[Washington Law Review](https://digitalcommons.law.uw.edu/wlr)

Volume 53 | Number 1

12-1-1977

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In the course of his vice-presidential confirmation hearings,[1] Nelson Rockefeller disclosed that he was the income beneficiary of two trusts which had a value of $116 million.[2] Under one of these trusts, his children will receive, after his death, the income for their lives and the trust property finally will be distributed to his grandchildren[3]—without payment of transfer taxes at Nelson's or his children's generation levels.[4] His father, John D. Rockefeller, Jr., used such trusts with liberality;[5] in 1974, the aggregate value of all such trusts created by the elder Rockefeller for lineal descendants was approximately three-quarters of a billion dollars.[6]

Transfers under arrangements such as the Rockefeller trusts—known as generation-skipping transfers—can guarantee substantial tax savings. Indeed, although Nelson Rockefeller has received vast sums of money under the trusts, *viz.*, $38 million over a ten-year period,[7] the trust property will likely escape transfer taxation until the twenty-first century.[8] This loophole has existed for generation-skipping transfers in trust because the termination of an interest in trust

1. *Nomination of Nelson A. Rockefeller of New York to be Vice President of the United States: Hearings Before the Senate Comm. on Rules and Administration,* 93d Cong., 2d Sess. (1974) [hereinafter cited as *Senate Rockefeller Hearings*]; *Nomination of Nelson A. Rockefeller to be Vice President of the United States: Hearings Before the House Comm. on the Judiciary,* 93d Cong., 2d Sess. (1974) [hereinafter cited as *House Rockefeller Hearings*].

2. *Senate Rockefeller Hearings, supra* note 1, at 48; *House Rockefeller Hearings, supra* note 1, at 29. Rockefeller also appears to have contingent remainder interests in trusts created for his sister and brothers. *Senate Rockefeller Hearings, supra* note 1, at 297 (testimony of Nelson A. Rockefeller).

3. *Senate Rockefeller Hearings, supra* note 1, at 45, 132 (statement and testimony of Nelson A. Rockefeller). In the other trust, Rockefeller's children will receive the trust property on his death. *Id.* at 45; P. Collier & D. Horowitz, The Rockefellers 561 n.* (1976).

4. *See* note 9 *infra.* Although in 1976 Congress provided for the taxation of certain generation-skipping transfers, *see* note 23 *infra,* the transfers under the Rockefeller trusts will be exempt from the tax under its "grandfather" provisions. *See* Part VI–*B infra.*

5. P. Collier & D. Horowitz, *supra* note 3, at 204, 484, 560–61.

6. *House Rockefeller Hearings, supra* note 1, at 848 (statement of J. Richardson Dilworth). The three-quarters of a billion dollars figure was based on the trusts created by John D. Rockefeller, Jr. in 1934 and 1952. *See* P. Collier & D. Horowitz, *supra* note 3, at 560. Overall, it has been estimated that he may have created as many as 75 separate trusts for his lineal descendants. *See* F. Lundberg, The Rich and the Super-Rich 156 (1968).

7. This figure represents the combined amount of income Rockefeller received from his two trusts for the 10-year period ending in 1973. *Senate Rockefeller Hearings, supra* note 1, at 47 (statement of Nelson A. Rockefeller).

8. If Rockefeller's youngest daughter, Mary Clark Rockefeller Morgan, lives until age 63, a portion of the trust property will not pass to her children in this century. *See* P. Collier & D. Horowitz, *supra* note 3, at 729 (Mary Morgan was born in 1938).

has not constituted a taxable event for estate or gift tax purposes.[9] As a result, persons have been able to pass their estates intact to recipients a generation or more removed,[10] while reserving some interest therein to members of their own or intervening generations.

Trusts, however, are not the only vehicle for generation-skipping transfers. In the broadest sense, a generation-skipping transfer occurs whenever property passes to a person at least two generations below the transferor and transfer taxation is not imposed at the intervening levels.[11] Thus, an outright transfer of property from a grandparent to a grandchild is a generation-skipping transfer because there is no transfer taxation at the child's generation level. Other generation-skipping arrangements include devises to children for life, with remainders to grandchildren; dispositions involving powers of appointment; and other schemes which split the enjoyment of property between younger generations.

The generation-skipping loophole has been widely used by wealthy families,[12] including the Du Ponts[13] and the Kennedys.[14] In contrast, the vast majority of families find it feasible only to make outright

9. *See* G. JANTSCHER, TRUSTS AND ESTATE TAXATION 38 & n.1 (1967). Gift and estate taxation is based on the transfer of interests in property and only the grantor is deemed to have transferred interests in trust. *Id.* at 2–3. When a successive income or corpus beneficiary receives his present enjoyment in trust property there is no transfer by the preceding beneficiary because his interest merely terminated under the original and only transfer in trust by the grantor.

10. The principal limitation on the number of generations which may be skipped has been the Rule Against Perpetuities. *See id.* at 39. Other restrictions have included the rules against suspension of the power of alienation, against trust duration, and against accumulations in trust. *See generally* L. SIMES, FUTURE INTERESTS 289–328 (2d ed. 1966).

11. *See* C. SHOUP, FEDERAL ESTATE AND GIFT TAXES 37–38, 126–27 (1966).

12. The most recent study is based on statistics from estate and gift tax returns filed in 1957 and 1959. HOUSE COMM. ON WAYS AND MEANS & SENATE COMM. ON FINANCE, 91ST CONG., 1ST SESS., TAX REFORM STUDIES AND PROPOSALS U.S. TREASURY DEPT. 388–89 (Comm. Print 1969) [hereinafter cited as TREASURY PROPOSALS]. In these years, over 25% of the value of property transferred by decedents with gross estates of one million dollars or over passed through the generation-skipping loophole. *Id.* The 1957 and 1959 statistics were extensively analyzed in two other situations. *See* G. JANTSCHER, *supra* note 9, at 60–155; C. SHOUP, *supra* note 11, at 36–46, 137–227.

13. It is estimated that property valued at approximately half a billion dollars is held in generation-skipping trusts created by William Du Pont and his wife in the 1920's. *See* Surrey, *Reflections on the Tax Reform Act of 1976*, 25 CLEV. ST. L. REV. 303, 325 n.40 (1976) (citing Estate of William Du Pont, Jr. v. Commissioner, 63 T.C. 746 (1975)).

14. President Kennedy is reported to have left half of his residuary estate in trust for his children for life, with principal to his children's descendants. *See* W. CASEY, ESTATE PLANNING 25, 109 (1975). Although the amount held in trust is not known, it is estimated that President Kennedy had an estate of approximately $10 million. *See* U.S. NEWS & WORLD REPORT, Jan. 6, 1964, at 4; N.Y. Times, Jan. 24, 1964, §1, at 20, col. 7.

transfers of property,[15] subjecting their wealth to transfer taxation at least once at each generation level.[16] This difference generates substantial inequity because, under the progressive estate and gift tax systems, the tax savings available through generation-skipping transfers increase as wealth increases. When employed,[17] such tax-free transfers have the effect of undermining the progressive tax structure.[18] This discrimination in favor of the wealthy should not be perpetuated under an enlightened transfer tax system.

Completely eliminating the inequities engendered by generation-skipping transfers requires the affirmative resolution of two policy issues: (1) should generation-skipping transfers be taxed, and (2) if so, should all such transfers be subject to tax.[19] In 1969, a United States

15. This undoubtedly stems in part from the uncertainty of less wealthy people that medical and other emergency expenses would be met if their principal were tied up in trust. *See Federal Estate and Gift Taxes: Public Hearings and Panel Discussions Before the House Comm. on Ways and Means,* 94th Cong., 2d Sess. 476 n.1 (1976) (statement of Thomas J. Reese) [hereinafter cited as *1976 House Hearings*].

16. *See* TREASURY PROPOSALS, *supra* note 12, at 388.

17. The tax advantages of generation-skipping transfers create an artificial inducement for disposition which would not otherwise be selected; indeed, families are discriminated against for failure to dispose of property by generation-skipping devices. *See* TREASURY PROPOSALS, *supra* note 12, at 31, 389.

18. *1976 House Hearings, supra* note 15, at 495–97 (statement of Stanley S. Surrey); *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means,* 91st Cong., 1st Sess. 3982–83 (1969) (statement of Jerome F. Kurtz).

19. Although generation skipping is perceived as a problem, the primary focus of scholarly criticism has been on the unfairness of allowing a member of an intervening generation to enjoy property, transfer tax free. *See, e.g.,* C. SHOUP, *supra* note 11, at 38. Those who view generation skipping as abusive because it undermines the progressive transfer tax system, however, would require the taxation of all generation-skipping transfers. *See* note 18 *supra.*

The diverse proposals for generation-skipping taxation are attributable to fundamental disagreements over the appropriate taxation system. Three major systems—each with its own proponents—have evolved: (1) The successions tax system, (2) the accessions tax system, and (3) the additional tax system. The operation of each was extensively studied and reported by the American Law Institute. *See* THE AMERICAN LAW INSTITUTE, FEDERAL ESTATE AND GIFT TAXATION (1969) [hereinafter cited as 1969 ALI STUDIES]. The successions tax is discussed *id.* at 351–410; the accessions tax, *id.* at 446–589; the additional tax, *id.* at 26–31, 166–78. For comparative purposes, it can be assumed that the tax under each system will be paid from the transferred property, although different persons may be liable for the tax. As a result, the systems basically differ in terms of when and how the tax will be determined.

Under a successions tax system, property in a generation-skipping transfer would be taxed when a person succeeded to its beneficial enjoyment as the result of the termination of a beneficially owned present interest. *See id.* at 351–99. The tax would be determined by adding the value of the transferred property to the estate of the person whose interest in the property terminated in order to determine the tax bracket. *See id.* at 399–403; *cf. id.* at 403–04 (there are other possibilities for determining the tax rate). In effect, the successions tax system would be integrated with the estate and gift tax systems. Those advocating a successions tax approach to generation-skipping transfers have included the American Bankers Association, Gerald Jantscher, and Willard Mills III. *See 1976 House Hearings, supra* note 15, at 90–93, 151–85 (setting forth the pro-

Treasury Department study recommended that all generation-skipping transfers be subject to tax, including transfers made outright.[20] When Congress, in 1976, set about to fashion a solution to the generation-skipping problem,[21] however, it decided in favor of taxing certain

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posal of the American Bankers Association); G. JANTSCHER, *supra* note 9, at 172–90; Mills, *Transfers from Life Tenant to Remainderman in Relation to the Federal Estate Tax*, 19 TAXES 195 (1941).

Under the accessions tax system, the time for determining the tax would be the same as for succession tax purposes, *i.e.*, on the expiration of an interest in property. *See* 1969 ALI STUDIES, *supra* at 508. *But see id.* at 522. However, under the accessions tax proposal, the tax on the property would be determined by reference to the recipient's transfer tax brackets. *Id.* at 446, 509. In addition to Professor Andrews, who was the reporter for the American Law Institute's accessions tax proposal, Professors Halbach and Shoup have advocated the system for taxing generation-skipping transfers. *See* Andrews, *What's Fair About Death Taxes?*, 26 NAT'L TAX J. 465, 466-67 (1973); *1976 House Hearings*, *supra* note 15, at 1416–18 (statement of Edward C. Halbach, Jr.); C. SHOUP, *supra* note 11, at 107–13. *See also* Rudick, *A Proposal for an Accessions Tax*, 1 TAX L. REV. 25, 35 (1945).

Due to the complexities of the successions and accessions tax systems, the American Law Institute proposed an additional tax system. *See* 1969 ALI STUDIES, *supra* at 6–7, 30–31, 403–04. Under this system, the tax would generally be determined either at the time a person created a generation-skipping arrangement or upon the termination of an interest. In either case, the tax would be an additional tax determined by reference to the transferor's tax brackets. *See id.* at 30–31, 166–78. The 1969 Treasury Proposals also recommended the additional tax system. *See* TREASURY PROPOSALS, *supra* note 12, at 389–401 (referred to as the "substitute tax").

20. TREASURY PROPOSALS, *supra* note 12, at 389–401. The Treasury proposal on generation-skipping is discussed in Kurtz & Surrey, *Reform of Death and Gift Taxes: The 1969 Treasury Proposals, the Criticisms, and a Rebuttal*, 70 COLUM. L. REV. 1365, 1376-78, 1391–94 (1970).

The earliest generation-skipping tax proposal in this country was made in 1941. *See* Mills, *supra* note 19, at 197, 238. *See generally* G. JANTSCHER, *supra* note 9, at 4–10. Great Britain has had a generation-skipping transfer system since 1894. Mills, *supra* note 19, at 197 n.6. *See* note 25 *infra*.

21. Although generation-skipping tax legislation was first introduced on May 24, 1976, H.R. 13966, 94th Cong., 2d Sess., 122 CONG. REC. H4848 (daily ed. May 24, 1976), the last House bill containing generation-skipping legislation was introduced on July 26, 1976. H.R. 14844, 94th Cong., 2d Sess., 122 CONG. REC. H7758 (daily ed. July 26, 1976).

Generation-skipping legislation was first introduced in the Senate on August 4, 1976 by way of amendments to H.R. 10612, 94th Cong., 1st Sess., 122 CONG. REC. S13,418, S13,421–24 (daily ed. Aug. 4, 1976). On Aug. 6, 1976, the Senate passed H.R. 10612, which included generation-skipping tax provisions. 122 CONG. REC. S13,797 (daily ed. Aug. 6, 1976). H.R. 10612, which had passed in the House on Dec. 4, 1975, 121 CONG. REC. H11,859 (1975), was then sent to a conference committee of the House and Senate.

On August 30, 1976, the House voted for an open-rule on H.R. 14844, which effectively foreclosed the possibility of that bill's passage during the 94th session of Congress. *See* 122 CONG. REC. H9216–24 (daily ed. Aug. 30, 1976). However, the conferees on H.R. 10612 agreed to consider estate and gift legislation, even though the House-passed version of H.R. 10612 contained none. *See* 122 CONG. REC. H10,263 (daily ed. Sept. 16, 1976) (remarks of Congressman Ullman). In the Conference Report, filed on September 13, 1976, 122 CONG. REC. H9809 (daily ed. Sept. 13, 1976), the generation-skipping provisions of H.R. 14844, with certain modifications, were adopted. *See* H.R. REP. No. 94–1515, 94th Cong., 2d Sess. 607, 614–21 (1976), *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 4246, 4252–59 [hereinafter cited as generation-skipping transfers, but against taxing all such transfers.[22]

In the Tax Reform Act of 1976, Congress enacted chapter 13 of the Internal Revenue Code,[23] which only taxes those generation-skipping transfers occurring in trusts and dispositions equivalent thereto.[24] Because this solution exempts certain generation-skipping transfers from tax, and because the structure of chapter 13 permits certain exceptions to transfer taxation, generation-skipping arrangements will remain attractive to those with wealth.

Despite congressional failure to close totally the generation-skipping loophole, chapter 13 of the Internal Revenue Code represents a

CONFERENCE REPORT]. Finally, on September 16, 1976, the House and Senate approved the estate and gift provisions of the Conference Report. 122 CONG. REC. H10,276, S16,028–29 (1976).

22. Interestingly, the House and Senate committee reports on generation-skipping taxation articulate basically the same equitable reasons for taxing less than all generation-skipping transfers as the Treasury Department proposals advanced for taxing all generation-skipping transfers. *Compare* H.R. REP. No. 94–1380, 94th Cong., 2d Sess., *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3356–438 [hereinafter cites as HOUSE REPORT], *and* S. REP. No. 94–938, Pt. II, 94th Cong., 2d Sess., *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 4030–117 [hereinafter cited as SENATE REPORT], *with* TREASURY PROPOSALS, *supra* note 12, at 31, 388–89. Although the Treasury Department made no recommendation to Congress in 1976 on generation-skipping transfers, the 1969 proposal was advanced by others. *Compare 1976 House Hearings, supra* note 15, at 1183–93 (statement of William F. Simon, Secretary of the Treasury) *and id.* at 1196–97 (testimony of Charles M. Walker, Assistant Secretary of the Treasury) *with id.* at 361–62 (statements of Robert Brandon and William Pietz).

The major alternative approaches to generation skipping, discussed at note 19 *supra*, were all presented to Congress. *See, e.g., 1976 House Hearings, supra* note 15, at 48, 71–72 (American Bankers Association proposal); *id.* at 1374–79 (ALI proposal). In addition, another major successions proposal was offered by the American Institute of Certified Public Accountants. *Id.* at 312–16 (statement of William C. Penick). Also, Professor Westfall proposed his "parental deduction" approach to generation-skipping taxation. *Id.* at 508–09 (statement of David Westfall); *see* Westfall, *Revitalizing the Federal Estate and Gift Taxes,* 83 HARV. L. REV. 986, 1012–13 (1970). Under this approach, forty percent of the value of property transferred outright from parent to child would be deductible by a parent for transfer tax purposes. The effect would be to place outright transfers on a relative par with generation-skipping transfers. The resulting revenue loss would be recovered through increased estate tax rates. *Id.* Finally, Congress was presented with the proposal of not taxing generation-skipping transfers at all. *See, e.g., 1976 House Hearings, supra* note 15, at 530 (statement of John C. Davidson).

23. I.R.C. §§ 2601–2622, as enacted by the Tax Reform Act of 1976, Pub. L. No. 94–455, § 2006, 90 Stat. 1879–90 (1976).

24. Congress' approach is explained in the House Ways and Means Committee report as follows:

> [T]he tax laws should be neutral and . . . there should be no tax advantage available in setting up trusts. Consequently, . . . property passing from one generation to successive generations in trust form is to be treated . . . substantially the same as property which is transferred outright from one generation to a successive generation.

HOUSE REPORT, *supra* note 22, at 47; *see* SENATE REPORT, *supra* note 22, at 20. In effect, Congress adopted a successions tax approach to generation-skipping. *See* note 19 *supra.*

radical development in this country's approach to transfer taxation.[25] It is the purpose of this article to analyze the operation and effect of this important and complex system of taxation, highlighting the areas in which future reform may be advisable.

I. THE REQUISITES FOR IMPOSING GENERATION-SKIPPING TRANSFER TAXATION

Section 2601 of the Internal Revenue Code of 1954 imposes a tax on every "generation-skipping transfer," defined by section 2611(a) as "any taxable distribution or taxable termination with respect to a generation-skipping trust or trust equivalent." Because taxable terminations and taxable distributions may occur only in generation-skipping trusts or trust equivalents,[26] these terms present the starting point for analysis.

A. *Generation-Skipping Trusts and Trust Equivalents*

A generation-skipping trust is defined by section 2611(b) as "any trust having younger generation beneficiaries . . . who are assigned to more than one generation." Once the determination has been made that a trust or trust equivalent exists, the younger generation benefi-

25. Prior to the enactment of chapter 13, transfer taxation at each generation depended on the ability of a person as owner or substantial owner to dispose of property. I.R.C. §§ 2033–2042, 2511, 2514. As a result of chapter 13, transfer taxation may be imposed if a person merely enjoys property, even without the freedom to dispose freely of it.

Until 1969, Great Britain employed a relatively ineffective type of successions tax system to reach generation-skipping transfers. *See* Westfall, *Revitalizing the Federal Estate and Gift Taxes*, 83 HARV. L. REV. 986, 1011 (1970). By it, generation-skipping transfers were taxed only on the termination of a life interest, which enabled avoidance of the tax by the use of discretionary trusts. *Id.* at 1011 n.130. Although avoidance possibilities were limited in 1969, they still remained open. *Id.*

In 1975, Great Britain enacted the Capital Transfer Tax. Finance Act, 1975, c. 7, §§ 19–52, *reprinted in* 45 HALSBURY'S STATUTES OF ENGLAND 463–67, 1798–834 (1975). It not only reaches all generation-skipping transfers in discretionary trusts, but imposes a tax every ten years on property held in trust. *See 1976 House Hearings, supra* note 15, at 1231–32 (statement of Carl S. Shoup). As Professor Shoup stated: "It seems not too much to say that the new U.K. capital transfer tax is one of the most significant innovations in the history of tax policy." *Id.* at 1232. Although the American Law Institute recognized a similar possibility for supplementing a successions tax system, chapter 13 of the Internal Revenue Code makes no effort to do so. *See* 1969 ALI STUDIES, *supra* note 19, at 406–10; *cf.* C. SHOUP, *supra* note 11, at 112 (recommending a quinquennial penalty tax on trust property in conjunction with an accessions tax system).

26. *See* I.R.C. §§ 2611(d)(3), 2613(a)(1), (b)(1).

ciary rules need to be explored to discover who the beneficiaries will be and how those beneficiaries will be assigned to generations.

1. The trust element

Although a trust is not defined under chapter 13, the following definition is provided in the regulations promulgated under section 7701, the general definitional section of the Code:

> In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts.[27]

According to this definition, a trust under chapter 13 includes any private express trust[28] created under state law. Although charitable trusts may also be included under this general definition, only arrangements which involve private express trusts[29] will have generation-skipping tax consequences.[30]

2. Trust equivalents

Because generation-skipping arrangements not involving the use of

27. Treas. Reg. § 301.7701–4(a) (1960). Certain arrangements generally considered trusts, *e.g.*, business trusts and certain types of investment trusts, are not classified as trusts under the regulations. *Id.* § 301.7701–4(b) to (d). At the same time, arrangements which are not considered trusts are treated as trusts for certain purposes under the Internal Revenue Code. *See, e.g.*, United States v. De Bonchamps, 278 F.2d 127 (9th Cir. 1960) (life estate-remainder arrangement considered a trust for purposes of I.R.C. § 641(a)). Since these arrangements may be considered generation-skipping trust equivalents under chapter 13, it is not necessary to treat them as trusts for generation-skipping tax purposes.

28. A private express trust is defined under trust law as a "fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it." RESTATEMENT (SECOND) OF TRUSTS § 2 (1959).

