

TO: Clients (Advisors)

DATE: March 8, 2002

RE: Allocation of Generation Skipping Transfer Tax Exemption

As you may know, the generation-skipping transfer tax ("GSTT") is a separate tax on gratuitous transfers that "skip" a generation. It was enacted to close a perceived loophole in the transfer tax system. In short, families were able to avoid estate taxation at the children's generation by transferring property directly to one or more grandchildren (or to trusts for the benefit of children and grandchildren) and were able to avoid estate taxation at many generation levels by transferring property to a "dynasty trust" that lasted for many generations. These types of planning opportunities are still available but must be accomplished within the framework of the GSTT. Currently, every individual has an exemption from the GSTT (a "GST exemption") that shelters up to \$1,100,000 worth of generation-skipping transfers from the GSTT. For many clients, this GST exemption is very valuable because it can be used in conjunction with the above-described trusts to shelter property from many generations of gift and estate taxation. Consequently, I felt it was incumbent upon me to advise my clients who have created one or more irrevocable trusts regarding this change in the law that could result in the inadvertent loss of all or a portion of their GST exemption.

Under prior law, an individual's GST exemption was not automatically allocated to an irrevocable trust that was designed to hold property beyond a child's generation (*i.e.*, a "GST trust"). Many individuals who created "GST trusts" failed to properly allocate their GST exemption to the trust, and as a result, incurred a substantial GSTT liability. To avoid such an inequitable result, the law was changed to provide an automatic allocation of an individual's GST exemption to a "GST trust". However, in solving this problem, another was created. In short, an irrevocable trust that is not intended to be a GST trust may be deemed to be a GST trust for purposes of the automatic allocation rule. Under such circumstances, an individual's GST exemption would be wasted because it is automatically allocated to the trust which was not intended to be a GST trust.

However, an individual may opt out of the automatic allocation of his or her GST exemption to a GST trust on a timely filed gift tax return and may do so with respect to that GST trust for either the year at hand or for all years. This decision regarding whether to opt out of the automatic allocation of GST exemption may be very important in light of current or future estate planning. Therefore, if you or your clients have made transfers after January 1, 2000, to any irrevocable trust, I suggest that you consult with me, your accountant or other tax advisor to determine how to proceed regarding the automatic allocation of your GST exemption. Please note that this may be fairly time-sensitive because gift tax returns are due by April 15, 2002, unless extended.

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