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## Generation-Skipping Transfer Tax Planning\*

There are federal estate taxes imposed on the estates of decedents that exceed the federal estate tax exemption. The federal estate tax exemption is \$13.61 million in 2024, but note that this exemption is reduced by lifetime taxable gifts. Assets held at death exceeding the estate tax exemption will be subject to estate taxes unless offset by a marital deduction for assets passing to a surviving spouse or by a charitable deduction for assets passing to a qualified charity. Note that the exemption is scheduled to be lowered significantly in 2026 absent legislation to address this anticipated change.

Usually, when parents pass away, the children receive their inheritance after the payment of estate taxes. Subsequently, when the children pass away, their estates are subject to another round of estate taxes before the remaining assets pass to their children, and so on. In other words, the IRS gets a “bite” with the passing of each generation.

For wealthier families, one solution to save on estate taxes is to leave assets to lower generations, skipping the intervening generations that do not need the assets to maintain their standard of living. Note that the federal government imposes an additional tax on generation-skipping transfers if the value of the assets exceeds the decedent’s unused generation-skipping transfer tax (GSTT) exemption, which is also \$13.61 million in 2024 (and also scheduled to be lowered in 2026). This GSTT is an additional tax (at the highest marginal rate) imposed for skipping one or more generations with gifts or inheritance.

For example, if a decedent dying in 2024 leaves an estate of \$15,000,000 to his grandchildren instead of to his living children, then there is an estate tax on the value of the estate assets exceeding the decedent’s unused federal exemption, plus an additional tax imposed on the value of the estate assets exceeding the decedent’s unused GSTT exemption.

Alternatively, assume that a parent had not made any lifetime taxable gifts, so his unused federal estate tax exemption and his unused GSTT exemption are both \$13.61 million. To minimize estate taxes for the family, the parent might instead leave \$13.61 million to his grandchildren to utilize the estate tax exemption and the GSTT exemption, while leaving the excess assets to his children to avoid the “penalty” tax for generation skipping. In this example, the parent maximized the use of the GSTT exemption, while not incurring the additional tax on the excess over the GSTT exemption. On their subsequent deaths, the children’s assets will be subject to estate taxes if exceeding their available exemptions at that time, but the \$13.61 million (plus all growth thereon) that passed to the grandchildren is not subject to estate taxes on the children’s deaths.

While this planning may lower the family’s taxes over generations, what if the children could use the assets or the parent was simply not comfortable skipping the children for some reason? In that case, the parent’s assets can be used to fund a GSTT trust with special provisions that allow the children to benefit from the assets without subjecting the assets to estate taxes on the children’s deaths. This can be accomplished by restricting a child’s access to the trust assets, either by providing for certain restrictions on the child’s right to withdraw assets from the trust, or by appointing a trustee (other than the child) with the discretion to make or withhold distributions as the trustee sees fit. With a GSTT trust for children and more remote descendants, family wealth can be managed for many generations (subject to state law with respect to the permissible duration of trusts) without being subject to estate taxes as each generation passes.

\*This article is for informational purposes only and is not intended as legal advice.