29. Although most dispositive schemes involve private express trusts alone, they need not be so limited. Other arrangements may include a private express trust combined with a legal estate (*see* note 39 *infra*), a resulting trust (*see* note 35 *infra*), a constructive trust (*see* note 41 *infra*), and a power of appointment (*see* Part I–*A–3–a infra*). In addition, an arrangement may involve an express trust with private and charitable beneficiaries. *See* notes 61–63 and Part III–*C–2–a infra.*

30. There will be no generation-skipping transfer tax consequences if the sole beneficiaries of a trust are charitable organizations. *See* I.R.C. § 2611(c)(7), *discussed at* notes 61–63 and accompanying text *infra.*

trusts may be employed, section 2611(a) defines "any taxable distribution or taxable termination with respect to a . . . trust equivalent" as a generation-skipping transfer. Pursuant to section 2611(d)(1), a generation-skipping trust equivalent is defined as "any arrangement which, although not a trust, has substantially the same effect as a generation-skipping trust." For example, a devise of real property to daughter for life, with remainder to grandnephew would be a generation-skipping trust equivalent. Other generation-skipping trust equivalents may include arrangements involving life estates and powers of appointment, estates for years, insurance and annuities, and other non-trust arrangements by which the beneficial enjoyment of property is split between younger generations.[31] For purposes of chapter 13, all of the generation-skipping trust provisions are applicable to generation-skipping trust equivalents.[32]

It may be difficult in certain respects to apply the generation-skipping tax scheme even to undisputed trust equivalents, because its provisions relate most easily to trusts.[33] The real question, however, is how one may determine precisely which arrangements will be deemed generation-skipping trust equivalents. At present there is no adequate answer to this question.[34]

3. *Beneficiaries under chapter 13*

A younger generation beneficiary is defined by section 2613(c)(1) as "any beneficiary who is assigned to a generation younger than the grantor's generation." This concept can be understood only by examining certain departures which chapter 13 takes from trust law. Bene-

31. *See* I.R.C. § 2611(d)(2).

32. Section 2611(d)(3) provides: "Any reference in this chapter in respect of a generation-skipping trust shall include the appropriate reference in respect of a generation-skipping trust equivalent." In addition, the effective date provisions relating to generation-skipping transfers in trust, *see* Part VI–*B infra,* are also applicable with respect to transfers in generation-skipping trust equivalents.

33. For example, in generation-skipping trust equivalents involving life estates and remainders, the remaindermen will presumably be personally liable for the tax in the first instance since there will be no trustee. *See* I.R.C. § 2603(a).

34. This uncertainty may in one respect have been intended by Congress, for it allows the Internal Revenue Service some latitude in policing against the avoidance of generation-skipping taxes. *See* I.R.C. § 2622, *quoted at* note 45 *infra.* If formal devices could accomplish results identical to generation-skipping trust arrangements without being taxed, the tax would to a certain extent become optional, in much the same way as it was prior to present law. *See 1976 House Hearings, supra* note 15, at 1333–36 (testimony of A.J. Casner).

ficiaries under chapter 13 are not limited to persons who have equitable interests in the trust corpus.[35] Rather, a beneficiary is "any person who has a present or future *interest* or *power* in the trust."[36] Furthermore, when noncharitable entities are trust beneficiaries, chapter 13 provides that such entities may be pierced and the individuals which they represent deemed to be beneficiaries.[37] The results of these provisions may be analyzed in three categories: (a) interests in trust, (b) powers in trust, and (c) trusts with noncharitable entities as beneficiaries.

a. Interests in trust

Pursuant to section 2613(d)(1), a person is defined as having an interest in the trust if he "(a) has a right to receive income or corpus from the trust, or (b) is a permissible recipient of such income or corpus."[38] In most cases, individuals who have the right to receive trust income or corpus will be beneficiaries both under chapter 13 and under trust law.[39] In addition, permissible recipients of trust income or corpus generally will be considered beneficiaries for both purposes, provided they are members of a definite class.[40] For example, if annual trust income is to be paid to the grantor's nieces for twenty years in whatever proportion the trustee decides, each niece will be considered a beneficiary under chapter 13 and under trust law.[41]

35. *Cf.* RESTATEMENT (SECOND) OF TRUSTS § 2, Comment f (1959) (beneficiaries under trust law). *See also* A. SCOTT, THE LAW OF TRUSTS § 130 (3d ed. 1967). In limited situations, a person having an equitable interest in the trust subject matter will not be considered a beneficiary of an express trust under trust law. For example, if a testator creates an express trust, but fails to dispose of the corpus, the residuary taker under the will has an equitable interest in the trust subject matter but he is not a beneficiary of the trust. RESTATEMENT (SECOND) OF TRUSTS § 200, Comment b (1959). However, he will be a beneficiary of the resulting trust when it arises. *Id.* § 430, Comment h, Illustration 3.

36. I.R.C. § 2613(c)(3) (emphasis added).

37. *See* I.R.C. § 2611(c)(7), *discussed at* notes 61–63 and accompanying text *infra.*

38. *Accord,* RESTATEMENT (SECOND) OF TRUSTS § 129, Comments b-d (1959).

39. The results may differ if property is not completely disposed of by an express trust. *See* note 29 *supra.* For example, although an individual having an equitable interest in subject matter will not be considered a beneficiary of an express trust, he will be considered a beneficiary of a trust under chapter 13 because his interest will enable him to receive trust income or corpus. *See* note 35 *supra. See also* RESTATEMENT (SECOND) OF TRUSTS § 88, Comment d, Illustrations 5 and 6 (1959).

40. "A class of persons is definite . . . if the identity of all the individuals comprising its membership is ascertainable." RESTATEMENT (SECOND) OF TRUSTS § 120, Comment a (1959).

41. *See id.* §§ 120, 129, Comment d, Illustration 6. However, if an express trust is

However, when the permissible recipients of trust property are members of an indefinite class,[42] persons may be beneficiaries under chapter 13 but not under trust law. For example, *G* creates a testamentary trust with income to *A* for life, and the trustee has the power to give the corpus to whomever he decides, except that the corpus is not to be given to the trustee, his estate, his creditors, or the creditors of his estate.[43] Under trust law, although a valid express trust has been created, no class member has a definite enough interest to be considered a principal beneficiary.[44] In enacting chapter 13, Congress contemplated that the Secretary of the Treasury would promulgate regulations prescribing who the permissible recipients are when trust property may be appointed to an indefinite class.[45]

b. Powers in trust

Chapter 13 departs most dramatically from trust law with respect to persons who hold powers in trust, *i.e.*, trustees, and those who hold

created and the trust property is subject to a special power of appointment, *see* RESTATEMENT OF PROPERTY § 320(2) (1940), the expectant appointees are not deemed to have interests in the trust property. *See* L. SIMES & A. SMITH, LAW OF FUTURE INTERESTS § 424 (2d ed. 1956). As a result, they will not be considered beneficiaries of an express trust. *Cf.* RESTATEMENT (SECOND) OF TRUSTS § 27 (1959) (if a donee of a special power of appointment fails to exercise the power, the expectant appointees may be entitled to the property on a constructive trust theory). In contrast, an expectant appointee will be a beneficiary under chapter 13 because he is a permissible recipient of trust property.

42. "A class of persons is indefinite . . . if the identity of all the individuals comprising its membership is not ascertainable." RESTATEMENT (SECOND) OF TRUSTS § 122, Comment a (1959).

43. In effect, this is a hybrid power of appointment—in between a general and a special power of appointment. *See* HOUSE REPORT, *supra* note 22, at 57 n.15; RESTATEMENT OF PROPERTY § 320, Comment a, at 1829 (1940).

44. The exercise of a hybrid power of appointment is considered optional with the donee. *See* L. SIMES & A. SMITH, *supra* note 41, § 1032. As a result, an expectant appointee has no interest in property held in trust which is subject to a hybrid power of appointment. *See id.* § 421. However, the taker in default will have a vested remainder in the property. *See id.* § 113, at 96 & n.58.

45. Section 2622 provides the Secretary with power to "prescribe such regulations as may be necessary or appropriate to carry out the purposes" of chapter 13. I.R.C. § 2622. With respect to powers exercisable in favor of an indefinite class, the House Ways and Means Committee expected the regulations to specify presumptive takers:

> The committee anticipates that the regulations will provide a series of presumptions to cover such cases and will provide, for example, that such a power will be exercised first on behalf of lineal descendants of the grantor who are members of the younger generation immediately succeeding the generation whose interests have all been terminated.

HOUSE REPORT, *supra* note 22, at 57 n.15. Presumably, the regulations will also pro-powers outside of trust, *i.e.*, donees of powers of appointment. Whether the powerholder is a trustee or a donee of a power of appointment, the person will not be considered a beneficiary under trust law.[46]

Pursuant to section 2613(d)(2), a beneficiary includes a person who has any power to alter or establish the beneficial enjoyment of trust income or corpus.[47] Although chapter 13 does not define what constitutes such a power, a similar concept is utilized in the context of estate taxation.[48] For estate tax purposes, a power to alter or establish beneficial enjoyment exists when a decedent holds a discretionary dispositive power, whether or not the power can be exercised in his favor.[49] Discretionary dispositive powers with regard to trusts include the powers to revoke, terminate, accumulate or distribute income, apportion or allocate income, invade corpus, change beneficiaries, and otherwise alter or amend beneficial enjoyment.[50] Managerial powers alone are not considered sufficient to alter or establish beneficial en-

vide presumptions if a power is coupled with a trust, *i.e.*, if a trustee has an imperative power to designate who, as among an indefinite class, will receive trust property. *See, e.g.*, Clark v. Campbell, 82 N.H. 281, 133 A. 166 (1926). In such situations, no member of the indefinite class would be considered a beneficiary under trust law, although the trustee may appoint the property if he so elects. *See* L. SIMES & A. SMITH, *supra* note 41, § 423; RESTATEMENT (SECOND) OF TRUSTS § 122, Comment c (1959).

46. A trustee is not considered a beneficiary because he holds only a legal, as distinct from an equitable, interest in the trust. *See* RESTATEMENT (SECOND) OF TRUSTS § 126, Comment c (1959). A donee of a power of appointment is not considered to have an interest in property under common law. *See* United States v. Field, 255 U.S. 257 (1921); L. SIMES & A. SMITH, *supra* note 41, § 942. Indeed, I.R.C. §§ 2041 and 2514 (dealing with the taxation of general powers of appointment) were enacted for this reason. *See generally* C. LOWNDES, R. KRAMER & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES §§ 12.2, 29.1 (3d ed. 1974). It is true, however, that a general power of appointment will be treated like an interest for many other purposes. *See* RESTATEMENT OF PROPERTY, Introductory Note, Chapter 25, at 1813–14 (1940).

47. I.R.C. § 2613(c)(2)–(3).

48. *See* I.R.C. §§ 2036(a)(2), 2038, 2041. The concept is also available for income and gift tax purposes. *See* I.R.C. § 674; Treas. Reg. § 25.2511–2 (1972).

49. *See* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, §§ 8.9, 9.17. Presumably, the regulation will provide that a discretionary distributive power which can be exercised only in conjunction with an adverse party will constitute a power under I.R.C. § 2613(d)(2). *See* Treas. Reg. §§ 20.2036–1(b)(3) (1958), .2038–1(a) (1958). The problem of contingent powers will also have to be resolved by regulations. *See, e.g.*, C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, § 9.20, at 228–29.

50. *See generally* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, §§ 8.8–.10, 9.20; R. STEPHENS, G. MAXFIELD & S. LIND, FEDERAL ESTATE AND GIFT TAXATION 4-126 (3d ed. 1974).

joyment for either estate[51] or generation-skipping tax purposes.[52] Thus, a trustee empowered to make investments and allocate principal and income among beneficiaries will not be a beneficiary, although such managerial powers will enable him to affect indirectly beneficial enjoyment.[53] Unlike the estate tax concept,[54] however, the power to alter or establish beneficial enjoyment under chapter 13 does include a power subject to an ascertainable standard.[55] In addition, a "power" under section 2613(d)(2) also includes a limited power of appointment.[56] Thus, the donee of a limited power will generally be considered a beneficiary.[57]

Under the proposed Technical Corrections Act of 1977,[58] an independent trustee would not be considered a beneficiary even though he has the power to alter or establish beneficial enjoyment of trust property.[59] If the measure is enacted, trustee beneficiaries under section

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51. *See* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, § 8.9, at 158. However, pursuant to the Tax Reform Act of 1976, the retention of voting power will constitute the retention of possession or enjoyment over transferred property for purposes of I.R.C. § 2036(a)(1). The proposed Technical Corrections Act of 1977, H.R. 6715, 95th Cong., 1st Sess., § 3(i), 123 CONG. REC. H3798 (daily ed. Apr. 28, 1977), would limit the application of § 2036(a)(1) to cases in which a decedent had voting control of the stock.

52. HOUSE REPORT, *supra* note 22, at 47, 49.

53. It is unclear how a power to vote stock in a controlled corporation will be treated under chapter 13. *See* note 51 *supra*.

54. *See* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, § 9.20, at 225; R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 50, at 4-131 to 32.

55. An ascertainable standard may be defined as "[a] clearly measurable standard under which the holder of a power is legally accountable." Treas. Reg. § 25.2511-1 (g)(2) (1958).

56. *See* HOUSE REPORT, *supra* note 22, at 49. In contrast, estate tax consequences will obtain only when a donee holds a general power of appointment. *See* I.R.C. § 2041.

57. The one exception to this rule, I.R.C. § 2613(e), hereinafter referred to as the "powerholder exception," relates to the power to distribute principal to lineal descendants of the grantor. *See* Part II–C *infra*.

58. H.R. 6715, 95th Cong., 1st Sess., 123 CONG. REC. H3798 (daily ed. Apr. 28, 1977).

59. Section 3(n)(1) of the proposed Technical Corrections Act of 1977 would amend I.R.C. § 2613(e) by redesignating § 2613(e) as paragraph (1) and adding paragraph (2) as follows:

> (A) For purposes of this chapter, an individual shall be treated as not having any power in a trust if such individual—
>
> (i) is a trustee who has no interest in the trust,
>
> (ii) is not a related or subordinate trustee, and
>
> (iii) does not have any present or future power in the trust other than a power to dispose of the corpus of the trust or the income therefrom to a beneficiary or a class of beneficiaries designated in the trust instrument.
>
> (B) For purposes of subparagraph (A), the term "related or subordinate trustee" means any trustee who is—

2613(d)(2) would be primarily limited to related or subordinate trustees.[60]

c. Trusts with noncharitable entities as beneficiaries

Section 2611(c)(7) provides that "if any beneficiary of the trust is an estate or a trust, partnership, corporation, or other entity . . . each individual having an indirect interest or power in the trust through such entity shall be treated as a beneficiary of the trust." In effect, whenever a noncharitable entity[61] is a beneficiary under chapter 13, the entity will be pierced and the individuals having an interest in the entity will be deemed beneficiaries for generation-skipping tax purposes.[62] For example, in a trust with income to Corporation *A* for twenty years and corpus to Partnership *B*, the beneficiaries will include the shareholders of Corporation *A* and each partner of Partnership *B*. As a result, closely held corporations, partnerships, and other entities such as voting trusts cannot be used to avoid generation-skipping transfer taxation.

On the other hand, a literal application of section 2611(b)(7) could produce an administrative nightmare. Consider a trust in which a corporate trustee having thousands of shareholders has the power to invade the corpus for the income beneficiary. Because the corporate trustee is a beneficiary, each shareholder rightfully could be considered a beneficiary of the trust. The anticipated regulations clearly should narrow the scope of this piercing provision.[63]

(i) the spouse of the grantor or of any beneficiary,

(ii) the father, mother, lineal descendant, brother, or sister of the grantor or of any beneficiary,

(iii) an employee of a corporation in which the stockholdings of the grantor, the trust, and the beneficiaries of the trust are significant from the viewpoint of voting control, or

(iv) an employee of a corporation in which the grantor or any beneficiary of the trust is an executive.

60. *See* note 59 *supra; cf.* I.R.C. § 672(c) (defining related or subordinate parties for income tax purposes).

61. Pursuant to § 2611(c)(7), charitable organizations described under § 511(a)(2) and (b)(2) will not be pierced, because the real beneficiary in interest in a charitable trust is the community at large. *See* A. SCOTT, *supra* note 35, at §§ 364, 391 at 3007–08.

62. In contrast, if an entity can be a beneficiary under trust law, it will not be pierced. *See* RESTATEMENT (SECOND) OF TRUSTS § 3, Comment c (1959); *id.* §§ 116, 119, 200.

63. The regulations are to define what constitutes an indirect interest in a noncharitable entity. HOUSE REPORT, *supra* note 22, at 57; *cf.* Treas. Reg. § 25.2511–1(h)

4. Assigning beneficiaries to generations

The rules for assigning beneficiaries to generations are provided in section 2611(c). If as a result of these assignments the trust has two or more younger generation beneficiaries assigned to different generations, the trust is a generation-skipping trust.[64]

Under section 2611(c), beneficiaries are assigned to respective generations in relation to the generation of the grantor of the trust.[65] If beneficiaries are related to the grantor, including relationships by adoption and by the half blood,[66] they are assigned to generations along family lines. Section 2611(c)(1) provides: "An individual who is a lineal descendant of a grandparent of the grantor shall be assigned to that generation which results from comparing the number of generations between the grandparent and such individual with the number of generations between the grandparent and the grantor."

Because the number of generations between a grantor and a grandparent of the grantor will always be one,[67] each beneficiary of a trust will be assigned to a generation by subtracting one from the number of generations between such beneficiary and the grantor's grandparent.[68] For example, *X* creates a family trust with income to his brother for life, with income thereafter to *X*'s daughter for life, with corpus to *X*'s grandchildren. The brother will be assigned to the same generation as *X* since the number of generations between the brother

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(1) (1958) (not all corporations will be pierced for gift tax purposes). *See also* STAFF OF JOINT COMM. ON TAXATION, 95TH CONG., 1ST SESS., DESCRIPTION OF H.R. 6715; TECHNICAL, CLERICAL AND CONFORMING AMENDMENTS OF THE TAX REFORM ACT OF 1976, at 30 (Comm. Print 1977) ("where a corporate trustee is used . . . the termination of a corporate interest does not trigger generation-skipping tax unless there is reason to look through the corporation to individual beneficiaries").

64. I.R.C. § 2611(b).

65. Regulations are to be prescribed for trusts which have more than one grantor. For this purpose, a grantor will include any person who contributes or adds property to a trust. HOUSE REPORT, *supra* note 22, at 48. Presumably, each grantor will be deemed to be a grantor to the extent of the proportionate value of property contributed. Some of the difficult tracing and attribution problems encountered under §§ 2040 and 2515 (the joint tenancy provisions) may arise in trusts with more than one grantor.

66. Relationships by the half blood and by legal adoption are considered relationships by blood for assignment purposes. I.R.C. §§ 2611(c)(3)–(4), 2613(f).

67. Although from one point of view there are two generations between a grandparent of the grantor and the grantor, the resulting assignments under § 2611 (c) would be the same.

68. This method of assigning beneficiaries to generations should be distinguished from the civil and common law methods of ascertaining degrees of heirship. *See* T. ATKINSON, LAW OF WILLS § 8 (1937).

and a grandparent of the grantor is one; the daughter and the grandchildren will be assigned to the first and second generations younger than the grantor since the number of generations between the grantor's grandparent and the daughter and grandchildren are two and three, respectively. *X* has created a generation-skipping trust because the daughter and grandchildren are younger generation beneficiaries assigned to different generations.

Spouses and former spouses of persons assigned to generations pursuant to section 2611(c)(1) are assigned to the same generation as such persons.[69] For example, if in the above trust the life beneficiary after the brother was the daughter's husband, he would be assigned to the daughter's generation. Similarly, any person ever married to the grantor will be assigned to the grantor's generation.[70]

Those beneficiaries not assigned to generations on the basis of family affiliation are assigned on the basis of their age in relation to the grantor's age.[71] Individuals not more than twelve and one-half years younger than the grantor are assigned to the grantor's generation.[72] Individuals more than twelve and one-half years younger than the grantor are assigned to younger generations by increments reflecting an assumption that a generation consists of twenty-five years.[73] For example, an individual who is younger than the grantor by more than twelve and one-half years but less than thirty-seven and one-half years will be assigned to the first generation younger than the grantor.[74]

In rare cases, a person may be initially assigned to more than one generation under the assignment rules. For example, a father adopts

69. I.R.C. § 2611(c)(2).
70. I.R.C. § 2611(c)(2).
71. I.R.C. § 2611(c)(5).
72. I.R.C. § 2611(c)(5)(A).
73. I.R.C. § 2611(c)(5)(C).
74. I.R.C. § 2611(c)(5)(B). A generation assignment based on age may be illustrated as follows: *G* creates a trust for his butler for ten years with corpus to the butler's eldest child. The butler is twelve years older than *G* and the butler's eldest child is ten years younger than *G*. Based on an age comparison, both the butler and his eldest child will be assigned to the same generation as the grantor. If, however, the butler were thirteen years younger than the grantor, he would be assigned to the first generation younger than the grantor. If the butler's son were more than thirty-seven and a half years younger than the grantor, he would be assigned to the second generation younger than the grantor so that a generation-skipping trust would exist. If, however, the butler's son were less than thirty-seven and a half years younger than the grantor, there would be no generation-skipping trust since both the butler and his son would be assigned to the first generation younger than the grantor.

