums on life insurance owned by the trust. Insurance death proceeds provide the liquidity needed to support the grantor's family after his or her death.

Case Study

The multi-generational estate tax savings of a dynasty trust funded with life insurance creates a pool of wealth. The following is a simplified example of the savings and helps growth potential of a dynasty trust.

Todd and Carol, a very successful married couple in their 70s, are part owners of a privately held family business. Their combined net worth is estimated to be over $20 million, with most of it in investments and a minority interest in the business. They have two children: Kate and Al. Their children are married and successful in their own right. Todd and Carol have six grandchildren. Todd and Carol transfer their full gift and estate tax exemption amounts to the dynasty trust (and each fully allocates his or her GSTT exemption to the transfer). The left table shows a dynasty trust, as you will see on the following page, allows the assets to grow and be protected from future estate and generation-skipping taxes. On the right side a dynasty trust is not used, transfer taxes are paid at each generation level, thereby decreasing the inheritance left over multiple generations.

DYNASTY TRUST

Generation	Dynasty Beginning Amount	Transfer Taxes	Net Dynasty Trust Transfer
Carol and Todd	$ 23,160,000	$0	$ 23,160,000
Children	$ 48,983,853	$0	$ 48,983,853
Grandchildren	$103,601,807	$0	$103,601,807
Great Grandchildren	$219,119,848	$0	$219,119,848

NO TRUST USED

Generation	Beginning Amount	Transfer Taxes	Net Transfer
Carol and Todd	$23,160,000	$ 0	$23,160,000
Children	$48,983,853	$19,599,541	$29,390,312
Grandchildren	$62,161,085	$24,864,434	$37,296,651
Great Grandchildren	$78,889,146	$31,555,658	$47,333,488

Assumptions:

1 | Estate grows for 25 years after the prior generation's death.

2 | 3.00% growth rate (after taxes and distributions).

3 | Exemption beginning second generation reverted back to $5,000,000 indexed.

4 | 40% transfer tax rate. Assume that subsequent generations are fully utilizing their exemptions to shelter personally earned and acquired wealth.

For a wealthy family, keeping money in the family for multiple generations can be accomplished by understanding the GSTT and working with your estate planning team.

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