

## 6 Elements CPAs Should Know About the Generation-Skipping Transfer Tax

The federal Generation-Skipping Transfer Tax (GSTT) can be important for wealth transfer strategy and design. By addressing the GSTT through proactive estate planning strategies, CPAs can help clients preserve assets, minimize tax liabilities, and ensure their wealth is passed on efficiently. Learn how the GSTT functions to help you support tax planning for clients who intend to pass their wealth to multiple generations of their family.

### 1. What is the GSTT?

The GSTT applies to both direct and indirect transfers of assets to "skip persons," beneficiaries who are more than two generations younger than the donor. This federal tax is imposed in addition to any applicable gift or estate tax to prevent families from bypassing federal estate taxes by transferring wealth directly to grandchildren or other lower-generation beneficiaries. Key aspects of the GSTT include:

- **TAX RATE:** The GSTT is levied at the highest federal estate tax rate, currently 40%, on wealth transfers exceeding the exemption limit.
- **APPLICABLE ASSETS:** Gifts subject to GSTT include 529 plans, brokerage accounts, real estate, digital assets, and other property. Regardless of the asset gifted, if the GSTT is involved, it's subject to the taxation once the exemption threshold is exceeded at a flat 40% tax.
- **EXEMPTION RULES:** Clients can apply their GSTT exemption to lifetime gifts or testamentary transfers of their choosing.
- **UNUSED EXEMPTION:** Any portion of a taxpayer's GSTT exemption not used for lifetime gifts remains available for future transfers at death, though it may be subject to reductions if estate tax laws change (e.g., the pending Estate Tax "Sunset" provisions).

### 2. The Different Kinds of Skip Persons

DIRECT SKIP	INDIRECT SKIP
A direct transfer of assets to a "skip person" (such as a grandchild) that is immediately subject to the Generation-Skipping Transfer Tax (GSTT), unless covered by an exemption.	A transfer made to a trust where a skip person is a beneficiary. While this may not trigger the GSTT at the time of transfer, the tax may apply later when distributions are made to the skip person beneficiary, depending on the trust structure and applicable exemptions.

### 3. The Predeceased Parent Rule

This rule applies when a beneficiary (such as a grandchild) receives a gift or inheritance, and their parent (the transferor's child) has already passed away. Under this rule, the grandchild is treated as if they belong to their deceased parent's generation, thereby avoiding the GSTT on the gift or inheritance. A common mistake is assuming that the parent can pass away after the GSTT transfer to qualify for this rule,

but the parent must be deceased **before** the transfer occurs for the exemption to apply.

## 4. GSTT Exemptions and Portability

Each individual or couple passing assets during life or at death has an exemption for federal gift and estate tax purposes. The 2025 lifetime exemption is \$13,990,000 per individual and \$27.98 million for married couples. Individuals and couples also have this same amount of GSTT exemption and can transfer up to this amount during their lifetime or at death without triggering the GSTT. However, while estate tax exemptions are portable between spouses (allowing a surviving spouse to use any unused portion of their deceased spouse's exemption) GSTT exemptions are **not** portable. This means each spouse must proactively plan their GSTT exemption use, as any unused portion does not carry over to the surviving spouse.

## 5. Identifying GSTT Triggers in Estate Planning Conversations

For CPAs working with high-net-worth and ultra-high-net-worth clients, a key indicator that the GSTT may come into play is when grandparents discuss gifting to their grandchildren. Recognizing these scenarios early on can help ensure proper tax planning and compliance. Common situations where the GSTT should be considered include:

- **Grandparents funding a 529 plan for a grandchild:** Contributions may be subject to GSTT if they exceed the annual exclusion threshold.
- **Annual exclusion gifts to grandchildren:** While annual gifts up to the GSTT exclusion limit may avoid tax, exceeding the annual exclusion threshold could trigger GSTT.
- **Healthcare and education gifts for grandchildren:** Direct payments to educational institutions or medical providers qualify for not only a GSTT but also gift tax exclusions, but gifts made through a **Health and Education Exclusion Trust (HEET)** require special planning to avoid GSTT.
- **Clients engaging in wealth transfer and gifting using trusts:** Clients have the opportunity to create trusts that last for generations, maximizing not only transfer tax savings but also creditor protection for beneficiaries.

### Scenario

The first-generation donor (G1) creates a trust for a 2nd generation beneficiary (G2). A third-generation beneficiary (G3) is also a current trust beneficiary but is not in line for distributions while G2 is alive. Here are the possibilities of when GSTT may apply:

- G2 dies, causing the trust assets to be distributed to G3
- G2 dies, and assets are distributed into a trust for G3
- G2 is alive, but G3 is a permissible beneficiary, and there is now a desire to distribute to G3.

Evaluating the estate plan and these differences in distribution can be critical to effective wealth transfer and tax efficiency for high-net-worth clients and their families.

## 6. GSTT Mitigation Strategies

A popular strategy to help circumvent the GSTT is to use dynasty trusts. These trusts provide for each succeeding generation, preventing the need for large, taxable wealth transfers down the generational line. Many commonly used gift trusts can be “dynasty trusts” with the right provisions added to them. Establishing trusts and managing clients' estate taxes involves collaboration between CPAs, wealth advisors, and estate planning attorneys.

### GSTT Planning is Critical

Changing tax laws and fluctuating asset values can impact wealth transfer to subsequent generations of your clients. Tax professionals may consider collaborating with financial advisors and estate planning attorneys to:

- Help clients establish wealth transfer and inheritance planning goals
- Manage potential tax burdens
- Preserve wealth for future generations through estate planning

By working collaboratively with Choreo, CPAs play a crucial role in helping their clients navigate the complexities of the GSTT as they engage in estate planning with the goal of passing wealth to future generations.

#### Sources:

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<https://www.irs.gov/newsroom/irs-releases-tax-inflation-adjustments-for-tax-year-2025>

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