X, his grandchild, and then creates a trust naming her as income beneficiary. Because *X* is a lineal descendant of a grandparent of the grantor, she will be assigned to the second generation younger than the grantor, but because she was adopted by the grantor, she arguably will also be assigned to the first generation younger than the grantor's generation. Section 2611(c)(6) provides that in such cases the beneficiary will be assigned to the younger generation.[75]

When a person is a beneficiary under chapter 13 as a result of his indirect interest in a noncharitable entity,[76] he will also be assigned to a generation based on the applicable family affiliation and age rules of section 2611(c).[77]

B. Generation-Skipping Transfers

Although a generation-skipping trust may enable property to skip transfer taxation at a generation level, the creation of such a trust is not the occasion for imposing a tax under chapter 13. Rather, the tax will be imposed when a generation-skipping transfer in trust occurs.[78] In statutory terms, the occurrence which constitutes a generation-skipping transfer is "any taxable distribution or taxable termination with respect to a generation-skipping trust or trust equivalent."[79] Such taxable distributions and terminations are next explored.[80]

1. Taxable distributions

A taxable distribution is defined by section 2613(a)(1) as "any dis-

75. Section 2611(c)(6) provides as follows: "an individual who, but for this paragraph, would be assigned to more than one generation shall be assigned to the youngest such generation." Since non-family members will be assigned to generations solely on the basis of age, they can be assigned to only one generation. Moreover, if an unrelated person marries a grantor or a relative of a grandparent of the grantor, that person will be assigned only to the grantor's or the relative's generation—assignments by age are to be made only if a person is not related to a grandparent of the grantor or has not been married to such a person or to the grantor. I.R.C. § 2611(c)(2), (5). As a result, § 2611(c)(6) has limited application.
76. *See* Part I–*A–3–c supra*.
77. I.R.C. § 2611(c)(7).
78. I.R.C. § 2601.
79. I.R.C. § 2611(a).
80. Certain trusts accorded special treatment under the "grandchild exclusion" do not involve taxable generation-skipping transfers to the extent of this exclusion. *See* I.R.C. § 2613(a)(4)(A), (b)(5)(A), (b)(6). The significance of this exclusion is discussed at Part II *infra*.

tribution which is not out of the income of the trust (within the meaning of section 643(b)) from a generation-skipping trust to any younger generation beneficiary who is assigned to a generation younger than the generation assignment of any other person who is a younger generation beneficiary." Because the time for imposing a generation-skipping transfer tax is when a taxable distribution occurs, younger generation beneficiaries are generally ascertained immediately before a distribution.[81]

A taxable distribution may be illustrated as follows: *G* creates a discretionary trust with income payable annually to her nephew *X* for life, with corpus to *X*'s eldest child *Y*. *Z* Corporation, as trustee, has the power to invade the corpus for *Y*. Since *X* and *Y* will be assigned to different younger generations, a generation-skipping trust has been created.[82] If *Z* Corporation partially invades the corpus for *Y*, a taxable distribution occurs, because immediately before the distribution *Y* was a younger generation beneficiary assigned to a generation younger than the generation assignment of *X*, who was also a younger generation beneficiary of the trust immediately before the distribution.

As a rule of administrative convenience,[83] generation-skipping transfers of trust accounting income[84] will not constitute taxable distributions.[85] Consider the following situation: *Z*, a trustee, has the power to apportion annually trust accounting income among the grantor's nephew and grandnieces for twenty years; the corpus is then payable to the grandnieces. *Z* also has the power to invade the corpus for the income beneficiaries. If, during the first year of the trust's exis-

81. I.R.C. § 2613(c)(2). A special rule in the case of a series of related transfers is discussed at Part IV–*C infra*.

82. Although the piercing provision of § 2611(c)(7) might apply, it would not alter the fact that a generation-skipping trust exists.

83. House Report, *supra* note 22, at 52.

84. For a definition of income as it relates to estates or trusts see I.R.C. § 643(b). As under § 662(a), it will be important to determine whether an annuity which is payable in all events is satisfied out of trust accounting income or corpus. *See* Treas. Reg. § 1.662(a)–2(c) (1960). If a beneficiary borrows from the trust assets and the loan is unsecured with nominal interest, the transaction may be equivalent to a distribution. In such cases, the Internal Revenue Service may require reporting and closely scrutinize the purported loan. House Report, *supra* note 22, at 52.

85. Because distributions of trust accounting income may be subject to income tax, I.R.C. § 662(a), this exception has the effect of preventing double taxation. If the exception is not applicable, double taxation may be ameliorated under § 691(c)(3). In addition, § 3(a) of the proposed Technical Corrections Act of 1977, H.R. 6715, 95th Cong., 1st Sess., 123 Cong. Rec. H3798 (daily ed. Apr. 28, 1977), would amend § 677 to prevent double taxation when accumulation distributions are made.

tence, *Z* distributes trust accounting income to the grandnieces, no taxable distribution occurs. However, to prevent abuses when trust accounting income and other trust property are distributed, trust accounting income will be deemed to have been first distributed to the oldest beneficiaries.[86] For example, if in the second year *Z* distributes trust accounting income of $2,000 to the grandnieces and invades the corpus to the extent of $2,000 for the nephew, the trust accounting income will be deemed to have been distributed to the nephew and the corpus to the grandnieces. As a result, the corpus distribution will constitute a taxable distribution.

In addition, section 2613(a)(1) provides that "an individual who at no time has had anything other than a future interest or future power (or both) in the trust shall not be considered as a younger generation beneficiary." This exception is consistent with the notion under chapter 13 that a generation-skipping transfer tax should be imposed only if a skipped-generation beneficiary enjoyed the property.[87] Consider the following example: Income to the grantor's wife for life, followed by income to the grantor's son for life, and corpus to the grantor's grandnephew, with a power in the trustee to invade the corpus for the benefit of the grandnephew. If the trustee invades the corpus during the lifetime of the grantor's wife, the grantor's son is not considered a younger generation beneficiary. Because the grantor's son is not a younger generation beneficiary and the grantor's wife is assigned to the same generation as the grantor, the grantor's grandnephew will be the *only* younger generation beneficiary. As a result, invasion of the corpus for his benefit will not be a taxable distribution. It is unclear how far this exception extends. For example, if the son pledged his interest as security or made a gift of his future interest, the son has enjoyed the benefit of the property, and arguably a taxable distribution should be deemed to have occurred.

Finally, section 2613(a)(4)(B) provides that a taxable distribution will not occur to the extent that the distribution also constitutes a transfer which is subject to gift or estate taxes. In effect, there is no need to impose a generation-skipping transfer tax in these situations, because the property will not pass free of any transfer tax.[88] For ex-

86. I.R.C. § 2613(a) (2). *See* House Report, *supra* note 22, at 52.
87. *Cf.* House Report, *supra* note 22, at 50 (discussing this exception under taxable terminations).
88. Although a transfer may be subject to gift or estate taxation, because of

ample, *G* creates a trust with income to her nephew *A* for life, with corpus to the nephew's children. *A* is also given a presently exercisable general power to appoint the trust corpus. If *A* appoints a portion of the trust corpus to his children, the exercise of the power will be deemed to be a transfer which is subject to gift taxation[89] and will not constitute a taxable distribution.

2. *Taxable terminations*

A taxable termination is defined by section 2613(b)(1) as the termination "of the interest or power in a generation-skipping trust of any younger generation beneficiary who is assigned to any generation older than the generation assignment of any other person who is a younger generation beneficiary of that trust." Under this section, a person will be a younger generation beneficiary of the trust only if he was a younger generation beneficiary of the trust immediately before the termination of an interest or power in the trust.[90] Taxable terminations will occur both when the entire corpus of the generation-skipping trust is distributed and when an interest or power terminates, even though other beneficiaries continue to have interests or powers in the trust.

A taxable termination involving the distribution of corpus may be illustrated as follows: *G* creates a generation-skipping trust with income to nephew *X* for life and corpus to nephew's child *Y*. On *X*'s death, his interest terminates and a taxable termination occurs because: (1) *X* was a younger generation beneficiary immediately before the termination; (2) *X* was older than the generation assignment of *Y*; and (3) *Y* was a younger generation beneficiary of the trust immediately before the termination.

The second type of taxable termination, involving an ongoing trust situation, is as follows: *G* creates a generation-skipping trust with income to his daughter *A* for life, then income to his grandnephew *B* for life, and corpus to his great-grandnephew *C*. Upon *A*'s death, a taxable termination will occur although the trust will continue until *B*'s death. Indeed, at *B*'s death, a second taxable termination will occur.

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various deductions and credits a tax may not be imposed with respect to the property. *See, e.g.*, I.R.C. §§ 2010(a), 2503(a), 2523(a).

89. I.R.C. § 2613(a)(4)(B). *See* I.R.C. § 2514(b).

90. I.R.C. § 2613(c)(2). *But see* Part IV–*C infra*.

Although the death of an individual will most often be the occasion for a termination, section 2613(b)(1) provides that a termination may occur not only by death but by "lapse of time, exercise or non-exercise, or otherwise." For example, if *G* creates a generation-skipping trust with income to *A* for ten years and corpus to *B*, after ten years *A*'s interest will terminate by lapse of time and a taxable termination will occur. In addition, the exercise of a power may result in a termination of that power. Consider a generation-skipping trust under which *T*, by virtue of having the power to invade corpus, is a beneficiary and is assigned to a younger generation by the rules in section 2611(c). If *T* exercises his discretion and invades the entire corpus, his power will terminate. Similarly, a termination may occur upon the non-exercise of a power. If a trustee is a younger generation beneficiary of a generation-skipping trust and he fails to exercise his power to appoint the principal to an indefinite class before his death or the expiration of a specific time period, his power will terminate.[91]

Two of the exceptions provided in the case of taxable distributions also apply in the case of taxable terminations. First, a taxable termination "does not include a termination of the interest or power of any person who at no time has had anything other than a future interest or future power (or both) in the trust."[92] Second, a taxable termination does not include any transfer to the extent such transfer is subject to gift or estate taxes.[93]

3. *Coordination of taxable terminations and taxable distributions*

In many cases, the same occurrence will cause a taxable distribution and a taxable termination. Although a generation-skipping transfer tax will be imposed when either occurs, there may be different tax and procedural consequences if the occurrence is treated as

91. *See* RESTATEMENT OF PROPERTY § 367, Comment d (1940).

92. I.R.C. § 2613(b)(1). The House Report contains the following example: "[I]f a trust provided income to the child for life, then to the grandchild for life, with remainder to the great grandchild, and the grandchild was the first to die, there would not be a taxable termination, because the grandchild never held a present income interest in the trust." HOUSE REPORT, *supra* note 22, at 50.

93. I.R.C. § 2613(b)(5)(B). For example, if a younger generation beneficiary dies before his term interest expires, his interest will terminate on death. Since the value of the unexpired term interest will be includible in the beneficiary's gross estate under § 2033, a taxable termination will not be deemed to occur to this extent. *See* note 222 *infra* for an application of this exception to a situation in which a taxable termination may be postponed until the term interest expires.

a taxable termination rather than a taxable distribution and vice-versa. Section 2613(b)(7)(A) stipulates that a taxable termination shall take precedence over a taxable distribution as follows:

> If—
> (i) the death of an individual or any other occurrence is a taxable termination with respect to any property, and
> (ii) such occurrence also requires the distribution of part or all of such property in a distribution which would (but for this subparagraph) be a taxable distribution,
> then a taxable distribution shall be deemed not to have occurred with respect to the portion described in clause (i).

This provision may be illustrated as follows: *G* creates a generation-skipping trust with income to *A* for life and corpus to *B*. If on the day of *A*'s death the corpus is distributed to *B*, a taxable distribution would occur because *A* and *B* were younger generation beneficiaries immediately before the distribution. Because a taxable termination would also occur on *A*'s death, the taxable termination takes precedence and the taxable distribution would not be deemed to have occurred with respect to the property.[94]

II. TRANSFERS EXCEPTED FROM TAXATION

It is clear from the definition of generation-skipping transfers[95] as well as from the legislative history[96] that not all generation-skipping transfers will be subject to tax. The most obvious exception involves generation-skipping transfers[97] made outright, that is, not involving a trust or trust equivalent. In addition, because a generation-skipping trust is not created unless it has younger generation beneficiaries who are assigned to different generations, grantors can avoid transfer taxa-

94. There may be situations in which an event results in termination but does not require distribution, and therefore § 2613(b)(7)(A) would be literally inapplicable. Consider a generation-skipping trust with income to *A* for life and corpus to *B* where the grantor's brother has the power to invade corpus for *B*. If the brother distributes the entire corpus to *B*, *A*'s interest will thereby terminate. Can it reasonably be said that the act of distribution is the occurrence which also requires the distribution? Perhaps the problem can be resolved by treating the exercise of the power as the occurrence which then will require the distribution. Otherwise, there would be a taxable termination and a taxable distribution without either taking precedence.

95. I.R.C. § 2611(a), *quoted in* text accompanying note 79 *supra*.

96. House Report, *supra* note 22, at 47; Senate Report, *supra* note 22, at 21.

97. House Report, *supra* note 22, at 47; Senate Report, *supra* note 22, at 21.

tion by transferring property in trust to one or more younger generation beneficiaries assigned to the same generation. Although these generation-skipping arrangements still allow wealthy families to avoid transfer taxation,[98] they are relatively inflexible ways to dispose of property. By various exceptions under chapter 13,[99] however, additional flexibility can be achieved without the imposition of generation-skipping transfer taxes. The most important of these are the grandchild exclusion and the powerholder exception, discussed in this Part. Because of these exceptions, transfers in trust will continue to receive more favorable treatment than outright transfers of property.[100]

A. The Prerequisites for the Grandchild Exclusion

The tax on a generation-skipping transfer is substantially equivalent to the tax that would have been imposed if a particular person in a skipped generation actually owned the property outright and then transferred it to a person in a lower generation.[101] The person in the skipped generation is the deemed transferor and the person who succeeds to the property or interest in the property in a generation-skipping transfer is the transferee. Although these concepts have broad significance under chapter 13, they will be fully treated at this point because they determine the use and availability of the grandchild exclusion.

1. The transferee concept

Although the transferee concept is not defined by statute, the Conference Report on the Tax Reform Bill of 1976 provides the following guidance:

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98. Because income will likely be taxed to a trust at lower tax brackets than if property were transferred outright, a greater amount of property can be passed transfer tax free by a generation-skipping trust for the grantor's grandchildren. The advantages will be significant in accumulation trusts for wealthy minors since the throwback rules generally do not apply to minors. *See* I.R.C. §§ 665(b), 667.

99. The exception for distributions of trust accounting income was previously considered at note 85 *supra*. Other exceptions will be considered at later points in the article.

100. The exceptions for transfers subject to gift or estate taxes and the exception for future interests or powers do not enable transfers in trust to receive preferential treatment. *See* Part I–*A*–*3*–*a* to *b supra*.

101. HOUSE REPORT, *supra* note 22, at 47–48.

> In the case of a taxable distribution, the "transferee" for the purposes of the tax on generation-skipping transfers is, of course, the person receiving the distribution. In the case of a taxable termination the "transferee" is generally any person who has a present interest or power in the trust or trust property after the termination.[102]

As a result, if a termination requires the distribution of trust corpus, the principal beneficiary will be the transferee.[103] In instances in which a trust will continue after a taxable termination, the transferee will usually be the person who succeeds to a present interest or power after the termination.[104] If persons belong to a definite or indefinite class, there may be multiple deemed transferees; these transferees will be the persons who are permissible recipients of trust income and corpus.[105]

Generally, the transferee will be the person who receives trust property or is entitled to enjoy the trust property as a result of a generation-skipping transfer. In all cases, the transferee with respect to a generation-skipping transfer will be a younger generation beneficiary of the trust who is assigned to a generation two or more generations younger than the grantor's generation.

2. *The deemed transferor concept*

The deemed transferor is defined by section 2612(a) as "the parent of the transferee of the property who is more closely related to the grantor of the trust than the other parent of such transferee (or if nei-

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102. CONFERENCE REPORT, *supra* note 21, at 619.

103. When an income beneficiary's interest terminates, the principal beneficiary succeeds to a present interest in the trust property. As a result, the principal beneficiary will be the transferee even if she dies before the corpus is distributed.

104. If, however, a charitable organization succeeds to a present interest after a taxable termination, the transferee will be the person having the next succeeding interest. CONFERENCE REPORT, *supra* note 21, at 619 n.2.

105. I.R.C. § 2613(b)(3) provides:

> Where, at the time of any termination, it is not clear who will be the transferee of any portion of the property transferred, except to the extent provided in regulations prescribed by the Secretary, such portion shall be deemed transferred pro rata to all beneficiaries of the trust in accordance with the amount which each of them would receive under a maximum exercise of discretion on their behalf. For purposes of the preceding sentence, where it is not clear whether discretion will be exercised per stirpes or per capita, it shall be presumed that the discretion will be exercised per stirpes.

Regulations will have to define the manner in which transferees in indefinite classes are ascertained. *See* note 45 and accompanying text *supra*.

ther parent is related to such grantor, the parent having a closer affinity to the grantor)." Because the transferee will always be assigned to a generation at least two generations below the grantor, the deemed transferor will always be a person assigned to a generation younger than the grantor and older than the transferee's generation. Yet, the deemed transferor will not necessarily be a younger generation beneficiary of the trust. Rather, when a disposition is along family lines, the deemed transferor will be the parent of the transferee who is related by blood or adoption to the grantor (the more closely related parent),[106] even though the other parent of the transferee was the younger generation beneficiary.[107] For example, in a trust with income to the grantor's daughter-in-law for life with corpus to her children, the grantor's son will be the deemed transferor.

However, if the more closely related parent of the transferee is not at any time a younger generation beneficiary, and at least one ancestor of the transferee is a younger generation beneficiary who is related by blood or adoption to the grantor, the youngest such ancestor will be the deemed transferor.[108] For example, in a trust with income to the grantor's son for life and corpus to the grantor's great-grandchild, the son will be the deemed transferor. If an ancestor of the transferee is not a younger generation beneficiary, however, the deemed transferor will remain the more closely related parent of the transferee.

If family members are not involved, the deemed transferor will always be the parent of the transferee having the closer affinity to the grantor.[109] In a trust for the grantor's butler's wife for life, with corpus to the butler's children, the butler will be the deemed transferor since he has the closer affinity to the grantor.[110]

106. Pursuant to § 2612(b), a parent related to the grantor of the trust by blood or adoption is considered more closely related to the grantor than a parent related to such grantor by marriage.

107. Although the House Report confirms this result, HOUSE REPORT, *supra* note 22, at 56, the reason for it is not contained in any committee report.

108. I.R.C. § 2612(a)(2). The House Report notes that an ancestor of the transferee will be the deemed transferor only if the more closely related parent "is not a younger generation beneficiary of the trust at any time." HOUSE REPORT, *supra* note 22, at 55. For example, *G* creates a trust with income to his only child for life and corpus to *G*'s lineal descendants, per stirpes. *A* has a child *B*, who in turn has a child *C*, and *B* dies before *A*. Since *B* was at one time a younger generation beneficiary of the trust, albeit he had a contingent future interest, he, rather than *A*, may be considered the deemed transferor.

109. I.R.C. § 2612(a)(1).

110. There may be situations in which one parent of the transferee does not have

Finally, it should be recognized that a person may be a deemed transferor even though he is not alive at the time of the generation-skipping transfer. In a trust with income to the grantor's daughter-in-law for life with corpus to her children by the marriage, the grantor's son will be the deemed transferor whether he outlives, dies simultaneously with, or predeceases his wife. The amount of tax may be significantly affected depending on whether the deemed transferor is alive or dead at the time of the generation-skipping transfer.[111]

B. *The Grandchild Exclusion*

Special treatment is accorded to generation-skipping trusts if grandchildren of the grantor are beneficiaries, *e.g.*, income to *G*'s son *A* for life and corpus to *G*'s grandchildren. The property will escape gift and estate taxation at *A*'s generation level and, through application of the grandchild exclusion, will also escape the generation-skipping transfer tax when the property is transferred to the grandchildren.

Section 2613 provides that taxable distributions and taxable terminations do not include "any transfer to the extent such transfer is to a grandchild of the grantor of the trust and does not exceed the limitation provided by subsection (b)(6)."[112] Section 2613(b)(6) provides:

> In the case of any deemed transferor, the maximum amount excluded from the terms "taxable distribution" and "taxable termination" by reason of provisions exempting from such terms transfers to the grandchildren of the grantor of the trust shall be $250,000. The preceding sentence shall be applied to transfers from one or more trusts in the order in which such transfers are made or deemed made.

As a result of the grandchild exclusion, grantors can make tax-free-generation-skipping transfers of up to $250,000 per deemed transferor.[113] Although the $250,000 limitation is for each deemed trans-

a closer affinity to the grantor. If in this example the butler's wife also worked for the grantor, who would be the deemed transferor? Or, consider the following trust disposition: Aunt to nephew for life, then to nephew's son's wife. Because neither parent of the transferee will be related by blood to the grantor, will one necessarily have a closer affinity to the grantor? Clearly, regulations will need to resolve these presently insoluble situations.

111. *See* Part III–*B infra*.

112. I.R.C. § 2613(a)(4)(A) (distributions). A similar provision relating to terminations is contained in § 2613(b)(5)(A).

113. House Report, *supra* note 22, at 52. Although the House Report refers to

feror, these rules[114] operate to prevent the creation of multiple deemed transferors by manipulation of the statute. In any transfer to a grandchild of the grantor, the deemed transferor will always be the more closely related parent.[115]

The $250,000 exclusion is to be applied against terminations and distributions in the order in which they occur.[116] For example, *G* creates the following two trusts: Trust 1: Income to *G*'s only child *A* for twenty years, with corpus to *A*'s eldest child *B*. Trust 2: Income to *A* for life, corpus to *C*, another child of *A*. If after twenty years, when *A*'s interest terminates, the fair market value of the property held in Trust 1 is $200,000, a transfer tax will not be imposed and $50,000 of the exclusion can be set off against the value of property in Trust 2 when *A* dies. If there are simultaneous transfers by a deemed transferor and the grandchild exclusion has not been fully utilized, the available exclusion is to be allocated pro rata between the transfers, based on fair market values.[117] Assume that *G* had created a third trust with income to *A* for life and corpus to *A*'s third child *D*. If at *A*'s death, the fair market value of the property held in Trust 2 was $80,000 and in Trust 3, $20,000, then $40,000 of the exclusion would be available to Trust 2 and $10,000 to Trust 3.

