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# GENERATION SKIPPING TRUSTS

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The main reason that our clients establish estate plans is to ensure that their estates are distributed according to their wishes upon death. However, we are told over and over again that our clients lay awake at night worrying about providing a large estate to children in rocky marriages, financially irresponsible children, or children who suffer addiction problems. How do you make sure that your hard-earned estate is not squandered by an irresponsible child or their spouse, while still providing some assurance that they will be taken care of in times of need? The answer many times is to include a “Generation Skipping Trust” in your estate plan.

A Generation Skipping Trust (or “GST Trust”) is exactly what it sounds like – a trust in which assets are held in trust for eventual outright distribution to your grandchildren, in effect skipping over your children. This is not intended as a punishment for your children, but rather it is used to protect the GST Trust assets from creditors, unscrupulous individuals, and other unfortunate events, as well as to escape estate tax (or potential double-taxation, as discussed below). GST Trusts afford this protection because the GST Trust assets are held in trust for a child’s lifetime, which means that the assets are never distributed to the child outright. Rather, the assets are managed by a trustee who can make interim distributions to your child according to guidelines dictated by you!

Commonly, GST Trusts are structured so they do not skip over your children completely. Instead, most GST Trusts hold the entire or a portion of a child’s share of the assets in trust for his or her lifetime. The GST Trust is managed by a trustee who is authorized to make income and principal distributions to your child, his or her children (your grandchildren), or some other customized scenario that is best for your family dynamic. In this way, the child receives the lifetime income of the GST Trust funds, while reaping many benefits afforded by GST Trusts.

Clients should seriously consider placing a portion of their estate into a GST Trust to be held for their children’s lifetime if the client is concerned about a child’s creditors, potential ex-spouse, failed businesses, and other misfortunes. A child’s creditors can reach assets which the child holds in his or her own name, even if the assets are inherited or received as a gift from another

person. GST Trusts protect against creditors or other persons trying to attach the GST Trust assets (because the assets are held for your children's lifetimes and are not distributed outright during their lives) because legally the assets are not deemed part of your child's estate and thus cannot be reached by an adverse claimant.

As another example, if your child is a lifetime beneficiary of a GST Trust and he or she divorces, the ex-spouse cannot claim a right to any portion of the GST Trust assets because the assets were never transferred outright to the child. Similarly, if a child experiences liability or a lawsuit, the GST Trust cannot be attached by the Court (or creditor). Also, if you are concerned that your child is a spendthrift who may go through his or her inheritance quickly, a GST Trust allows your child to have access to the trust assets, but not necessarily direct control over the amount or timing of distributions. Similarly, if your child starts a new business and the company fails, the GST Trust is not obligated to be used to pay the debts of the business.

As we have seen in our recent recession, some responsible and levelheaded individuals have fallen on hard times due to lost investments or bad luck with business investments. Further, everyone knows someone who has had a severe illness or injury that results in excessive debt for medical and other expenses not fully covered by insurance. GST Trusts protect against these types of unforeseen catastrophic events and provides a "safety net" for your child during his or her life, while allowing you to control the ultimate distribution of the GST Trust.

Finally, GST Trusts also provide estate tax protection. Because the federal estate tax exemption has risen to its current level of \$5,450,000 per person (\$10,900,000 per married couple), GST Trusts are still widely used by those families who have a taxable estate (above \$10,900,000 for a married couple) who want to ensure to the greatest extent possible that their assets escape double taxation in both the parents' estate and then again in their child's estate. As an example, a family with assets totaling above their joint federal exemption amount (\$10,900,000 in 2016, less any taxable gifts made during life) will be taxed at a rate of 40% on any assets above the exemption amount. Subsequent to that distribution, when the children eventually pass their assets on to their children, the children's taxable estates will be taxed at a rate of 40% again. By "skipping" over the second generation for some assets, families are in effect protecting the GST assets from this double tax.

While GST Trusts require some administration during a child's lifetime, they can provide

significant protection and peace of mind for families with taxable estates or families who wish to protect their children's inheritance for generations to come. Don't discount the use of a GST Trust if it will help to carry out your goals of protecting your assets from both taxation and real life issues.