GST Tax: What Every Grandparent Needs To Know Before Making Gifts

By: Principal & Family Wealth Strategist, Abbey Flaum, J.D., LL.M.

As we approach the scheduled sunset of certain tax laws on December 31, 2025, estate planning attorneys are devoting countless hours to discussing estate and gift tax laws with their clients. However, another, often-addressed but less-often-discussed tax, the Generation-Skipping Transfer Tax (“GST Tax”), is also due for a change. This tax is complicated, even for some estate attorneys, but it is important to understand the basics.

John D. Rockefeller is the name often associated with the GST Tax. The business magnate and his family were known for using sophisticated estate planning techniques, including the establishment of “dynastic trusts” designed to pass wealth to multiple generations without incurring estate taxes, thereby allowing numerous generations to avoid substantial estate tax liabilities. The federal GST Tax structure, as it exists today, was adopted in 1986, and was created to prevent families from bypassing estate taxes by “skipping” a generation of tax by transferring wealth directly to younger heirs.

The forty percent (40%) GST Tax is assessed on gifts or inheritances transferred to someone at least 37.5 years younger than the gift giver (the “Donor”), usually the Donor’s grandchildren, great-grandchildren, or trusts for their benefit.

Here are the three primary situations in which the tax applies:

1. **Direct Gifts:** Giving significant gifts directly to grandchildren or younger generations;
2. **Indirect (Trust) Gifts:** Distributions from certain trusts – while the trust is in place or when it ultimately terminates – that benefit grandchildren or younger generations; and

3. **Estate Transfers:** Including provisions for a significant transfer – directly or in trust – to grandchildren or younger generations under the terms of your estate plan, to take effect following your death.

Much like the estate and gift exemption for bequests and lifetime gifts, there is an exemption that allows Donors to give a certain amount of assets without incurring the GST Tax. In 2024, the estate, gift, and GST Tax exemptions are all the same: $13.61 million. Also like the gift tax, certain gifts are excluded from the GST Tax, including medical expenses paid directly to a grandchild's medical provider, educational expenses paid directly to a grandchild's school, and gifts given directly to a grandchild or to certain eligible trusts for grandchildren that are under the "annual exclusion" amount (currently $18,000 per donor, per recipient, per year). Ultimately, while this tax will only apply to the wealthiest of Americans, you do not have to be a Rockefeller for the tax to apply.

Here is a very simple example of how this works[1]:

- **If you give $13.61 million to your daughter in 2024:** No gift tax is due because the gift is within the exemption limit.
- **If you give $<u>14.61</u> million to your daughter in 2024: You will owe a <u>gift tax of $400,000</u> on the $1 million that exceeds the exemption.**
- **If you give $13.61 million to your grandson in 2024: No gift or GST tax is due because the gift is within the exemption limits.**
- **If you give <u>$14.61</u> million to your grandson in 2024:** You will owe a <u>gift tax of $400,000</u> on the $1 million that exceeds the gift tax exemption, <u>and</u> you will also owe <u>GST Tax of $400,000</u> on the $1 million that exceeds the GST Tax exemption.

The $13.61 million exemption is scheduled for an inflationary increase in 2025, and then, under the 2017 tax act commonly referred to as "The Tax Cuts and Jobs Act," the exemption will essentially be halved on December 31, 2025, to an estimated $7 to $7.5 million per Donor. As a result, estate planners are busy assisting clients with planning to use exemptions before this 2025 deadline, as the IRS issued regulations confirming that individuals who use their exemptions before the sunset will not be adversely impacted in 2026 when the estate, gift, and GST Tax exemptions decrease. In other words, you can give away $13.61 million today, and when the exemption drops, the IRS will not seek any additional tax from you as a result of the change in the laws.

[1]To provide the simplest calculations possible, these examples address only the gift and GST Tax rates applied to the underlined amounts, without considering annual exclusions, additional gift tax due, etc.

If you are like the overwhelming majority of Americans, reading these “basics” will make your head spin…so what do you really need to know? Whether or not the GST Tax will impact you depends on the size of your estate and your estate planning goals. If you are planning to leave a significant amount to your grandchildren or other younger beneficiaries, it is important to work with your financial advisor, CPA, and estate planning attorney to develop a strategy that minimizes taxes and maximizes the inheritance for your loved ones.

If you have any questions or would like to discuss this further, please reach out to your client service team, call us at 404.264.1400, or visit us on the web at **HomrichBerg.com.**

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