Although the more closely related parent will always be the deemed transferor, it does not follow that a grantor can pass only $250,000 to her grandchildren free of transfer tax. The exclusion applies to each deemed transferor; therefore, if the grantor has more than one child, she may be able to transfer some multiple of $250,000 tax free. Consider the following situation: *G* has two children, *A* and *B*. *A* has one child *X* and *B* has one child *Y*. *G* creates a trust with income to *A* for life and corpus to her grandchildren. On *A*'s death, *X* and *Y* will be the transferees, and as a result *A* and *B* will be the transferors. If the corpus at *A*'s death has a value of $500,000 and the exclusion has not been utilized, there will be no taxable termination. If the grantor had three children and a child of each such child was a transferee, up to

an exclusion of $1 million, the amount was reduced in conference to $250,000. CONFERENCE REPORT, *supra* note 21, at 618. *See* note 121 *infra*.

114. I.R.C. § 2612.

115. Except for the grandchild's parents, no ancestor of a grandchild can be assigned to a generation younger than the grantor's. Thus, if the more closely related parent or his spouse is a younger generation beneficiary of the trust, the more closely related parent will always be the deemed transferor.

116. I.R.C. § 2613(b)(6).

117. HOUSE REPORT, *supra* note 22, at 53.

$750,000 could be passed to the grantor's grandchildren transfer tax free. Under the grandchild exclusion, then, a grantor can make tax-free transfers of property in as many multiples of $250,000 as she has children who are themselves parents.

It should also be recognized that if more than one trust is involved, there may be two deemed transferors for each transferee, with the result that one grandchild can receive up to $500,000 free of transfer tax. For example: *G,* the father of *S,* creates a trust with income to *S* for life and corpus to *S*'s eldest child *T. H,* the father-in-law of *S,* creates a trust with income to *S* for life and corpus to *S*'s eldest child *T.* When *S* dies, *T* will be the transferee of both generation-skipping trusts. With respect to the trust created by *G, S* will be the deemed transferor; with respect to the trust created by *H, S*'s wife will be the deemed transferor. Because up to $250,000 may be excluded per deemed transferor, *T* can receive $500,000 free of transfer tax. On the other hand, if *G*'s wife created the second trust, there would be only one exclusion because *S* would be the deemed transferor with respect to both trusts.[118]

Although there are no other statutory limitations on the grandchild exclusion, the Conference Report indicates the exclusion should be available only "where the property vests in the grandchild . . . as of the time of the termination or distribution."[119] For example, in the following trust the grandchild exclusion would not be available because the trust property does not vest in a grandchild: Income to my son for life, with income to my son's child for life, with corpus to my great-grandchildren. At the same time, the Conference Report states that as long as the property vests in the grandchild at the time of the termination or distribution, the exclusion will be available "even where the property continues to be held in trust for the grandchild's benefit."[120] Thus, the exclusion would be available if a grantor created a trust with income to his only son *A* for life with corpus to *A*'s eldest child *B* at twenty-one, but in the event that *B* is under twenty-one at *A*'s death, the income is to be accumulated and paid over, with the corpus, to *B* at twenty-one, or if *B* dies under the age of twenty-one, the

118. *Id.* at 53 n.8.

119. CONFERENCE REPORT, *supra* note 21, at 618. Vesting is not used in the technical sense. Rather, vesting will occur only if the property or some undivided interest therein passes to the grandchild. Moreover, the Conference Report provides that the manner of vesting is not important. *Id.*

120. *Id.*

accumulated income and corpus is payable to his estate. However, if the trust provided an alternate taker in the event that *B* died under twenty-one, the property would not vest in the grandchild at the time of the taxable termination and the grandchild exclusion would not be available.

The grandchild exclusion will seriously undermine the extent to which chapter 13 neutralizes the tax advantages of generation-skipping transfers in trust. Properly utilized, it will enable wealthy families to transfer a significant amount of property free of transfer tax, while those families which can only make outright transfers to successive generations will continue to pay transfer taxes at each generation level. This result cannot be justified; it can only be explained on the basis of political expediency.[121]

C. The Powerholder Exception

Generally, a person holding a dispositive power over trust property will be treated as a beneficiary under chapter 13.[122] If a powerholder is a younger generation beneficiary, a generation-skipping trust may exist and a generation-skipping transfer occur. Pursuant to section 2613(e), a person with the power only "to dispose of the corpus of the trust or the income therefrom to a beneficiary or a class of beneficiaries who are lineal descendants of the grantor assigned to a generation younger than the generation assignment of such individual" will not be considered to have a power in the trust, and will therefore not be treated as a beneficiary.

This powerholder exception permits property to skip a generation of transfer taxation even though children of the grantor will control and thereby enjoy the property. Suppose *G* creates a trust whereby

121. The original House bill, H.R. 13966, 94th Cong., 2d Sess., 122 CONG. REC. H4848 (daily ed. May 24, 1976), contained no grandchild exclusion provision. However, during its final round of decisions, the House Ways and Means Committee approved, by a vote of 19–17, "the one-skip $1 million provision." *See* HOUSE REPORT, *supra* note 22, at 174 (supplemental views of Congressman Abner Mikva and others). The grandchild exclusion of $1 million was subsequently included in H.R. 14844, 94th Cong., 2d Sess., 122 CONG. REC. H7758 (daily ed. July 26, 1976). Although Congressman Mikva attempted to have the exclusion deleted by a floor amendment, 122 CONG. REC. H8252 (daily ed. Aug. 3, 1976), he was defeated in his efforts. *See* 122 CONG. REC. H9216–21 (daily ed. Aug. 30, 1976). The eventual $250,000 limitation was a compromise; the Senate-passed version of H.R. 10612, 94th Cong., 2d Sess., 122 CONG. REC. S13,797 (daily ed. Aug. 6, 1976), contained no exclusion for grandchildren. *See* 122 CONG. REC. H10,263 (daily ed. Sept. 16, 1976) (remarks of Congressman Ullman).

122. *See* Part I–*A–3 supra*.

income is to be accumulated or distributed for *G*'s grandchildren as the trustee (*G*'s son) decides, with corpus payable to each grandchild at age twenty-one. Applying the powerholder exception, *G*'s son will not be a beneficiary of the trust. Since the grandchildren are the only younger generation beneficiaries of the trust, a generation-skipping trust does not exist, and a generation-skipping transfer cannot occur.

As in the case of outright transfers that skip a generation of taxation, the benefits of the powerholder exception will inure principally to families sufficiently wealthy to enable their members to pass property to recipients a generation or so removed without fear that they will leave persons in the skipped generation without adequate resources.[123] In less wealthy families, the children will more likely receive at least an income interest in property, which will thereby render the exception inapplicable.

III. THE IMPOSITION OF TAXATION

A. The Tax Base

Because a generation-skipping transfer tax is imposed on the value of property transferred,[124] a determination must be made as to property which will be included in the tax base.[125] It is also appropriate to consider the exclusion for transfers subject to estate or gift tax[126] and the grandchild exclusion[127] in relation to the tax base.

In the case of a taxable distribution, the tax base will consist of the property's value at the time of distribution.[128] Because a taxable distribution will include a direct payment of generation-skipping transfer taxes with trust property,[129] the property used to pay such taxes will also be included in the tax base.[130]

123. In the event the independent trustee exception is enacted, *see* note 59 *supra*, a further option would be available for making untaxed generation-skipping transfers in trust.

124. I.R.C. §§ 2601–2602, *discussed at* Part III–*B infra.*

125. If, at the time of a generation-skipping transfer, the deemed transferor is a non-resident and not a citizen of the United States, the property included in the tax base will be determined under § 2614(b).

126. *See* Part I–*B–1* and *2 supra.*

127. *See* Part II–*B supra.*

128. HOUSE REPORT, *supra* note 22, at 53.

129. I.R.C. § 2613(a)(3).

130. HOUSE REPORT, *supra* note 22, at 53. In the event a trust authorizes the payment of the generation-skipping transfer tax out of the trust property, the tax will have to be determined, with great difficulty, on a pyramidal basis. *Cf.* Safe Harbor

In the case of a taxable termination, the property includible in the tax base will depend on whether an interest or a power in the trust terminates. When an interest terminates, the House Report specifies that the tax base should include "the value of the trust property in which an interest has terminated."[131] For example, if *G* creates a generation-skipping trust with income to *A* for life and corpus to *B*, the property included in the tax base will be the value of the trust property at *A*'s death. The same result occurs when a trust has successive income beneficiaries who are assigned to different generations: *G* creates a generation-skipping trust with income to *A* for ten years, income to *B* for ten years, and corpus to *B*'s wife. When *A*'s interest terminates after ten years, the property held in trust will be included in the tax base.

If a person holds a power in trust and the termination of his power causes a taxable termination, section 2613(b)(4) provides that "the property transferred shall be deemed to be the property subject to the power immediately before the termination." For example, *G* creates a generation-skipping trust with income to her husband for ten years and corpus to her grandnephew *A*. *G*'s son *T*, as trustee, has the power to invade the corpus for *A*. After ten years, *T*'s power will terminate, a taxable termination will thereby occur, and the property then held in trust will be included in the tax base. It should be recognized that the entire trust property would be subject to tax even if *T* could invade only a portion of the corpus—the entire trust property would still be subject to the power.[132]

The effect on the tax base of a transfer which is subject to gift or estate tax may be illustrated as follows: *G* creates a generation-skipping trust with income to *A*, a child of nephew *B*, for ten years, with the principal payable to *A* after ten years. *B* is given the power to invade up to $5,000 of corpus each year for his own benefit. If *B* dies in the first year of the trust's existence, at a time when the trust property is worth $100,000, only $95,000 will be included in the tax base. The $5,000 will be subject to estate taxation,[133] and to that extent a taxable termination will be deemed not to have occurred.[134]

Water Power Corp. v. United States, 303 F.2d 928 (Ct. Cl. 1962) (illustrating the pyramiding process to determine amounts included in gross income).

131. HOUSE REPORT, *supra* note 22, at 53.

132. *See* CONFERENCE REPORT, *supra* note 21, at 618–19.

133. I.R.C. § 2041(a)(2). *See* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, at 318.

134. I.R.C. § 2613(b)(5)(B); *see* note 93 and accompanying text *supra*.

The grandchild exclusion may also affect the tax base. *G* creates a generation-skipping trust with income to his only child *A* for life, and corpus to *G*'s grandchildren. If at *A*'s death the trust property has a value of $1,000,000, only $750,000 may be included in the tax base.[135] If the grantor had more than one child, and each child had a child, the amount excluded from the tax base could exceed $250,000.

B. Computing the Generation-Skipping Transfer Tax

Pursuant to section 2602, the property included in the tax base on a generation-skipping transfer is taxed by reference to the deemed transferor's transfer tax brackets. Effectively, the property is taxed at the rates that would have been imposed had the deemed transferor actually owned the property and then transferred it outright.[136] Only the general method for computing the tax under section 2602(a) will be considered here. The actual tax imposed will depend on whether certain adjustments under section 2602 are applicable.

The amount of the generation-skipping transfer tax can be computed in five steps. First, the fair market value of the property included in the tax base is ascertained.[137] Second, this value is added to the deemed transferor's adjusted taxable gifts,[138] to the value of prior

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135. This assumes that the grandchild exclusion was not previously utilized.

136. *See* HOUSE REPORT, *supra* note 22, at 55. The deemed transferor is not liable for the tax imposed under chapter 13; rather it is expected that the tax will be paid out of the trust property. *Id.* at 57; *see* note 130 *supra.* This is arguably a direct tax and thereby unconstitutional. *See* U.S. CONST. art. I, § 2, cl. 3; *id.* § 8, cl. 1.

The generation-skipping transfer tax is better understood, however, as a postponed tax on the manner of disposition by the grantor, *i.e.*, an excise tax which need not be apportioned under the Constitution. *Id.*; *cf.* Bromley v. McCaughn, 280 U.S. 124 (1929) (upholding the constitutionality of the gift tax as a validly imposed excise tax). Similarly, because generation-skipping transfers undermine the progressive tax system, a reasonable basis exists for taxation, and the classification is not constitutionally infirm. *See* United States v. Maryland Savings-Share Ins. Corp., 400 U.S. 4, 6 (1970), wherein the Court stated: "Normally, a legislative classification would not be set aside if any state of facts rationally justifying it is demonstrated to or perceived by the courts." *See also* Tyler v. United States, 281 U.S. 497, 505 (1930).

137. Under § 2602(a)(1), an alternate valuation date may be elected pursuant to § 2602(d). *See* Part III–*C–1–a infra.* Presumably, the mortgage and other indebtedness on property held in trust will reduce the amount subject to tax because the trust and not the deemed transferor will be personally liable for such items. *Cf.* Treas. Reg. § 20.2053–7 (1958) (if the decedent's estate is not liable on a mortgage or other indebtedness, the gross estate will include only the net value of the property).

138. Adjusted taxable gifts will generally include taxable gifts made after December 31, 1976. *See* I.R.C. § 2001(b) ("For purposes of paragraph (1)(B), the term 'adjusted taxable gifts' means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent").

generation-skipping transfers made by the deemed transferor and, if the current generation-skipping transfer occurs at or after the deemed transferor's death, to the deemed transferor's taxable estate. Third, a tentative tax on the resulting sum is computed by applying the unified estate and gift tax rate schedule of section 2001(c). Fourth, a tentative tax on the total value of the deemed transferor's taxable and prior deemed transfers is computed by applying the section 2001(c) tax rate schedule. Finally, the excess of the tax in step three over the tax in step four is determined. The resulting amount constitutes the generation-skipping transfer tax imposed on the generation-skipping transfer.[139]

The computational scheme may be illustrated in the case of a generation-skipping transfer which occurs at the death of the deemed transferor. Assume the following facts: The fair market value of the property at the time of the generation-skipping transfer is $500,000; the deemed transferor made no actual or deemed transfers during his lifetime; and the deemed transferor's taxable estate is $250,000. The sum of the deemed transferor's total transfers is $750,000 and the tentative tax thereon is $248,300.[140] The tentative tax on the deemed transferor's taxable estate is $70,800.[141] Thus, the amount of the generation-skipping transfer tax is $177,500.[142] In effect, the computational scheme insures that the property transferred in a generation-skipping transfer will be subject to tax at the deemed transferor's highest marginal transfer tax brackets.

Although the scheme for taxing generation-skipping transfers takes into account taxable and prior deemed transfers, such transfers are not accounted for under the unified estate and gift tax system. As a result, the overall transfer tax burden with respect to a deemed transferor's actual and deemed transfers may be significantly lower if a

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139. In the case of multiple simultaneous transfers, § 2602(b) provides the following rule:

> If two or more transfers which are taxable under section 2601 and which have the same deemed transferor occur by reason of the same event, the tax imposed by section 2601 on each such transfer shall be the amount which bears the same ratio to—
>
> (1) the amount of the tax which would be imposed by section 2601 if the aggregate of such transfers were a single transfer, as
>
> (2) the fair market value of the property transferred in such transfer bears to the aggregate fair market value of all property transferred in such transfers.

140. I.R.C. § 2001(c).

141. I.R.C. § 2001(c).

142. I.R.C. § 2602(a).

generation-skipping transfer occurs during the deemed transferor's lifetime. Consider the following example: *G* creates a trust with income to the wife of *G*'s son *A* for life and corpus to *G*'s great-grandchild *B*. In the two situations under this example, assume the following: The generation-skipping transfer occurs in 1981; *A* is the deemed transferor;[143] the value of the transferred property at the time of the generation-skipping transfer is $500,000; *A* made no taxable or deemed transfers during his lifetime; and *A*, dying after 1980, has a taxable estate of $250,000.

Situation One:

If *A* is alive at the time of his wife's death, the tax on the generation-skipping transfer is $155,800.[144] Assuming *A* dies more than three years after the transfer,[145] the estate tax liability will be $23,800.[146] As a result, the combined transfer tax on *A*'s deemed and actual transfers will be $179,600.

Situation Two:

If *A* is not alive at the time of his wife's death, the tax on the generation-skipping transfer will take into account *A*'s taxable estate and the resulting tax is $177,500.[147] The tax on *A*'s taxable estate is $23,800 and the combined transfer tax on *A*'s deemed and actual transfers will be $201,300.

The failure of the unified estate and gift tax system to take into account deemed transfers will likely encourage the use of term interests of substantial length rather than life interests in cases in which the deemed transferor will be the income beneficiary. Compare the following two situations and assume that in each case *A* is the deemed transferor, the value of the property transferred in the generation-skipping transfer is $500,000, and *A* made no deemed or actual transfers during his lifetime.

143. *See* I.R.C. § 2612(a)(2).
144. I.R.C. § 2602(a).
145. If *A* dies within three years of the transfer, the transfer will be taxed as if it occurred at death. I.R.C. § 2602(e), *discussed at* Part III–*C–1–b infra*.
146. Although under § 2001(c) the tentative tax on a taxable estate of $250,000 is $70,800, the tax will be reduced by the unified credit under § 2010(a) in the amount of $47,000. Other credits are not taken into account in this example. *See, e.g.*, I.R.C. § 2011 (credit for state death taxes).
147. *See* I.R.C. § 2602(a).

Situation One:

> *G* creates a generation-skipping trust in 1977 with income to *A* for life and corpus to *B*. If *A* has a taxable estate of $250,000 and the generation-skipping transfer occurs in 2022, the combined transfer tax burden will be $201,300.[148]

Situation Two:

> *G* creates a generation-skipping trust in 1977 with income to *A* for forty years and corpus to *B*. If *A* survives until 2017, the tax upon the generation-skipping transfer will be $155,800. If *A* dies five years later in 2022, his estate will not include the net income after taxes and expenses from the trust for five years. Assuming the combined net income for this five year period would be $70,000, *A*'s taxable estate will be $180,000 and the tax imposed thereon will be $1,400. The combined transfer tax burden will be $157,200.[149]

While it is true that, in Situation Two, *A* will not have the benefit of the income for his entire life,[150] he may not need this additional income. Indeed, income beneficiaries in wealthier families will not likely need income from trust property.[151] As a result, wealthier families may be able to achieve considerable transfer tax savings by creating long-term income interests.

C. *Adjustments to the Generation-Skipping Transfer Tax*

The generation-skipping tax is calculated as if the deemed transferor actually owned the property outright.[152] If this were true, the estate or gift tax liability would depend on the applicability of various adjustments, *e.g.*, deductions and credits. Under section 2602, some, but not all, of these adjustments are available in computing the generation-skipping tax liability.[153] Because most of the adjustments correspond to the familiar estate tax adjustments under subchapter A of

148. I.R.C. § 2602(a).

149. *See* I.R.C. §§ 2001(c), 2010(a), 2601, 2602(a).

150. If *A* dies before the term expires, a taxable termination may be postponed until the term interests expire. *See* note 222 *infra*. The generation-skipping transfer will then be taxed as if *A* had a life interest in the property.

151. Clearly, Nelson Rockefeller could survive on the $38 million he received between 1964–1973. *See* note 7 and accompanying text *supra*.

152. *See* Part III–*B supra*.

153. Gift tax adjustments which are not allowed for generation-skipping transfer tax purposes include the annual exclusion under § 2503(b), the splitting of gifts under § 2513, and the unified credit under § 2505. With respect to these items, outright

chapter 11,[154] they need not be explained at length. The superimposition of these adjustments upon the generation-skipping tax has created some anomalies, several of which merit comment. These will be analyzed in three estate tax categories: (1) provisions which affect the amount of property subject to tax (gross estate adjustments), (2) provisions which reduce the amount subject to tax by way of deductions (computation of taxable estate), and (3) provisions which reduce the amount of tax directly by way of credits.

1. The amount of transferred property initially subject to tax

a. The alternate valuation date

If a taxable termination occurs at the death of the deemed transferor, a trustee may elect to value the property in accordance with section 2032, the alternate valuation date provision for estate tax purposes.[155] The alternate valuation date for purposes of the generation-skipping tax is six months after the date of the deemed transferor's death.[156]

In certain cases, a taxable termination would have occurred at the deemed transferor's death, but it is postponed under section 2613(b)(2). Under these circumstances, the alternate valuation date may also be available to the trustee,[157] but it will be six months after

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transfers to successive generations may recieve more favorable treatment; however, overall generation-skipping transfers are accorded more preferences under chapter 13.

154. With the exception of § 2014 (relating to credit for foreign death taxes) and § 2032A (relating to the valuation of certain farm or business real property), all relevant substantive estate tax adjustments under subchapter A of chapter 11 are provided under chapter 13.

155. Section 2602(d)(1)(A) provides that in the case of "1 or more generation-skipping transfers from the same trust which have the same deemed transferor and which are taxable terminations occurring at the same time as the death of such deemed transferor," the trustee may elect to value all of the property transferred in such transfers in accordance with § 2032. The Conference Report provides some guidelines; the election may be made even though the executor of the deemed transferor's estate does not make the election. If there are multiple simultaneous transfers from different trusts, the trustee of each trust may make the election regardless of whether other trustees similarly elect. "However, where more than one taxable termination occurs in the same trust at the same time, the trustee must select the same valuation date for all the transferred property." CONFERENCE REPORT, *supra* note 21, at 615. The alternate valuation date election need not be extended to taxable distributions, for taxable terminations take precedence on a deemed transferor's death. *See* Part I–*B–3 supra*.

156. I.R.C. § 2602(d)(2)(A).

157. Section 2602(d)(1) provides:

In the case of—

. . . .

the date of the postponed transfer.[158]

b. Generation-skipping transfers within three years of the deemed transferor's death

Pursuant to section 2602(e), regulations are to be promulgated which apply the principles of section 2035 to generation-skipping transfers which occur within three years prior to the deemed transferor's death. Section 2035(a) provides in part as follows: "the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death." Applying this proviso, a generation-skipping transfer made within the deemed transferor's lifetime and within three years of her death will be taxed as if it had occurred *after* the deemed transferor's death; the transfer tax computation thereby takes into account her cumulative lifetime and death-time transfers.[159]

2. Adjustments in the nature of deductions

a. The charitable deduction

Section 2602(c)(2) allows the appropriate gift or estate tax chari-

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(B) 1 or more generation-skipping transfers from the same trust with different deemed transferors—

(i) which are taxable terminations occurring on the same day; and

(ii) which would, but for section 2613(b)(2), have occurred at the same time as the death of the individuals who are the deemed transferors with respect to the transfers; the trustee may elect to value all of the property transferred in such transfers in accordance with section 2032.

158. I.R.C. § 2602(d)(2)(B).

159. *See* CONFERENCE REPORT, *supra* note 21, at 617. For example, on December 30, 1977, *F* creates a testamentary trust with income to his son *A* for twenty years and corpus to *A*'s eldest child *B*. On December 30, 1997, the corpus has a value of $100,000. Assuming the grandchild exclusion has been previously utilized, a taxable termination would then occur. If *A* made no taxable gifts after 1976 and was not a deemed transferor in any prior transfer, a generation-skipping transfer tax of $23,800 will be imposed. Assuming that *A* dies within three years of the termination, a generation-skipping transfer tax would be imposed as if the 1997 transfer occurred after *A*'s death. If *A* had a taxable estate of $400,000 and at *A*'s death, the value of the property which was held in trust on December 30, 1997 was still $100,000, the tentative tax under § 2602(a) would be $155,800. This should be reduced by not only the tentative tax on *A*'s taxable estate of $121,800 but also by the previously paid generation-skipping transfer tax of $23,800. The additional generation-skipping transfer tax would be $10,200. Because gift taxes are not payable out of transferred property, § 2035(c) provides that the amount of the gift tax will be included in the decedent's

table deduction[160] in computing the generation-skipping tax.[161] As under the gift and estate tax provisions,[162] charitable deductions with respect to trust property will generally be limited to charitable remainder trusts[163] and charitable lead trusts.[164]

b. The marital deduction

Application of the marital deduction to generation-skipping transfers permitted under section 2602(c)(5)(A) promises to produce results not intended by certain testators. Under section 2602(c)(5)(A), the adjusted gross estate of the deemed transferor will automatically be increased by the amount of the generation-skipping transfer.[165] Since the maximum marital deduction is generally limited to one-half of the adjusted gross estate,[166] the maximum marital deduction will be increased by one-half the value of the generation-skipping transfer. As a result, if property passes to a surviving spouse in an amount equal to the augmented maximum marital deduction, then that amount will be used in computing the deemed transferor's taxable estate.[167] The benefit to the deemed transferor's estate (and the surviving spouse) also inures to the benefit of the transferee, because the generation-skipping transfer tax is computed by adding the amount of the deemed transferor's taxable estate to the amount of the generation-skipping transfer. With a smaller taxable estate, the generation-skipping transfer will be taxed at lower rates, and more property will be available for the transferee.[168]

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gross estate if the transfer occurs within three years of death. In contrast, only the value of the property at the deemed transferor's death should be included in the tax base under chapter 13, because the generation-skipping tax on the lifetime transfer will effectively be payable out of the transferred property. *See* Part VI–*A–2 infra.*

160. *See* I.R.C. §§ 2055, 2522.

161. Section 2602(c)(2) also provides that the charitable deduction under § 2106(a)(2) (relating to the taxation of estates of nonresidents not citizens of the United States) will be allowed in computing the tax under chapter 13. *See* note 125 *supra.*

162. I.R.C. §§ 2055(e)(2), 2522(c)(2).

163. A charitable remainder trust is defined in § 664(d).

164. *See* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, § 16.9, at 434. In the event a generation-skipping transfer occurs within three years of the deemed transferor's death, the charitable deduction should be allowed in computing the tax as in the comparable estate tax situation. *See id.* § 16.6, at 421.

165. Although § 2602(c)(5)(A) serves to increase the gross estate, a corresponding increase in the adjusted gross estate will result. *See* I.R.C. § 2056(c)(2)(A).

166. I.R.C. § 2056(c)(1)(A).

167. I.R.C. § 2056(a).

168. *See* HOUSE REPORT, *supra* note 22, at 54.

The savings in estate and generation-skipping transfer taxes under this section will accrue only if the surviving spouse receives more than the maximum marital deduction allowable absent a generation-skipping transfer. Because existing marital deduction formula clauses are designed to leave the surviving spouse an amount which will equal the maximum marital deduction,[169] these clauses will automatically enable the deemed transferor's estate to receive the full benefit of the increased marital deduction. On the other hand, the benefits may be outweighed by other considerations and formula clauses may have to be modified accordingly. For example, should a deemed transferor want to leave one-half of his estate to his surviving spouse and one-half to his children, an existing formula clause would likely subvert this purpose. If such a deemed transferor had an adjusted gross estate of $1,000,000 and the amount of the generation-skipping transfer was also $1,000,000, a formula clause would give his entire estate to the spouse and nothing to the children. Furthermore, although estate and generation-skipping transfer tax savings may be realized, the surviving spouse's transfer tax may be increased to a point which more than offsets the savings.[170] Consequently, any person who may be a deemed transferor should carefully consider the effect of using formula clauses in disposing of his estate and, if necessary, draft such clauses to exclude the amount of any generation-skipping transfers.

c. *Reduction for administrative expenses*

If a taxable termination occurs at or after the deemed transferor's death, the value of the transferred property may be reduced by the administrative expenses which would have been allowed if the deemed transferor actually owned the trust corpus at his death.[171] These expenses include trustee's commissions, attorney's fees, and other costs of administering the transferred property.[172]

The reduction for administrative expenses is unavailable if the

169. *See generally* R. Covey, The Marital Deduction and the Use of Formula Provisions 1–9 (1966).

170. For example, if in the text situation the surviving spouse separately owned property in excess of $500,000, the transfer tax savings as a result of § 2602(c)(5)(A) would be less than if the surviving spouse received only half the actual gross estate.

171. I.R.C. § 2602(c)(5)(B)(i). A reduction is also allowed for casualty and theft losses. *See* I.R.C. §§ 2053, 2054.

172. *See* House Report, *supra* note 22, at 55.

items have been deducted for income tax purposes.[173] As a result, the trustee will have to elect whether to deduct the expenses for trust income or for generation-skipping transfer tax purposes.[174] This election will create a fiduciary conflict in certain instances.[175] For example, in a generation-skipping trust providing income to *A* for life, then income to *B* for life, and corpus to *C*, *B* may well prefer to have the administrative expenses deducted for income purposes, while *C* would prefer to have them reduce the amount of the generation-skipping transfer.[176] The conflict of interest problem does not appear if the taxable termination occurs during the lifetime of the deemed transferor. In such cases, administrative expenses are allowable only for trust income tax purposes.[177]

Administrative expenses may also reduce the amount of property subject to tax when the transfer is effected through a taxable distribution. In the case of a taxable distribution occurring at or after the deemed transferor's death, the amount of the transfer will only be reduced by those expenses "incurred in connection with the determination, collection, or refund" of the generation-skipping tax.[178] In effect, those expenses available to the distributee as an income tax deduction under section 212 may, at the distributee's option, reduce the amount of transferred property subject to tax.

173. *Id.* Although such a circumstance is difficult to conceive, deductions will be barred if they have been previously deducted for estate tax purposes. *Id.*

174. *Cf.* I.R.C. § 642(g) (a deduction allowable under § 2053 will not be allowed for trust income tax purposes unless the § 2053 deduction is waived).

175. *Cf.* Wallace, *Postmorten Tax Responsibilities of Executors,* 109 TRUSTS & ESTATES 193, 197–98 (1970) (discussing the fiduciary conflict if an executor may elect to deduct expenses for income or estate tax purposes).

176. There may also be a conflict among the beneficiaries and the surviving spouse with respect to the treatment of administration expenses, although this may not present a fiduciary problem if the trustee is not the executor. The problem will arise if the reduction for administrative expenses must also reduce the amount by which the deemed transferor's gross estate will be increased as a result of the marital deduction adjustment. The surviving spouse will prefer to have the administration expenses deducted for trust income purposes since this would increase the amount available under a marital deduction formula. In contrast, it may be more beneficial for the beneficiaries of the trust to deduct the administration expenses in computing the generation-skipping transfer tax.

The reduction for administrative expenses should limit the increase in the marital deduction, for otherwise the combined transfer tax burden with respect to a deemed transferor would be less than if the deemed transferor actually owned the property and his estate deducted the § 2053 expenses.

177. *See* I.R.C. § 212(1)–(2).

178. I.R.C. § 2602(c)(5)(B)(ii).

Taxable distributions occurring at or after the deemed transferor's death are clearly treated less favorably than similar taxable terminations, due to the limited expenses deductible upon such distributions. The discrimination is not pervasive, however; in cases in which the deemed transferor is also a younger generation beneficiary, a distribution at his death will also result in the termination of his interest, and the taxable termination will take precedence.[179] If the deemed transferor is not a younger generation beneficiary, and the taxable distribution occurs after her death, expenses incurred in connection with the distribution of property may only be deducted for income tax purposes. The probable rationale for this result is that payment of these expenses is unquestionably for the benefit of the distributee and not for the benefit of the trust.[180]

3. *Credits against the tax imposed*

a. *Credit for unused portion of the unified credit*

If the deemed transferor actually owned the property included in the tax base on a generation-skipping transfer, that property would be subject to estate tax, and a credit would be available with respect to the estate tax thereon imposed.[181] Under section 2602(c)(3),[182] basically the same treatment is made available for deemed transfers.[183]

If the deemed transferor has made a prior generation-skipping transfer, however, the amount of the unused portion of the unified

179. *See* I.R.C. § 2613(b)(7)(A), *discussed at* Part I–*B–3 supra.*

180. *See* Treas. Reg. § 20.2053–3(a) (1958) which provides in part as follows:

> The amounts deductible from a decedent's gross estate as "administration expenses" . . . are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate . . . . Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions.

181. I.R.C. § 2010.

182. Section 2602(c)(3) provides:

> If the generation-skipping transfer occurs at the same time as, or after, the death of the deemed transferor, then the portion of the credit under section 2010(a) (relating to unified credit) which exceeds the sum of—
>
> (A) the tax imposed by section 2001, and
>
> (B) the taxes theretofore imposed by section 2601 with respect to this deemed transferor,
>
> shall be allowed as a credit against the tax imposed by section 2601. The amount of the credit allowed by the preceding sentence shall not exceed the amount of the tax imposed by section 2601.

183. Consistent with § 2010(d), the unused portion of the estate tax credit cannot exceed the amount of the generation-skipping transfer tax imposed.

credit may not be available as a credit against a generation-skipping transfer tax currently imposed. Assume the following facts: In 1977, *A* was a deemed transferor in a generation-skipping transfer of $300,000; in 1981, *A* was the deemed transferor in a second transfer of $300,000; *A* died in 1981 with a taxable estate of $150,000; she made no taxable or other deemed transfer after 1976. Although the available estate tax credit in 1981 is $47,000,[184] it does not exceed the sum of the estate tax credit utilized by the deemed transferor's estate ($38,800) and the generation-skipping transfer tax imposed on the lifetime transfer ($87,700). Thus, even though the unused portion of the estate tax credit amounts to $8,200, no portion of it is allowed as a credit for generation-skipping transfer tax purposes by section 2602(c)(3). This result seems anomalous: the unused portion of the estate tax credit is reduced or eliminated without a corresponding credit against the generation-skipping transfer tax imposed on the lifetime transfer.

b. Credit for inheritance taxes

Paralleling the credit for state inheritance taxes allowed for estate tax purposes,[185] section 2602(2)(5)(C) allows a credit for state taxes paid with respect to any property included in a generation-skipping transfer which occurs at or after the deemed transferor's death.[186] Because the overall generation-skipping transfer tax liability will not be increased if a state limits the amount of its generation-skipping transfer tax, the effect of section 2602(c)(5)(C) is to encourage states to enact generation-skipping transfer tax legislation.[187]

c. Credit for tax on prior transfers

Section 2602(c)(4) provides that the credit allowed estates under section 2013 for taxes on prior transfers will be allowed against the

184. *See* I.R.C. § 2010.
185. I.R.C. § 2011.
186. I.R.C. § 2602(c)(5)(C).
187. A comparable credit for generation-skipping taxes paid to a foreign country is not allowed under chapter 13. *See* I.R.C. § 2014 (credit for foreign taxes paid for estate tax purposes). As a result, there will be no tax relief when a generation-skipping tax is imposed in Great Britain and a United States citizen is the deemed transferor. *See* note 25 *supra*.

generation-skipping tax.[188] Under section 2013, a credit is generally allowed with respect to property which passed to the decedent from a transferor who died no more than ten years before or two years after the decedent.[189] Although the maximum credit is limited to the estate tax paid by the transferor's estate attributable to the value of the property which passed to the decedent,[190] the credit can in no event exceed the estate tax imposed on the decedent's estate attributable to the value of the transferred property.[191]

Consider the following situation: *A* creates a testamentary trust with income to *B* for life and corpus to *C*. If *B* dies within two years after *A*'s death, *B*'s estate will be entitled to a credit under section 2013 with respect to the value of the property transferred to her—in this case, the life interest valued at *A*'s death.[192] The credit will be the lesser of (1) the estate tax paid by *A*'s estate which is attributable to the value of the life estate or (2) the estate tax deemed to be imposed on *B*'s estate with respect to the value of the life estate.

If, in the above example, the testamentary trust created by *A* was also a generation-skipping trust, a taxable termination would occur at *B*'s death. If *B* was the deemed transferor, the value of the corpus would be subject to a generation-skipping transfer tax. *B*'s estate would receive a credit against estate taxes with respect to the value of the life estate under section 2013, and section 2602(c)(4) would allow a credit against the generation-skipping tax with respect to the remainder interest.[193]

D. *Relief Against Double Taxation*

Although there is no prohibition against imposing transfer taxes at the same generation level when outright transfers are made by gift or

188. Through § 2013(g), added by the Tax Reform Act of 1976, Pub. L. No. 94-455, § 2006(b)(2), 90 Stat. 1888 (1976), the estates of certain transferees may be entitled to a credit under § 2013(a) with respect to generation-skipping transfer taxes.

189. I.R.C. § 2013(a).

190. I.R.C. § 2013(b).

191. I.R.C. § 2013(c). For all purposes, the value of the transferred property is the amount used for purposes of determining the federal estate tax liability in the estate of the transferor. I.R.C. § 2013(d).

192. The § 2013 credit is available even if the transferred property is not included in the decedent's gross estate. Rev. Rul. 59-9, 1959-1 C.B. 232. *See generally* C. Lowndes, R. Kramer & J. McCord, *supra* note 46, § 20.16.

193. *See* Conference Report, *supra* note 21, at 616.

at death,[194] Congress has determined that a taxable termination or taxable distribution will not be deemed to occur to the extent that the property has already been subject to a generation-skipping transfer tax at the same generation level.[195] For example, *G* creates a generation-skipping trust with income to son *A* for ten years, income to *A*'s child for ten years, income to son *B* for ten years, and corpus to *B*'s child. After ten years a taxable termination will occur,[196] and the corpus will be subject to tax at *A*'s transfer tax brackets. When *B*'s interest terminates, a second taxable termination occurs,[197] but only to the extent that the amount of the trust property then exceeds the amount previously taxed.[198]

Under this rule, double taxation may also be avoided if a distribution occurs after a taxable termination.[199] Consider a trust with income to niece *A* for ten years, income to *A*'s son for ten years, income to nephew *B* for ten years and corpus to *B*'s daughter, in which *T* has the power to invade the corpus for *B*'s daughter. After ten years, a taxable termination will occur and *A* will be the deemed transferor. If *T* invades the corpus for *B*'s daughter while *B* is enjoying his term interest, the distribution will constitute a taxable distribution only to the extent that the value of the property was not subject to tax on the first termination.

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194. There may be some relief against double taxation in certain instances by application of the prior transfer tax credit and marital deduction provisions. *See* I.R.C. §§ 2013, 2056, 2523.

195. *See* House Report, *supra* note 22, at 53. Section 2613(b)(7)(B) provides as follows:

> To the extent that—
>
> (i) the deemed transferor in any prior transfer of the property of the trust being transferred in this transfer was assigned to the same generation as (or a lower generation than) the generation assignment of the deemed transferor in this transfer,
>
> (ii) the transferee in such prior transfer was assigned to the same generation as (or a higher generation than) the generation assignment of the transferee in this transfer, and
>
> (iii) such transfers do not have the effect of avoiding tax under this chapter with respect to any transfer,
>
> the terms "taxable termination" and "taxable distribution" do not include this later transfer.

196. The grandchild exclusion does not apply because *A*'s child will not receive a "vested" interest in the property on the termination. *See* notes 119–20 and accompanying text *supra*.

197. This example assumes that the grandchild exclusion has been fully utilized. *See* Part II–*B supra*.

198. For example, if the property subject to tax when *A*'s interest terminated was $100,000 and the property when *B*'s interest terminated was $150,000, the amount subject to tax would then be $50,000.

199. There will be no double taxation when a taxable termination occurs after a taxable distribution because the distributed property will not then be held in trust.

Section 2613(b)(7)(B) will also prevent the imposition of a second tax if the deemed transferor, the transferee, or both, in the second transfer are in generations different from their counterparts in the first transfer.[200] Consider the following disposition: Income to grandson *A* for ten years, income to *A*'s child *B* for ten years, income to nephew *C* for ten years, corpus to *C*'s grandchild *D*. After ten years, a taxable termination will occur; *A* will be the deemed transferor and *B* the transferee. When *C*'s interest terminates, he will be the deemed transferor[201] and *D* will be the transferee. Since *C* is assigned to a higher generation than *A*, a taxable termination will occur when *C*'s interest terminates only to the extent that the property was not previously subject to tax on the first termination.[202] It is unclear why a taxable termination should not occur on the second transfer; if the order of beneficiaries had been reversed, the second termination would constitute a taxable termination. Indeed, if the disposition was income to nephew *C* for ten years, income to grandchild *A* for ten years, income to great-grandchild *B* for ten years and corpus to great-grandchild *D*, there would be two taxable terminations.

Relief against double taxation will not be allowed if a transfer has the effect of avoiding tax.[203] Regulations will have to determine whether the use of deemed transferors who are in low transfer tax brackets has the effect of avoiding taxes. For example, assume on the following disposition that son *A* had made no taxable or deemed transfers: Income to son *A* for one day, income to *A*'s son for ten years, income to daughter *B* for life, remainder to *B*'s daughter. If section 2613(b)(7)(B) applies, the property in trust will be subject to tax

200. The deemed transferor in the second transfer may be assigned to a higher (older) generation than the deemed transferor in the first transfer, and the transferee in the second transfer may be assigned to a lower (younger) generation than the transferee in the first transfer. *See* I.R.C. § 2613(b)(7)(B), *quoted at* note 195 *supra;* HOUSE REPORT, *supra* note 22, at 53.

201. *See* I.R.C. § 2612(a)(2).

202. I.R.C. § 2613(b)(7). The House Report illustrates the application of § 2613(b)(7)(B) with the following example: Income to the grantor's son for life, then income to the grantor's great-grandchild *A*, then income to the son's mother for life, with corpus to the grantor's grandchild *B*. HOUSE REPORT, *supra* note 22, at 53. However, the son's mother, who was not a younger generation beneficiary, will not be a deemed transferor under § 2612(a). Ordinarily the more closely related parent of *B* would be the deemed transferor, I.R.C. § 2612(a)(1), however, the special ancestor rule of § 2612(a)(2) will apply and the grantor's son will be the deemed transferor. Section 2613(b)(7)(B) should apply even though the deemed transferor would be the same in both transfers if the second transfer otherwise constitutes a taxable termination. *See* Part IV–*C infra* (considering the related transfer rule).

203. I.R.C. § 2613(b)(7)(B)(iii), *quoted at* note 195 *supra*.

at the lowest possible brackets rather than at *B*'s highest transfer tax brackets.[204]

IV. COMPLEX DISPOSITIONS

A. The Postponement of Taxation in Complex and Unusual Terminations

Until now, relatively simple generation-skipping trust dispositions have been considered. As a result, in the case of a taxable termination, the relevant younger generation beneficiary has had only one terminable interest or power in the trust and no other younger generation beneficiary has been assigned to his generation. In more complex generation-skipping trusts, terminations may occur if a person holds more than one power or interest and more than one younger generation beneficiary is assigned to the same generation. In addition, events may cause interests or powers in generation-skipping trusts to terminate in an unusual order.

Under section 2613(b)(2), taxable terminations will generally be postponed in these complex and unusual situations and this will have the effect of postponing imposition of the tax. As a result, generation-skipping transfers in trust will be treated more favorably than outright transfers to successive generations because imposition of the tax cannot be postponed.

1. Younger generation beneficiary with more than one interest or power

If a younger generation beneficiary has more than one interest or power in a generation-skipping trust, section 2613(b)(2)(B) provides that "the termination with respect to each interest or power shall be treated as occurring at the time when the last such termination occurs." Consider a generation-skipping trust in which *A* has the power to invade up to $5,000 of the corpus each year for fifteen years. Although *A*'s yearly power will terminate at the end of each year on the non-exercise of the power, this power is not deemed to terminate until

204. Although a term period of one day may be considered de minimis, a term period at some point will have to be recognized.

the fifteen-year period has expired. Furthermore, if *A* also has the right to receive income from the trust for life, his power to invade the corpus will not be treated as terminating until *A*'s death.[205]

Since all terminations are deemed to occur when the younger generation beneficiary's last interest or power terminates, the effect is to postpone the imposition of the generation-skipping transfer tax. At the same time, the value of the property subject to the generation-skipping transfer tax is to be determined on a cumulative basis at the date of the last termination.[206]

However, it can be anticipated that a transfer tax will not be postponed on the termination of a younger generation beneficiary's interest or power if his remaining interests or powers are nominal or contingent.[207] Further, under the proposed Technical Corrections Act of 1977, a transfer tax would not be postponed if on the termination of a younger generation beneficiary's interest or power he held only a future interest or power in the trust.[208]

2. *Two or more younger generation beneficiaries assigned to the same generation*

Section 2613(b)(2)(A) provides a special rule when more than one younger generation beneficiary is assigned to the same generation: "the transfer constituting the termination with respect to each beneficiary shall be treated as occurring at the time when the last such termination occurs." By this rule, taxable terminations will be postponed

205. HOUSE REPORT, *supra* note 22, at 51.

206. CONFERENCE REPORT, *supra* note 21, at 618. If, for example, *A* has the power to invade up to $5,000 of corpus annually for fifteen years, as well as the right to receive one-half of the income from the property for life, the termination occurs at *A*'s death. The value of the property subject to the power is the value of the trust corpus at *A*'s death, not the value after fifteen years. Similarly, the value of the property in which *A* has a life interest is the value of one-half of the trust property at *A*'s death. Although these two amounts are to be cumulated, the total amount subject to tax cannot exceed the value of the property at the time of the last termination. Actually, whenever a person holds a power under § 2613(d)(2) and the entire trust is subject to the power, the amount subject to tax will be the entire value of the property when the last interest or power terminates. *See* I.R.C. § 2613(b)(4). As a result, the cumulation of other interests will be unnecessary.

207. HOUSE REPORT, *supra* note 22, at 51 n.6.

208. H.R. 6715, 95th Cong., 1st Sess., § 3(n)(2), 123 CONG. REC. H3798 (daily ed. Apr. 28, 1977).

in both mandatory[209] and discretionary trusts.[210] The House Report offers the following example with respect to a discretionary trust:

> [A]ssume that the grantor creates a trust providing that the trustee, in his discretion, is to distribute the income for the benefit of the grantor's three children, *A, B,* and *C,* during their lives, and is to distribute the corpus of the trust to his great grandchildren upon the cessation of the life income interests. No tax would be imposed upon the death of *A* and *B*; upon the death of *C,* however, there would be a taxable termination with respect to the trust and the tax base (i.e., the trust assets) would be valued at that time.[211]

Although justified by the difficulty in valuing a terminated interest until the interests and powers of all members of the intervening generations have terminated,[212] the postponement rule is yet another exception to chapter 13's attempt to neutralize the tax advantages of trusts. By employing the postponement rule, the imposition of taxation can be postponed beyond the time when taxes are imposed on outright transfers[213] and, in addition, the property will be subject to tax only once when the eventual taxable termination occurs.[214]

This postponement rule has limitations. First, it will not apply if it is utilized primarily to postpone taxation.[215] Second, regulations are to provide that a transfer tax will not be postponed if younger generation beneficiaries assigned to the same generation have substantially

209. For example, in the following mandatory trust—income to sons *A* and *B* for their lives, with income to the survivor and corpus to the grantor's grandnephews—a taxable termination would be postponed until the survivor's death.

210. A discretionary trust will exist whenever a trustee holds any of the discretionary distributive powers enumerated in Part I–*A–3–b supra. See* RESTATEMENT (SECOND) OF TRUSTS § 155 (1959). Although persons will only be permissible recipients of trust income or corpus in discretionary trusts, they are considered beneficiaries under chapter 13. If a discretionary trust provided income for 20 years to son *A* and grandchildren *B, C,* and *D,* in whatever proportion *T* decided, a taxable termination would not be postponed under § 2613(b)(2)(A) if *A* died after 15 years and *T* was not a younger generation beneficiary assigned to *A*'s generation. *A* would be the only younger generation beneficiary assigned to the first younger generation and a taxable termination would occur in this generation-skipping trust at his death.

211. HOUSE REPORT, *supra* note 22, at 50. Of course, *C* will not necessarily be the deemed transferor on the taxable termination. *Id.* at 50 n.4; *see* Part II–*A–2 supra.*

212. HOUSE REPORT, *supra* note 22, at 50.

213. Subject to trust duration restrictions, accumulation trusts may enable the postponement of taxation for extended periods of time. *See* RESTATEMENT (SECOND) OF TRUSTS § 62, Comment n (1959).

214. In contrast, taxable transfers would occur on each outright transfer of property.

215. *See* HOUSE REPORT, *supra* note 22, at 51 & n.5 (indicating that postponements should not be allowed by regulation if beneficiaries hold only nominal interests or powers).

separate shares in a trust.[216] Each beneficiary will be treated as the beneficiary of a separate trust to the extent of his share.[217] In most discretionary trusts, however, separate share treatment will not be appropriate.[218]

An additional limitation denies postponement of tax under section 2613(b)(2)(A) if younger generation beneficiaries have only future interests or powers.[219] This limitation may be illustrated as follows: Income to son *A* for ten years, income to *A*'s child for ten years, income to daughter *B* for ten years, corpus to *B*'s child. Although *A* and *B* are younger generation beneficiaries assigned to the same generation, a generation-skipping transfer tax will be imposed when *A*'s interest terminates because *B* has only a future interest at this point.[220] Indeed, there is no reason to postpone the tax, because the amount transferred can be readily ascertained after *A*'s interest terminates.

The above limitation does not apply, however, if members of the same generation have successive interests in a generation-skipping trust. Specifically, section 2613(b)(2)(D) makes the general postponement rule of section 2613(b)(2)(B) applicable in cases in which a younger generation beneficiary has a present interest or power in the trust immediately after and arising from the termination of an interest or power of a younger generation beneficiary who is assigned to the same generation.[221] For example, if a trust provided income to nephew *A* for life, income to nephew *B* for life, and corpus to the nephews' children, *A*'s interest would be deemed to terminate at *B*'s death.[222] Presumably, this rule would also apply when a trustee who is a younger generation beneficiary dies, and a successor trustee is assigned to the same generation as the deceased trustee.

216. *See id.* at 51; CONFERENCE REPORT, *supra* note 21, at 618.

217. Pursuant to § 2622, regulations are to provide "the extent to which substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts." It is contemplated "that the regulations will, to the extent practicable, prescribe rules which are substantially similar to those which apply presently to the income taxation of trusts (under Subchapter J)." CONFERENCE REPORT, *supra* note 21, at 618. *See* I.R.C. § 663; Treas. Reg. § 1.663(c)–3 to 4 (1956).

218. *See* Treas. Reg. § 1.663(c)–3(b) (1956).

219. *See* HOUSE REPORT, *supra* note 22, at 50.

220. When *B*'s interest terminates, a taxable termination will not occur to the extent the property was previously subject to tax on the first taxable termination. *See* I.R.C. § 2613(b)(7)(B), *discussed at* Part III–*D supra*.

221. I.R.C. § 2613(b)(2)(D), *quoted at* note 226 *infra*. *See* CONFERENCE REPORT, *supra* note 21, at 615–16.

222. If a generation-skipping trust provides income to *A* for ten years and corpus to *B*, and *A* dies before his term interest expires, a taxable termination would be post-

3. *Terminations occurring in an unusual order*

Beneficiaries having the same present interests or powers in a generation-skipping trust may also be assigned to more than one generation. For example, a grantor creates a trust with income to her husband and son *A* for their joint lives, with the survivor receiving the income for his life, and on the death of the survivor, the corpus is payable to a grandniece. If all goes according to the usual order, *A* will outlive his father, and a taxable termination will occur on his death. If, however, *A* predeceases his father, a taxable termination will then occur even though the trust property will not be distributed until after *A*'s father dies. Under section 2613(b)(2)(C)(i), however, a taxable termination will be postponed until the older beneficiary's interest or power terminates.[223]

A taxable termination will also be postponed if terminations occur in an unusual order and younger generation beneficiaries continue to have present interests or powers in the trust.[224] Consider a trust with income to the grantor's son *A* and the grantor's grandson *B* for their joint lives, with the survivor receiving the income for his life, and on the death of the survivor, corpus to *B*'s children. If *B* dies before *A*,

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poned under this rule if a person in *A*'s generation succeeded to the unexpired term. However, the amount subject to tax would be reduced by the value of the unexpired term interest included in *A*'s gross estate. *See* note 93 *supra*. Regulations will be necessary in this area since there may be a delay in appointing a successor trustee. If the successor trustee is a younger generation beneficiary assigned to a lower generation than the deceased trustee, a postponed taxable termination will not be appropriate.

223. Section 2613(b)(2)(C)(i) provides:

> If—
>
> (I) but for this subparagraph, there would have been a termination (determined after the application of subparagraphs (A) and (B)) of an interest or power of a younger generation beneficiary (hereinafter in this subparagraph referred to as the "younger beneficiary"), and
>
> (II) at the time such termination would have occurred, a beneficiary (hereinafter in this subparagraph referred to as the "older beneficiary") of the trust assigned to a higher generation than the generation of the younger beneficiary has a present interest or power in the trust,
>
> Then, except to the extent provided in regulations prescribed by the Secretary, the transfer constituting the termination with respect to the younger beneficiary shall be treated as occurring at the time when the termination of the last present interest or power of the older beneficiary occurs.

A taxable termination will not always occur when there is an unusual order of terminations. Consider the following: *G* creates a trust with income to his wife for life, income to his son for life, and corpus to a grandnephew. If *G*'s son predeceases his mother, a taxable termination will not occur at the mother's death because the son never had anything other than a future interest in the trust. *See* I.R.C. § 2613(b)(1). The termination of the mother's interest will be of no consequence since she was not a younger generation beneficiary of the trust.

224. I.R.C. § 2613(b)(2)(C)(ii), *quoted at* note 225 *infra*.

B's interest will be deemed to terminate at *A*'s death and a taxable termination will then occur. In addition, a second taxable termination would occur on *A*'s death. In such situations, section 2613(b)(2)(C)(ii) provides that the interest or power of the younger generation beneficiary assigned to the older generation is deemed to terminate before any other interest or power terminates.[225] Accordingly, *A*'s interest will be deemed to terminate before *B*'s.

The general postponement rule of section 2613(b)(2)(A) also applies if a younger generation beneficiary's interest or power terminates and, as a result, a person assigned to a higher generation obtains a present interest or power in the trust.[226] This situation may be illustrated as follows: *G* creates a trust with income to his son for ten years, then income to *G*'s wife *W* for life and corpus to *G*'s grandnephews. Although the son's interest terminates after ten years, the interest is not treated as terminating until *W*'s death.

Although the relevant beneficiaries must have present interests or powers in the trust before or immediately after the first termination occurs, the postponement rules do not require beneficiaries to have the same interest or power in the trust. For example, if *A* is a trustee and also a younger generation beneficiary assigned to a generation older than *B* and *B* is a younger generation beneficiary with a term interest in the trust, *B*'s interest will not be treated as terminating until *A*'s power in the trust terminates. At the same time, it is presumed that, pursuant to regulations, postponements will not be allowed if only nominal or contingent interests or powers are involved.[227]

225. Section 2613(b)(2)(C)(ii) provides:

> If clause (i) applies with respect to any younger beneficiary—
>
> (I) this chapter shall be applied first to the termination of the interest or power of the older beneficiary as if such termination occurred before the termination of the power or interest of the younger beneficiary; and
>
> (II) the value of the property taken into account for purposes of determining the tax (if any) imposed by this chapter with respect to the termination of the interest or power of the younger beneficiary shall be reduced by the tax (if any) imposed by this chapter with respect to the termination of the interest or power of the older beneficiary.

See CONFERENCE REPORT, *supra* note 21, at 616.

226. Section 2613(b)(2)(D) provides:

> Subparagraphs (A) and (C) shall also apply where a person assigned to the same generation as, or a higher generation than, the person whose power or interest terminates has a present power or interest immediately after the termination and such power or interest arises as a result of such termination.

If, in the example set forth in note 222 *supra*, a person in a higher generation received *A*'s term interest, the termination of *A*'s interest would also be postponed until the term expired.

227. The regulations should also consider the unusual order of termination in re-

B. Assignments and Other Transfers by Beneficiaries

Transfers of interests in trust involve tax avoidance potentials which do not arise in connection with outright transfers. Consider the following example: *G* creates a generation-skipping trust with income to his son *A* for life and corpus to *A*'s child *B* in which the grandchild exclusion has been fully utilized. *A* then gratuitously assigns his interest to his other son *C*. If *A*'s interest were deemed to terminate by the assignment, the resulting generation-skipping transfer tax would be based on *A*'s lifetime transfer tax brackets[228] and, when *A* dies, no generation-skipping transfer would occur because *B* and *C* would be assigned to the same generation. The effect of the assignment will be to avoid the tax, imposed at *A*'s highest transfer tax brackets, on the value of the property held in trust at *A*'s death. Although this is the literal result under chapter 13, the Conference Report states that "assignment of a beneficiary's interest in a generation-skipping trust is not to be treated as a taxable termination."[229] Rather, the assignor's interest would be deemed to terminate when it would have terminated under the original trust grant.[230] In effect, an assignment will result in

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lation to § 2613(b)(7)(B), the double taxation provision. *See* Part III–*D supra*. For example, if a trust provided income to *G*'s grandson *A* for ten years with income to *G*'s son *B* for ten years and corpus to *G*'s great-grandchild *C* after twenty years, there would be two taxable terminations. *See* I.R.C. § 2613(b)(2)(C)–(D). If, instead, the trust provided income to *A* for ten years, with income to *A*'s son *C* for one year (or a period not considered nominal), with income to *B* for ten years and corpus to *C*, will § 2613(b)(7)(B) apply, *i.e.*, will there be no taxable termination when *B*'s interest terminates to the extent that the property has already been taxed? Arguably, relief from double taxation should not be allowed in these cases because such transfers will have the effect of avoiding taxes. *See* I.R.C. § 2613(b)(7)(B)(iii), *quoted at* note 195 *supra*.

228. *See* I.R.C. § 2602(a). Since the value of the interest pur autre vie would be subject to gift tax, a taxable termination would occur only to the extent of the value of the remainder interest. I.R.C. § 2613(b)(5)(B). On the other hand, if *A* had owned the property outright, the value of the property, less the amount of the annual exclusion, would be subject to tax. I.R.C. §§ 2501(a), 2503(b). In addition, a credit against the tax imposed could be available under § 2505.

229. Conference Report, *supra* note 21, at 619.

230. *Id.* Although the committee reports are silent on this matter, it is presumed that the release of a power will be similarly treated. However, it is not clear whether an assignment will be altogether disregarded under chapter 13. This may be illustrated as follows: *G* creates a generation-skipping trust with income to son *X* for life and corpus to *X*'s grandchild *Y*. *X* gratuitously assigns his interest to his son *Z*, the father of *Y*. If, as a result of the assignment, *Z* is considered a beneficiary under chapter 13, he will be a younger generation beneficiary of the trust. On *X*'s death, *Z*, rather than *X*, would be the deemed transferor. I.R.C. § 2612(a)(1). In addition, if *X* and *Z* are considered younger generation beneficiaries, arguably two terminations would occur on *X*'s death. I.R.C. § 2613(b)(2)(C).

a postponed termination as in other situations under section 2613(b)(2)(A). Therefore, assignments in trust also will receive more favorable tax treatment than outright transfers, which are subject to transfer tax on each transfer.[231]

Additionally, an assignment may result in a generation-skipping transfer unintended by the grantor. For example, *G* creates a testamentary trust with income to son *A* for ten years, and corpus to son *B*; *B* then gratuitously assigns his interest to *A*'s son *C*. As a result of the assignment, immediately before *A*'s death *A* and *C* will be younger generation beneficiaries assigned to more than one generation, and a taxable termination will occur under section 2613(b)(1) even though *G* did not create a generation-skipping trust.

The conclusion that a tax may be imposed when a grantor does not create a generation-skipping transfer is consistent with the statutory scheme of chapter 13, *i.e.*, taxation depends only on whether a generation-skipping transfer occurs immediately upon a termination or distribution.[232] Moreover, a contrary result would allow for generation-skipping at a relatively small cost. This may be illustrated by reference to the above example. The only price for transferring the property to *C* would be the gift tax on the remainder interest in the property. Although one may object that the property will be taxed twice at *A*'s generation level if a generation-skipping tax is imposed at *A*'s

231. In the text example, the taxable termination will be postponed until *A*'s death and the generation-skipping transfer tax will be imposed on the value of the trust property at *A*'s death, based on *A*'s highest transfer tax brackets. In contrast, if *B* had received the property outright from *A*, the property would be subject to gift or estate taxation when transferred to *C*. Overall, the property would be twice subject to transfer taxation if transferred outright. Moreover, if *A* and *C* were left term interests under the trust grant the property would be taxed at *A*'s lifetime brackets. *See* Part III–*B supra*.

The committee reports do not consider the effect of other assignments or transfers by beneficiaries. For example, *G* creates a trust with income to daughter *A* for life and corpus to *A*'s son *B*. If *B* dies before *A* and leaves his remainder interest to *A*'s husband *C*, the only younger generation beneficiaries immediately before *A*'s death will be *A* and *C* who are assigned to the same generation. Hence, no taxable termination occurs under § 2613(b)(1). A similar result would be reached if *B* gratuitously assigned his remainder interest to *C*.

Nor is it necessary to impose a generation-skipping transfer tax in this situation because the property will not skip transfer taxation at *A*'s generation level. The property will be subject to estate or gift taxation when transferred by *C*. On the other hand, in outright transfers the full value of the property would be subject to tax at two different times, instead of just the remainder interest and then again the full value when *C* transfers the property.

232. I.R.C. § 2613(a)(1), (b)(1).

death,[233] this would also be the result if it passed outright. It is beyond question that property may be subject to gift or estate tax more than once if transferred outright by successive owners in the same generation.

Arguably, however, it is not valid to compare *B*'s assignment in the above example to an outright transfer, because if he assigns his interest, *B* can never have full ownership. A second example better illustrates the rationality of applying the generation-skipping tax when an assignment creates a generation-skipping transfer not intended by the grantor. If *B* assigned his remainder interest to *D*, a member of *B*'s generation, there would be a gift tax on the transfer and there would be a gift or estate tax when *D* transferred the property to *C*. Since the full value of property would be subject to transfer taxation at this generation level, transfer taxation should not be avoided when the property passes to *C* without the imposition of gift or estate taxes.[234] If no generation-skipping tax were imposed, then by not leaving the property outright, the grantor of a trust could enable transfers to skip transfer taxation.

C. *A Series of Related Transfers*

Because taxation under chapter 13 depends on a generation-skipping transfer, generally the appropriate time for ascertaining younger generation beneficiaries is immediately before a transfer occurs.[235] Section 2613(c)(2), however, provides that in the case of a series of related transfers, a person will be a younger generation beneficiary "only if such person was a younger generation beneficiary of the trust immediately before the first of such transfers." It is not clear, however, under what circumstances such transfers will occur.[236]

It has been suggested that a series of related transfers will occur when distributions are made in postponed termination situations.[237] Consider the following trust disposition: *G* creates a trust with income

233. *Cf.* I.R.C. § 2613(b)(7)(B) (preventing double taxation in certain situations).
234. In certain cases, the estate of the transferee may be entitled to a credit with respect to both the remainder interest and the value of the property actually transferred to him. *See* I.R.C. § 2013(a), (b), (g).
235. I.R.C. § 2613(c)(2); *see* Part I–*B supra*.
236. Unfortunately, the committee reports do not consider a series of related transfers. *See* R. COVEY, GENERATION-SKIPPING TRANSFERS IN TRUST 62–63 (1976).
237. *See id.* at 62.

to his wife *A* and his son *B* for their joint lives, with income to the survivor and corpus to *G*'s grandchild *C* at the death of the survivor. Trustee *T*, who is not a younger generation beneficiary, has the power to invade the corpus for *C* at any time. If *T* invades the corpus while *B* is alive, a taxable distribution will occur.[238] If *B* predeceases *A*, and *T* then invades the corpus for *C*, and *B* is not then considered a younger generation beneficiary, no taxable distribution will occur because *C* was the only younger generation beneficiary immediately before the distribution.[239] If, however, the distribution is the second in the series of related transfers, then *B* will be a younger generation beneficiary and a taxable termination will occur.[240]

This example assumes that *B* will not be a younger generation beneficiary of the trust after his death. Yet, under the postponement rule of section 2613(b)(2)(A), "the transfer constituting the termination with respect to each such beneficiary shall be treated as occurring at the time when the last such termination occurs." Applying this rule, *B* would arguably be a younger generation beneficiary when the second distribution occurs, because his interest does not terminate until *A*'s death. As a result, it would not be necessary to consider the two distributions as a series of related transfers in order to impose a tax on the second distribution.[241] The regulations defining related transfers should at least ensure that, to the extent possible, transfers in trust will be taxed no more favorably than outright transfers of property.[242]

238. I.R.C. § 2613(a)(1).

239. I.R.C. § 2613(a)(1), (c)(2). Although a taxable termination will occur at *A*'s death, generation-skipping taxation may be avoided if substantially all of the corpus is distributed to *C* during *A*'s lifetime.

240. Covey gives an example of a distribution in a postponement situation in which a higher beneficiary is involved, but concludes that Congress did not intend the related transfer rule to apply in such situations. *See* R. COVEY, *supra* note 236, at 62–63. In other words, the distribution would be made transfer tax free.

241. If, in the text example, *T* did not invade the corpus for *C* until after *B* predeceased *A*, and *B* was not then considered a younger generation beneficiary as a result of § 2613(b)(2)(A), the distribution would not be one in a series of related transfers. Rather, it would be the only transfer and no generation-skipping transfer tax would be imposed.

242. It is suggested that the trust disposition, discussed at note 202 *supra*, constitutes a series of related transfers. If not, generation-skipping taxation would be imposed only once, whereas if the property was transferred outright it would be subject to transfer taxation at three different times.

V. CONFORMING TRANSFERS IN TRUST

Although chapter 13 was enacted to neutralize the advantages of generation-skipping transfers in trust,[243] it is clear that this purpose is seriously undermined by several exceptions.[244] For basis adjustment and disclaimer purposes, however, generation-skipping transfers in trust and outright transfers are similarly treated.[245]

A. Basis Adjustment

Section 2614(a) provides that the basis of property which is transferred to any person pursuant to a generation-skipping transfer will be adjusted as if the property were transferred by gift or at death.[246] If the deemed transferor is alive at the time of the generation-skipping transfer, the basis of the transferred property will be adjusted as follows:[247] The basis of the property in the hands of the transferee will be increased by the amount of the generation-skipping transfer tax which is attributable to the appreciation element, *i.e.*, the excess of the fair market value of property over its adjusted basis.[248] For example, assume that a taxable distribution occurs during the deemed transferor's lifetime and that property with a basis of $50,000 in the hands of

243. *See* House Report, *supra* note 22, at 47.

244. These include: the grandchild exclusion, Part II–*B supra*; the powerholder exception, Part II–*C supra*; the exception for trust accounting income distributions, Part I–*B–1 supra*; the double taxation exception, Part III–*D supra*; the postponement exceptions, Part IV–*A supra*; and the assignment exception, Part IV–*B supra*. *But see* note 100 *supra*. *See also* the grandfather provisions, Part VI–*B infra*.

245. Generation-skipping transfers in trust and outright transfers are similarly treated under § 691(c) (relating to deductions for income in respect of a decedent) and under § 2013 (relating to credit for tax on prior transfers). *See* notes 85 & 188 *supra*.

246. Section 2614(a) provides:

> If property is transferred to any person pursuant to a generation-skipping transfer which occurs before the death of the deemed transferor, the basis of such property in the hands of the transferee shall be increased (but not above the fair market value of such property) by an amount equal to that portion of the tax imposed by section 2601 with respect to the transfer which is attributable to the excess of the fair market value of such property over its adjusted basis immediately before the transfer. If property is transferred in a generation-skipping transfer subject to tax under this chapter which occurs at the same time as, or after, the death of the deemed transferor, the basis of such property shall be adjusted in a manner similar to the manner provided by section 1023 without regard to subsection (d) thereof (relating to basis of property passing from a decedent dying after December 31, 1976).

247. I.R.C. § 2614(a).

248. *See* House Report, *supra* note 22, at 58; *cf.* I.R.C. § 1015(d)(6)(B) (defining net appreciation when adjusting basis for gift taxes paid).

the trustee is distributed. Further assume that the transferor made no taxable or deemed transfers and that the value of the transferred property was $100,000. The generation-skipping transfer tax imposed on the transfer is $23,800 and the portion of the tax which is attributable to the appreciation element of $50,000 is $11,900.[249] As a result, the basis of the property in the hands of the distributee will be $61,900.[250]

The actual application of the basis adjustment is uncertain in some situations. Consider the following: A generation-skipping trust provides income to *A* for twenty years and corpus to *B*. Assume that *A* is the deemed transferor and that at the time of the taxable termination there is one asset in the trust which has a basis of $50,000 and a fair market value of $100,000. Because the trustee will be personally liable if the tax is not paid when due,[251] the trustee will have to sell the asset to pay the generation-skipping transfer tax of $23,800.[252] The question becomes whether the basis of the asset in the hands of the trustee may be increased by the tax on the appreciation element. Applying section 2614(a) literally, the property was transferred only to the purchaser of the asset—assuredly, his basis will not be increased by the tax on the appreciation element.[253] In such situation, however, the basis should be increased in the hands of the trustee,[254] because otherwise, the trustee will have to distribute the property to the beneficiary, who will get the basis adjustment, with an agreement that the beneficiary pay the tax.

If a generation-skipping transfer occurs at or after the deemed transferor's death, the basis of the transferred property is to be adjusted in a manner similar to the manner provided in section 1023.[255]

249. *Cf.* I.R.C. § 1015(d)(6) (the tax attributable to the appreciation element is computed at the average rate of tax on the entire value of the gift).

250. The basis adjustment under § 2614(a) cannot increase the basis above the property's fair market value.

251. *See* I.R.C. § 2603(a)(1), *discussed at* Part VI–*A–2 infra*.

252. *See* I.R.C. § 2602(a) (assuming *A* made no prior taxable or deemed transfers).

253. *See* I.R.C. §§ 1011, 1012.

254. The regulations should also provide that the trustee will receive a basis adjustment if the trust continues after a taxable termination.

255. I.R.C. § 2614(a), *quoted at* note 246 *supra*. Section 1023 generally provides that the basis of property received from a decedent will be the adjusted basis of the property in the hands of the decedent subject to further adjustments. *But see* I.R.C. § 1023(a)(2), (b). These adjustments include the fresh start adjustment (subsection (h)), the adjustment for federal and state taxes attributable to the appreciation element (subsections (c) and (e)), and the minimum basis adjustment (subsection (d)). However, the minimum basis adjustment of § 1023(d) is not permitted under § 2614(a). *See* CONFERENCE REPORT, *supra* note 21, at 614.

Again, the question arises as to whether only that property which is actually transferred receives the basis adjustment or whether the trustee will be entitled to the basis adjustment. Under section 1023 the trustee would be entitled to the adjustment,[256] and the result should be the same in the case of a generation-skipping transfer.

B. Disclaimers

Transfer taxation may be avoided by a disclaimer,[257] whether property is transferred outright or in trust.[258] A valid disclaimer for transfer tax purposes, including generation-skipping transfers,[259] depends on compliance with the qualified disclaimer rules of section 2518.[260] For purposes of chapter 13, however, the time for making a disclaimer commences when the generation-skipping transfer occurs,[261] not when an interest is created.[262] As a result, a disclaimer for generation-skipping transfer tax purposes will generally have to be made within nine months after the date of the generation-skipping transfer.[263] If a younger generation beneficiary is under twenty-one

256. *See* I.R.C. §§ 1014(b)(1), 1023(a)(1).

257. A disclaimer, or renunciation, is the refusal to accept the benefits of property. *See* HOUSE REPORT, *supra* note 22, at 65; Newman & Kalter, *Disclaimers after TRA,* 116 TR. & EST. 293 (1977).

258. The House Report provides that "[i]f a qualified disclaimer is made, the Federal estate, gift, and generation-skipping transfer tax provisions are to apply with respect to the property interest disclaimed as if the interest had never been transferred to the person making the disclaimer." HOUSE REPORT, *supra* note 22, at 67; *see* I.R.C. § 2518(b) (defining a qualified disclaimer), *quoted at* note 260 *infra.*

259. *See* I.R.C. § 2614(c).

260. A qualified disclaimer is defined by § 2518(b) as:

> an irrevocable and unqualified refusal by a person to accept an interest in property but only if—
> (1) such refusal is in writing,
> (2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of—
> (A) the day on which the transfer creating the interest in such person is made, or
> (B) the day on which such person attains age 21,
> (3) such person has not accepted the interest or any of its benefits, and
> (4) as a result of such refusal, the interest passes to a person making the disclaimer (without any direction on the part of the person making the disclaimer).

261. CONFERENCE REPORT, *supra* note 21, at 617.

262. *See* I.R.C. § 2518(b)(2)(A), *quoted at* note 260 *supra.*

263. *See* I.R.C. § 2518(b)(2).

when the transfer occurs, however, the allowable time extends to nine months after the beneficiary becomes twenty-one.[264]

Although Congress intended to create a federal disclaimer rule,[265] it is not clear how a disclaimer invalid under state law can constitute a qualified disclaimer.[266] More specifically, if the disclaimant's refusal to accept an interest in property effectively decides who will receive the disclaimed interest, a qualified disclaimer does not occur under the statute.[267] Accordingly, if the disclaimer is invalid under state law, the disclaimant will first have to accept and then direct who will receive the interest.[268] In the context of disclaimers for generation-skipping transfer tax purposes, this result would render meaningless the extended time for disclaiming generation-skipping transfers, if the state law period had already passed. Clarification by regulation is definitely needed in this area.

A qualified disclaimer will not automatically prevent the occurrence of a generation-skipping transfer even though a disclaimant is treated under section 2518(a) as if he never had an interest in the property.[269] Rather, it will depend on who receives the disclaimed interest. Consider the following situation: *G* creates a generation-skipping trust by will, with income to son *A* for life and corpus to *B*, *A*'s eldest child. *G* leaves her residuary estate to her daughter *C*. If *B* makes a qualified disclaimer after *A*'s death, *C* will be deemed to have held the interest from *G*'s death.[270] As a result, there will be no generation-skipping transfer on *A*'s death because there was then no genera-

264. *See* I.R.C. § 2518(b)(2)(B). Because a qualified disclaimer must be made before a beneficiary has accepted the interest or any of its benefits, it seems impossible for a qualified disclaimer to occur on a taxable distribution; upon the distribution, the distributee will receive the benefits of his interest in trust. *See* R. COVEY, *supra* note 236, at 111. Moreover, this requirement may mean that minors will not be able to disclaim when they reach majority. For example, in a generation-skipping trust with income to *A* for life and corpus to *B*, a minor, the property will be distributable to the minor or for his benefit at the time of the trust's termination. Since the minor has received the benefits of the interest, he presumably will not be able to disclaim when he reaches majority. In such cases, it may be necessary for the guardian of the minor to make a disclaimer before the benefits are received.

265. *See* HOUSE REPORT, *supra* note 22, at 67.

266. *See* Newman & Kalter, *supra* note 257, at 294.

267. I.R.C. § 2518(b)(4), *quoted at* note 260 *supra*.

268. *See* Newman & Kalter, *supra* note 257, at 294.

269. A qualified disclaimer of a power for transfer tax purposes will also be recognized pursuant to § 2518(c)(2).

270. Under common law, when a disclaimed interest was created by will or the transferor was not alive at the time of the disclaimer, the interest passed either to the residuary takers or by intestacy. *See* T. ATKINSON, LAW OF WILLS § 139, at 776 (2d ed. 1953). Several states have created provisions which treat the disclaimed interest under antilapse statutes. *See, e.g.*, N.Y. EST., POWERS & TRUSTS LAW § 3–3.10 (Mc-

tion-skipping trust—both beneficiaries, *A* and *C*, are younger generation beneficiaries assigned to the same generation. If, however, *A*'s child *D* is the residuary taker under *G*'s will, the disclaimer by *B* will not prevent a generation-skipping transfer from occurring at *A*'s death. On the other hand, if *A*, rather than *B*, disclaimed his interest, *B*'s remainder interest would be accelerated,[271] *i.e.*, he would be entitled to immediate possession of the trust as if the property were left to him outright. As a result, the transfer would be another generation-skipping transfer which would not be subject to tax under chapter 13.[272]

Because disclaimers are a means of avoiding taxes,[273] they may well be advisable when interests are created by inter vivos generation-skipping trusts. Consider the following situation: *G* creates an irrevocable inter vivos trust with income to *A* for life and corpus to *B*. *A* dies before *G*, and *A* has a large taxable estate. If *B* makes a qualified disclaimer, a generation-skipping transfer will not occur on *B*'s death. Upon *B*'s disclaimer, the property will pass to *G* who could then make a new transfer to *B*. If *G* was in a lower transfer tax bracket than *B*, the gift tax on the second transfer would be less than the generation-skipping transfer tax.[274]

VI. PROCEDURAL, ADMINISTRATIVE, AND EFFECTIVE DATE PROVISIONS

A. Procedural and Administrative Provisions

Procedures for the filing of returns, as well as the liability for the generation-skipping transfer tax, are provided under chapter 13.[275] Other procedural aspects will generally be determined by applying the procedural provisions applicable to estate and gift taxation.[276]

Kinney Supp. 1976). If the creator is alive, the disclaimed interest will revert back to the transferor. *See* A. SCOTT, *supra* note 35, § 36.1, at 295.

271. *See generally* L. SIMES & A. SMITH, *supra* note 41, §§ 791–802 (discussing the acceleration of future interests).

272. *See* HOUSE REPORT, *supra* note 22, at 47.

273. *See* Newman & Kalter, *supra* note 257, at 293.

274. It remains to be seen whether the government will claim that a qualified disclaimer does not occur in cases of prearrangements. *See* I.R.C. § 2518(b)(4); *cf.* Treas. Reg. § 20.2036–1(a) (1958) (a decedent will be deemed to have retained possession or enjoyment of property if prearranged).

275. *See* I.R.C. §§ 2603, 2621(c).

276. Section 2621(a) provides the following general rule:

1. *Return requirements*

A generation-skipping transfer tax return must be filed in the case of any generation-skipping transfer.[277] The nature of the transfer determines the person who is required to file the transfer tax return.[278] Generally, on a taxable termination, the trustee is the person required to file the return; on a taxable distribution, the distributee is required to file the return.[279]

2. *Payment of the tax*

Applying general estate and gift tax procedures for the payment of taxes, the generation-skipping transfer tax will be payable at the time the return is due to be filed.[280] Although the time for paying the tax may be extended,[281] the installment payment options permitted under

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Insofar as applicable and not inconsistent with the provisions of this chapter—

(1) if the deemed transferor is not alive at the time of the transfer, all provisions of subtitle F (including penalties) applicable to chapter 11 or section 2001 are hereby made applicable in respect of this chapter or section 2601, as the case may be, and

(2) if the deemed transferor is alive at the time of the transfer, all provisions of subtitle F (including penalties) applicable to chapter 12 or section 2501 are hereby made applicable in respect of this chapter or section 2601, as the case may be.

277. *See* I.R.C. § 2621(c)(1), which provides that the return requirements are to be prescribed by regulation. Although a generation-skipping transfer may not occur when the grandchild exclusion is utilized, a generation-skipping transfer tax return must still be filed. *See* HOUSE REPORT, *supra* note 22, at 59.

278. Section 2621(c)(2) provides that a trustee may also be required by regulation to file information returns.

279. *See* I.R.C. § 2621(c)(1) (providing that these general filing rules shall, to the extent practicable, be provided by regulations). For example, the regulations will have to determine who will file the return if a trustee or distributee dies before the filing date.

The time for filing the return will depend on whether the deemed transferor is alive or dead. *See* I.R.C. § 2621(c)(1)(B) (providing general rules relating to the time for filing returns which shall, to the extent practicable, be prescribed by regulation). If the generation-skipping transfer occurs before the death of the deemed transferor, a return must be filed ninety days after the close of the taxable year of the trust in which the transfer occurred. I.R.C. § 2621(c)(1)(B)(i). If the transfer occurs at the deemed transferor's death, a return must be filed within nine months (the time prescribed for filing an estate tax return, I.R.C. § 6075(a)) plus ninety days (I.R.C. § 2621(c)(1)(b)(ii)), for a total of approximately one year after the date of the deemed transferor's death. If the generation-skipping transfer occurs after the deemed transferor's death, the date of the deemed transferor's death will be important. If the transfer occurs within ninety days of the deemed transferor's death, the time for filing the return will be the same as if the transfer occurred at the deemed transferor's death. If the transfer occurs later, the time for filing will be nine months after the transfer.

280. *See* I.R.C. § 6151(a).

281. *See* I.R.C. § 6161(a) (providing that extensions of up to six or twelve months may be obtained for the payment of gift or estate taxes, respectively). Presumably, if

sections 6166 and 6166A are not available under chapter 13.[282]

Unlike the estate and gift tax provisions,[283] the generation-skipping transfer tax provisions do not specify who is initially liable for the payment of the tax. Section 2603, however, practically ensures that the person required to file the return will pay the generation-skipping transfer tax.[284] Thus, section 2603(a)(1) provides:

> If the tax imposed by section 2601 is not paid when due then—
> (A) . . . the trustee shall be personally liable for any portion of such tax which is attributable to a taxable termination, and
> (B) the distributee of the property shall be personally liable for such tax . . . .[285]

There are, however, limitations on the personal liability of the trustee or distributee. The distributee is only liable for the tax to the extent of the fair market value of the property he receives.[286] The trustee situation is more difficult because the rate of tax on a generation-skipping transfer may depend on the deemed transferor's taxable estate, the amount of taxable gifts, and prior generation-skipping transfers. Indeed, if the trustee does not have such information about the deemed transferor, he cannot properly compute the amount of the generation-skipping transfer tax. In such a situation, procedures are to be established whereby the trustee will be able to file a request with the Internal Revenue Service to obtain information with respect to the deemed transferor's transfer tax bracket.[287]

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the generation-skipping transfer occurs at or after the deemed transferor's death, the regulations will provide that an extension of up to twelve months may be obtained. On the other hand, since the deemed transferor is deemed to own the transferred property at death, § 6163 (relating to extensions of time for payment of estate tax on value of reversionary or remainder interest in property) would be inapplicable for generation-skipping transfer tax purposes.

282. I.R.C. § 2621(b). However, § 303 treatment (relating to distributees in redemption of stock to pay death taxes) applies in redemptions to pay generation-skipping transfer taxes. I.R.C. § 303(d).

283. *See* I.R.C. § 2002 (the executor is liable for the estate tax); I.R.C. § 2502(d) (the donor is liable for the gift tax).

284. It could be argued that the person required to file the return is also liable for the payment of the tax. *See* I.R.C. § 6151(a).

285. Presumably, transferees will also be liable for generation-skipping taxes by application of § 2621(a), *quoted at* note 276 *supra*. However, regulations are needed to conform the transferee liability provision, § 6901, to generation-skipping transfer taxes.

286. I.R.C. § 2603(a)(3) (value "determined as of the time of the distribution"). *See also* § 6324(a)(2), which provides that distributees and transferees are liable for estate taxes only to the extent of the value of the property as of the date of the decedent's death.

287. *See* CONFERENCE REPORT, *supra* note 21, at 617. If the trustee has used the

If a taxable termination also requires a distribution, there may be some question as to whether the trustee remains liable after the distribution. For example, on a taxable termination the trustee will compute the generation-skipping transfer tax liability, pay the tax, and distribute the balance to the distributee. Suppose that within the period of limitations for assessing a deficiency, the IRS contends that the fair market value of the property is higher and that additional taxes are owed. Will the trustee, as well as the distributee or transferee,[288] be personally liable for the additional taxes?[289] If a trustee may still be liable after distributions, she may seek to delay distribution until the period of limitations has expired, or require some security from the distributee. These and other problems should be resolved by regulations.[290]

B. *Effective Date Provisions*

Generally, the generation-skipping transfer tax provisions[291] apply to any generation-skipping transfer which occurs after April 30, 1976.[292] However, these provisions do not apply to certain generation-skipping transfers made after April 30, 1976, from irrevocable trusts, wills, or revocable trusts already in existence on that date. These critical exceptions, not contained in chapter 13, are set forth in section 2006(c)(2) of the Tax Reform Act of 1976,[293] which provides that the generation-skipping transfer tax provisions

rate information furnished by the Internal Revenue Service in computing the tax, he will not be liable for any additional tax because the generation-skipping transfer should have been taxed at higher brackets. I.R.C. § 2603(a)(2)(A). A trustee is also absolved from liability if he has relied on information from the Internal Revenue Service in computing the grandchild exclusion and that information proves incorrect. I.R.C. § 2603(a)(2)(B).

288. I.R.C. § 2603(a)(1); *see* note 285 *supra*.

289. Although an executor may be discharged from personal liability under § 2204, the procedure is not specifically available to trustees by application of § 2621(a). Section 2204 is provided under subtitle B, whereas § 2621(a) extends only to generation-skipping taxation the procedural and administrative provisions of subtitle F.

290. It is clear, however, that a lien will remain on the transferred property until the taxes are paid or collection becomes unenforceable. I.R.C. § 2603(b). Generally, a tax must be collected within six years after its assessment. *See* I.R.C. § 6502(a).

291. These provisions are contained under chapter 13 and §§ 303(d), 691(c)(3), 2013(g). *See* notes 85, 188 & 282 *supra*.

292. Tax Reform Act of 1976, Pub. L. No. 94–455, § 2006(c)(1), 90 Stat. 1889 (1976).

293. *Id.* § 2006(c)(2), 90 Stat. 1889–90. Presumably, these grandfather provisions will apply in cases in which a "generation-skipping transfer" does not occur because

shall not apply to any generation-skipping transfer—

(A) under a trust which was irrevocable on April 30, 1976, but only to the extent that the transfer is not made out of corpus added to the trust after April 30, 1976, or

(B) in the case of a decedent dying before January 1, 1982, pursuant to a will (or revocable trust) which was in existence on April 30, 1976, and was not amended at any time after that date in any respect which will result in the creation of, or increasing the amount of, any generation-skipping transfer.

Because of these grandfather provisions, generation-skipping transfers in trust will be treated more favorably than property transferred outright to a succeeding generation because that property has already been or will be subject to transfer taxation.[294]

1. *Irrevocable trusts*

If a trust was irrevocable as of April 30, 1976 (a grandfathered trust), almost any generation-skipping transfer which occurs in such a trust will pass untaxed. For example, the generation-skipping transfers in the Rockefeller trusts created in 1934 and 1952 will not be subject to tax whenever they occur.[295] However, generation-skipping transfers may not escape taxation if property in a grandfathered trust can be appointed to a generation of younger generation beneficiaries who were not beneficiaries before the power was exercised. For example, if *G* created an irrevocable trust before April 30, 1976, with income to his son for life, and the remainder to such of *G*'s lineal descendants as his son appoints by will, the remainder could be appointed to such younger generation beneficiaries. The Conference Report specifies that in such trusts, generation-skipping transfers will be grandfathered only

> so long as the exercise of the power (including the creation of a new trust) cannot result in the creation of an interest which postpones, or a new power which can be validly exercised so as to postpone, the

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of the grandchild exclusion. Otherwise, the exclusion available when a generation-skipping transfer occurs in an unprotected instrument will be reduced by the transfer from a grandfathered instrument.

294. The House Report estimated that chapter 13 will have no revenue effect for 20 years and that it will not be fully effective for approximately 50 years. HOUSE REPORT, *supra* note 22, at 8, table 1, n.1.

295. *See* note 6 *supra*.

vesting of any estate or interest in the trust property for a period ascertainable without regard to the date of the creation of the trust.[296]

The position of the Conference Report accords with the treatment of special powers of appointment at common law, *i.e.*, the exercise of such power relates back to the creation of the power.[297] In effect, the appointees are deemed to have received their interests from the grantor of the power as if the grantor had initially created such interests rather than a power of appointment.[298] It follows that irrevocable trusts with powers of appointment should be treated in the same manner as trusts that dispose of property by creating interests.[299] The principal limitation on such trusts is that the exercise of the power cannot violate the common law Rule Against Perpetuities,[300] apparently regardless of whether the rule is in force in a particular state.[301]

Regulations will be needed to clarify several problems with respect to generation-skipping transfers in grandfathered trusts if additions to corpus are made after April 30, 1976. For example, if after April 30, 1976, a grandfathered trust pours over property into another grandfathered trust, will this constitute an addition to corpus? Furthermore,

296. CONFERENCE REPORT, *supra* note 21, at 621.

297. *See* L. SIMES & A. SMITH, *supra* note 41, § 911.

298. *See id.* If a power is not exercised, the takers in default are also deemed to have received their interest from the grantor of the power. *Id.* § 1276.

299. This result should apply also on the exercise or non-exercise of a power of appointment in grandfathered wills or revocable trusts. *See* Part VI–*B–2 infra*. Moreover, because a disclaimed interest also relates back to the date of the creation of the interest, *see* T. ATKINSON, LAW OF WILLS § 139, at 776 (2d ed. 1953), generation-skipping transfers which occur in such grandfathered trusts should also be grandfathered.

300. The common law Rule Against Perpetuities may be stated as follows: "No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest." J. GRAY, RULE AGAINST PERPETUITIES § 201 (4th ed. 1942). As applied to special powers of appointment, the Rule Against Perpetuities measures the validity of the exercise of a power from the date of its creation, not from the date of its exercise. *See* L. SIMES & A. SMITH, *supra* note 41, § 1274. *See also id.* at § 1276 (relating to the Rule Against Perpetuities with respect to takers in default); note 10 *supra*.

301. *See* CONFERENCE REPORT, *supra* note 21, at 621. *Cf.* § 2041(a)(3) (enacted in response to Delaware's modification of the common law Rule Against Perpetuities with respect to powers of appointment). *See* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 46, § 12.14. Several states have modified the common law rule by adopting the wait-and-see doctrine. *See, e.g.*, MASS. ANN. LAWS ch. 184A, § 1 (Michie/Law Coop 1977). Moreover, as the House Report notes, Idaho and Wisconsin have no Rule Against Perpetuities. HOUSE REPORT, *supra* note 22, at 46. Finally, although Louisiana generally restricts the disposition of property in trust to persons who were alive at the creation of the trust, in effect, a more restrictive rule than under common law (LA. REV. STAT. ANN. § 1803 (West 1965)), powers of appointment are prohibited under Louisiana law. *See* LA. CIV. CODE ANN. art. 1573 (West 1952).

if there has been an unquestioned addition to corpus after April 30, 1976, regulations will have to resolve how generation-skipping transfers are to be taxed. If there is a taxable distribution, for example, the corpus may either be deemed to be distributed on a first in, first out basis, or be allocated between the pre-existing assets and the assets added after April 30, 1976. Moreover, in the event an allocation is required, it may be done on the basis of fair market values computed either at the time of distribution or at the time the property was contributed to the trust.

2. *Wills and revocable trusts*

Generation-skipping transfers which occur under wills and revocable trusts in existence on April 30, 1976 (protected instruments), will be grandfathered if a decedent dies before January 1, 1982.[302] As a result, if a decedent dies at any time before this date, a generation-skipping transfer will generally be grandfathered whenever it occurs. If, however, a protected instrument is amended after April 30, 1976, and the amendment will create, or increase the amount of, a generation-skipping transfer, the generation-skipping transfer will not be grandfathered.[303] During the next few years it will be important to know whether a particular amendment to a protected instrument will render the grandfather provision inapplicable.[304]

302. Tax Reform Act of 1976, Pub. L. No. 94–455, § 2006(c)(2)(B), *quoted in* text accompanying note 293 *supra*. However, "if the decedent on April 30, 1976, was under a mental disability to change the disposition of his property, the period . . . shall not expire before the date which is two years after the date on which he first regains his competence to dispose of such property." *Id.*

303. *Id.* The regulations should take the position that the effect of an amendment will be viewed as of the time of the generation-skipping transfer, at least when the amendment does not directly bear on a generation-skipping trust. CONFERENCE REPORT, *supra* note 21, at 620.

304. The Conference Report provides the following guidance:

> For purposes of this transitional rule, a change of trustee is not a change creating or increasing the amount of a generation-skipping transfer. Also, an amendment changing the beneficiaries, or a change in the size of the share used for the benefit of a paticular beneficiary, does not disqualify the trust under the transition rule, so long as the number of younger generations provided for under the trust (or the potential duration of the trust in terms of younger generation beneficiaries) is not expanded and the total value of the interests of all beneficiaries in each generation below the grantor's generation is not increased. For example, assume a revocable trust was created prior to April 30, 1976, for the benefit of the grantor's nephews, A, B, and C, in equal shares for life, with the remainder to be distributed to the children of A, B, and C. A becomes disabled and the trust is modified to increase his share of the income; this does not disqualify the trust be-

The real danger with respect to protected instruments lies with amendments that will indirectly result in an increase in the amount of a generation-skipping transfer. These problems will likely occur when the residuary clause in a protected will creates a generation-skipping trust. Thus, if a codicil is executed after April 30, 1976, whereby a small bequest is revoked, an increase in the amount of the generation-skipping transfer is likely to result. Furthermore, a literal reading of the grandfather provision compels the conclusion that the entire amount of the generation-skipping transfer will be subject to tax—*i.e.*, the entire property will be tainted by increasing the amount of the generation-skipping transfer.

Actual events may prove that the amount of the generation-skipping transfer has not increased as a result of an amendment. For example, if the specific legatee, whose legacy has been revoked, dies before the testator and an antilapse statute[305] is not applicable, the amendment will not have the effect of increasing the amount of the generation-skipping transfer because the property would still have passed to the residuary takers.[306] Similarly, if the property has adeemed,[307] an amendment previously revoking the bequest will not result in an increase in the amount of the generation-skipping transfer. In fact, a possible way to avoid the effect of an amendment which has revoked a specific legacy would be for the decedent to dispose of the property during his lifetime so that the disposition would constitute an

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> cause it does not create or increase the amount of a generation-skipping transfer. Likewise, if the trust is amended to include nephew D as an income beneficiary, this would not disqualify the trust under the transition rules. However, if the trust were amended so that the income was to be held in trust for the lives of the children of A, B, and C, with the remainder distributed to the nephews' grandchildren, this would increase generation-skipping (by increasing the number of generations skipped) and would disqualify the trust. An amendment creating a power of appointment would also disqualify the trust if there were any possibility, under the power of appointment, of increasing the number of generations which might be skipped.

CONFERENCE REPORT, *supra* note 21, at 620.

As the Conference Report indicates, considerable latitude may be exercised with respect to the alteration of interests of existing classes of younger generation beneficiaries. These changes will simply not result in the creation of, or increase the amount of, any generation-skipping transfer. Presumably, an amendment which accelerates the interest of a younger generation beneficiary will also be permitted. For example, if a protected will contains a generation-skipping trust with income to *A* for life and with corpus to *B* for life, the reduction of *A*'s interest to twenty years would not increase the amount of the generation-skipping transfer. The amount will hypothetically be the same whether the termination occurs after twenty years or at *A*'s death.

305. *See, e.g.*, N.Y. EST., POWERS & TRUST LAW § 3–3.3 (McKinney 1967).

306. T. ATKINSON, LAW OF WILLS § 140, at 784 (2d ed. 1953).

307. *See generally id.* § 134.

ademption of the property.[308] With respect to an amendment which revokes a general cash legacy, the decedent could execute another codicil or amend the revocable trust to leave the amount to another person. In this way, the first amendment would not cause an increase in the amount of the generation-skipping transfer.[309]

VII. THE CONTINGENT BENEFICIARY PROBLEM

If younger generation beneficiaries have contingent interests or powers in trust, a literal application of chapter 13 may result in the imposition of taxation even though property may not skip estate or gift taxation at a generation level. One such situation is as follows: *G* creates a trust with income to his son *A* for life, with corpus to *G*'s lineal descendants per stirpes. At the time of *A*'s death, *G*'s lineal descendants are his daughter *B* and *B*'s child *C*. Immediately before *A*'s death, *A* and *B* were younger generation beneficiaries assigned to the first generation younger than the grantor, and *C* was a younger generation beneficiary assigned to the next younger generation. Therefore, a taxable termination would occur on *A*'s death under a literal reading of section 2613(b)(1),[310] even though the property will be subject to tax at *A*'s generation level when *B* transfers the property. In such situations, in which generation-skipping clearly will not

308. *Id.* § 134, at 743–44.

309. Other changes may also cause an otherwise grandfathered generation-skipping transfer to be subject to taxation. These may include a change in a tax apportionment clause which reduces the tax burden for the generation-skipping trust and an amendment exonerating the generation-skipping trust from the payment of certain administrative expenses. Moreover, although a change in trustee will not cause generation-skipping transfer tax problems in a protected instrument, it is unclear whether the reduction in the number of trustees or executors, which would reduce commissions, will be deemed to result in an amendment which effectively increases the amount of a generation-skipping transfer. *See* CONFERENCE REPORT, *supra* note 21, at 620.

Finally, changes in marital deduction provisions may result in unintended generation-skipping transfer tax consequences. Suppose a protected will provides a marital deduction bequest based on a fractional share formula and the balance of the residue is left to a trustee of a generation-skipping trust. A post-April 1976 codicil which substitutes a pecuniary legacy formula for the fractional share formula may have the effect of increasing the amount which will pass to the trustee. This will generally occur if the overall value of the assets in a decedent's estate appreciates after a decedent's death. If this appreciation occurs in the described situation, the amendment will result in increasing the amount of the generation-skipping transfer and, presumably, the generation-skipping transfer will not be grandfathered. *See* R. COVEY, *supra* note 169, at 1–9 for a description of fractional share and pecuniary legacy formulas.

310. *See* Part I–*B–2 supra*. The exception under § 2613(b)(1) for persons with future interests relates to younger generation beneficiaries who are older than other beneficiaries in a trust.

occur, generation-skipping transfer taxes need not be imposed.

There will be additional situations in which a generation-skipping transfer may not occur but a tax might still be imposed. These problems will arise with both ascertained and unborn persons who are contingent younger generation beneficiaries. The following situation illustrates the problem with an ascertained contingent beneficiary: *G* creates a testamentary trust with income to his only child *A* for life and corpus to *G*'s grandchildren who attain the age of twenty-one. The trust further provides that income is to be accumulated for the grandchildren until they reach twenty-one and paid to them if they reach twenty-one. *G* leaves his residuary estate to *A*'s wife *B*. On *A*'s death, *A*'s only child *C* is twelve years old. Pursuant to section 2613(b)(1), a taxable termination will occur on *A*'s death. The difficulty with this outcome is that property might *not* skip transfer taxation at *A*'s generation level. Thus, if *C* dies before reaching twenty-one, the property, as well as the accumulated income, will pass to *B*. Furthermore, when *B* transfers the property, a gift or estate tax will be imposed at *A*'s generation level.

The problems are more complex when unborn persons are involved. The following example will be the subject of discussion in the balance of this Part:

> *G* creates a testamentary trust with income to nephew *A* for ten years and corpus to the first child born of the grantor's three grandchildren *X*, *Y*, and *Z*. The trust also provides that in the event no child has been born after ten years, the income will be accumulated for the benefit of the eventual taker. *G* leaves his residuary estate to his daughter *B*.

If after ten years none of the grantor's grandchildren has had children, will a taxable termination occur? The answer depends on whether an unborn great-grandchild can be considered a younger generation beneficiary. Under trust law, an unborn person may be a beneficiary of a trust if his interest must vest or fail to vest within the perpetuities period.[311] To be consistent, an unborn person should also be considered a beneficiary for generation-skipping tax purposes.[312]

311. *See* Restatement (Second) of Trusts § 112, Comment d (1959); note 300 *supra*.

312. *Cf.* Treas. Reg. § 20.2056(e)–3 (1958) (persons include members of a class to be ascertained in the future for marital deduction purposes). In effect, the Rule Against Perpetuities serves to prevent the unlimited skipping of generations. *See* C.

Furthermore, if unborn persons are not to be deemed beneficiaries under chapter 13, transfers which skip taxation at generation levels would be possible, because such unborn persons could not be younger generation beneficiaries under section 2613(c)(1). Thus, in the example above, if no great-grandchild were in existence after ten years, a generation-skipping transfer would never occur even though transfer taxation at *A*'s level would be avoided if a great-grandchild were subsequently born.[313] On the other hand, if an unborn great-grandchild is to be considered a younger generation beneficiary, a taxable termination will occur at the termination of *A*'s term interest.

As in the case of contingent beneficiaries who are ascertained, the difficulty with imposing a generation-skipping transfer tax when unborn persons are involved is that it is impossible to determine in advance whether transfer taxation will, in fact, be avoided. If *X*, *Y*, and *Z* died without ever having children, the property would pass to *B* and the property would not escape transfer taxation at this generation level. Moreover, when unborn persons are involved, there may be insuperable difficulties in imposing the tax. Thus, when *A*'s interest terminates, it is not possible to know who as among *X*, *Y*, and *Z* will have the first-born child. Because the transferee cannot be determined, it is not possible to know who the deemed transferor is.

It is possible to justify the imposition of a generation-skipping tax when ascertained and unborn persons are involved, because outright transfers to such persons would be taxed. Thus, if *A* received the property outright from *G* and left the property to the first-born child of *X*, *Y*, and *Z* with the residue of this estate to *B*, the property would be subject to tax when *A* dies even though subsequent events could

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SHOUP, *supra* note 11, at 34. Therefore, extreme caution must be exercised in creating an interest for an unborn child because, if it violates the Rule Against Perpetuities, the interest will be void ab initio, *see* L. SIMES & A. SMITH, *supra* note 41, § 1256, and unintended transfer tax consequences may result. For example, if the testator's wife is the income beneficiary and his unborn great-grandchildren are the corpus beneficiaries, with the residue to his wife, the remote interest violates the Rule Against Perpetuities and the entire property will be subject to transfer tax when the wife transfers it.

313. If an unborn great-grandchild is not considered a younger generation beneficiary after ten years, the only beneficiaries immediately before the term interest expired would be *A* and *B* (as a result of his reversionary interest) who belong to the same generation. Nor would the termination of *A*'s interest be postponed under § 2613(b)(2)(A), because *B* did not have a present interest. *See* Part IV–*A–2 supra*. If a great-grandchild were subsequently born, a taxable termination would not occur on the termination of *B*'s reversionary interest, because *B* "at no time . . . had anything other than a future interest . . . in the trust." I.R.C. § 2613(b)(1).

determine the property will again be taxed on a transfer by *B*. Since the grantor elected to leave the property in trust, he created the possibility that the property may skip transfer taxation at a generation level, which is sufficient reason to impose a generation-skipping tax.

Although it may not be unreasonable to impose a generation-skipping transfer tax when transfer taxation cannot be avoided, it would be more reasonable and administratively simpler to postpone the time for the generation-skipping transfer determination until the contingency is resolved. By this approach, the resolution of the contingency would terminate any relevant interest, and the person whose interest is deemed to terminate at this point would be considered a younger generation beneficiary. The person who would be entitled to receive the property on the date the contingency is resolved would also be considered a beneficiary and assigned to the appropriate generation level.

This proposal, effectively a postponed termination, may be illustrated by the previous example: If there is no great-grandchild in existence after ten years, *A*'s interest will not then terminate. If a great-grandchild is subsequently born, the contingency will be resolved, and on the date of the great-grandchild's birth *A*'s interest will be deemed to terminate. Since the great-grandchild will be assigned to a lower generation than *A*, a taxable termination will occur on this date. If, however, all the grantor's grandchildren die without ever having children, *A*'s interest will be deemed to terminate on the death of the last grandchild. As a result, on the resolution of the contingency, *B* will be entitled to receive the property. Since she is assigned to *A*'s generation, no generation transfer would then occur. In effect, this is a wait-and-see approach, whereby generation-skipping transfer taxation will be imposed only if property actually skips gift or estate taxation at a generation level.

VIII. CONCLUSION

The Treasury proposal unveiled in 1969, which would have taxed all generation-skipping transfers,[314] was regarded by many as too complex.[315] Responding to the criticism, the present Commissioner of Internal Revenue, Jerome Kurtz,[316] stated:

314. TREASURY PROPOSALS, *supra* note 12.

315. *See, e.g., Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means,* 91st Cong., 1st Sess. 3997–98 (1969) (statement of George Craven).

316. Mr. Kurtz was confirmed as Commissioner by the Senate on April 29, 1977. 123 CONG. REC. S6822 (daily ed. Apr. 29, 1977).

> [t]he complexity arises from the challenge presented by the generation-skipping arrangements themselves. Those arrangements are complex matters, for the draftsman must often project himself almost a hundred years into the future and try to perceive and handle all contingencies. It is asking far too much that such a complex situation be dealt with in comparatively simple fashion by the tax law.[317]

Although exceedingly more complex than the system proposed by the Treasury, chapter 13 seeks only to neutralize generation-skipping tax advantages with respect to trusts and trust equivalents.[318] Consequently, generation-skipping arrangements will continue to give substantial advantage to the wealthier segments of society.[319] Family wealth will continue to be leveled at each generation for all but the wealthy, who can continue the perpetuation of their position. Until property is taxed at every generation level for all persons,[320] the inequity will continue. Fortunately, it is not too late for Congress to rethink the generation-skipping problem in terms of taxing all generation-skipping transfers.[321]

By the same token, the exceptions to taxation under chapter 13 for generation-skipping transfers in trust should be eliminated.[322] Each exception, in its own way and with varying impact,[323] will perpetuate the discrimination between those whose wealth is subject to tax at every generation and those who can avoid this leveling of wealth by generation-skipping transfers in trust. Furthermore, these exceptions, when considered in conjunction with the exception for outright gener-

317. Kurtz & Surrey, *supra* note 20, at 1393.

318. *See* note 24 *supra*.

319. In his statement of July 1, 1977, on fundamental tax reform, Senator Edward Kennedy observed that "the provisions adopted contain gaping loopholes that probably make the tax a nullity for extremely wealthy families, the very group that makes the greatest use of generation-skipping transfers." 123 CONG. REC. S11,417 (daily ed. July 1, 1977).

320. Equitable taxation of all persons' generation-skipping transfers does not, of course, preclude a modest exemption for outright transfers, analogous to that provided in the estate and gift taxation provisions. *See* I.R.C. §§ 2010, 2503(b), 2505. Such a provision would support the progressive tax structure, whereas the present generation-skipping tax provisions still tend to undermine it.

321. Because of the grandfather provisions, the generation-skipping tax system which Congress enacted will have no significant effect for at least fifty years. *See* note 294 *supra*. In his statement on fundamental tax reform, *see* note 319 *supra*, Senator Kennedy called for the taxation of all generation-skipping transfers. 123 CONG. REC. S11,417 (daily ed. July 1, 1977).

322. *See* note 244 *supra*.

323. Although the grandchild exclusion may provide the greatest opportunity for transfer tax avoidance, the sophisticated use of other exceptions, such as the exclusion for trust accounting income distributions, may prove equally effective.

ation-skipping transfers, have resulted in an inordinately complex piece of legislation which is difficult to enforce.[324] Consequently, as suggested throughout this article, the system laid down in chapter 13 is sorely in need of amplification and refinement by extensive regulations and possibly by additional legislation.

Chapter 13 represents a radical departure from this country's prior approach to taxing wealth. Whereas taxation at a generation level formerly depended upon the ownership of property,[325] its mere enjoyment may now be sufficient.[326] Congress should nonetheless move beyond this initial evolutionary development to equalize the effects of the transfer tax system on wealth. All generation-skipping transfers should be subject to tax. An equitable system demands no less.

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324. In commenting upon the original House bill, H.R. 13966, 94th Cong., 2d Sess., 122 Cong. Rec. H4848 (daily ed. May 24, 1976), the Tax Section of the New York State Bar Association stated as follows:

> While we admire the erudition, ingenuity and drafting skill of the writers . . . , we are appalled by the amount of study that would be required of the bar throughout the United States and of the Internal Revenue Service to comprehend it. Indeed, so complex and intricate is the Bill that we doubt whether it could generally be understood and enforced, if enacted.

Certain Committee Amendments to H.R. 10612: Hearings Before the Senate Comm. on Finance, 94th Cong., 2d Sess. 217 (1976). When confronted by chapter 13, the average practitioner and the public at large may find that Judge Wilkey's general observation on taxation rings a responsive chord: "[I]f 200 years ago men revolted on the principle that 'Taxation without representation is tyranny', then today men may rise in righteous wrath because taxation with representation but beyond human comprehension is even worse." "Americans United" Inc. v. Walters, 477 F.2d 1169, 1184 n.1 (D.C. Cir. 1973) (concurring opinion), *rev'd sub nom.* Commissioner v. "Americans United" Inc., 416 U.S. 752 (1974).

325. *See* note 25 *supra*.

326. The prior conceptual basis for imposing transfer taxation, *i.e.*, ownership of property, is preserved under chapter 13 by equating property enjoyment with ownership.