

decisions about health care, including decisions to continue treatment, if desired, rather than being limited to certain decisions such as life-sustaining treatment. However, if an individual does not desire to have life-sustaining treatment such as artificial nutrition and hydration administered, a living will should be executed along with a health care proxy to make clear the principal's wishes.

### Procedure for Objecting

The law provides that a health care provider (i.e., a health care professional or facility), must comply with decisions made by a health care agent to the same extent as if such decisions had been made by the principal. However, the law permits licensed health care professionals to refuse to honor an agent's decision based on "sincerely held moral convictions or religious beliefs," provided that the professional would have objected to the same decision if made by the principal, promptly informs the facility and the health care agent of his or her refusal, and cooperates in facilitating the transfer of the patient to another professional willing to honor the decision. Private health care facilities can also object to an agent's decision based on "religious convictions" or "sincerely held moral convictions central to the facility's operating principle." However, these objections can only be raised if they are set forth in a formally adopted policy, the facility has informed the patient or the health care agent of such policy prior to or upon admission, if reasonably possible, and the patient is transferred promptly to another facility that is reasonably accessible under the circumstances.

Finally, the law provides that the person acting as a health care agent pursuant to a health care proxy, as well as a health care provider honoring a health care decision by an agent in good faith, will not be subject to criminal or civil liability or be deemed to have engaged in unprofessional conduct.

### Part of Estate Planning

New York State residents now have the opportunity to designate an individual or individuals to make health care decisions on their behalf in the event they lose decision making capacity. A health care proxy and a living will should be discussed with every client as a routine part of an estate plan, along with the creation of a Durable Power of Attorney to insure that financial affairs will be attended to in the event of disability.

## GENERATION SKIPPING TRANSFER TAX—FILING REQUIREMENTS FOR THIS TAX YEAR

By Robert E. Flanagan, CPA, Weber Lipsbie & Co.

Tax practitioners at this time of year are busy preparing 1040s and 709s. This filing season, though, three new forms may be required to be filed. As with all required tax forms, tax practitioners risk late filing and late payment penalties for their clients if reporting and payment requirements are not met.

TRA 86 instituted a Generation Skipping Transfer Tax (GST Tax) upon transfers to or for the benefit of persons two or more generations below that of the grantor (referred to as skip persons). Current law relating to the tax is included in IRC Secs. 2601 to 2663, Temp. Reg. 26.2601-1 (which discusses the tax), and Temp. Reg. 26.2662-1 (which discusses the return requirements.)

### Taxable Transfers—Direct Skips

A transfer made directly to a skip person, either during life as an *inter-vivos* transfer or at death as a testamentary transfer, is a "direct skip." A transfer made to a trust in which all beneficiaries are "skip persons" is also a "direct skip."

**Example 1:** Grandfather gives \$100,000 to his granddaughter. Because his granddaughter is two generations below that of the grandfather donor, the transfer is a direct skip. If Grandfather instead gives \$100,000 to a trust for his grandson, the sole beneficiary, this will also be a "direct skip" because only a "skip person," the grandson, has an interest in the trust.

### Taxable Transfers—Trust Distribution or Terminations

Transfers to trusts that have skip and non-skip persons as beneficiaries do not pay the GST Tax upon the funding of the trust.

**Example 2:** Grandfather gives \$100,000 to a trust for the benefit of father and son. The father is not a "skip person" because he is one generation below the donor grandfather. The son is a "skip person" because he is two generations below the grandfather. Because the trust has both a skip person and a non-skip person, no tax is payable upon the funding of the trust.

The GST Tax is paid either when distributions are made to the skip persons or when the trust terminates (termination, for

GST Tax purposes, is that point when all interests by non-skip persons have terminated).

**Example 3:** The trust in Example 2 provides that upon the death of the father the trust continues for the life of the son. When the father dies, the son is the sole beneficiary. Because all non-skip interests have terminated (i.e., the father), a taxable termination has occurred and a GST Tax is imposed on the trust. If, prior to the death of the father, a distribution of \$50,000 is made to the son, a taxable distribution occurs. A GST Tax is payable on the distribution.

### Computation of the GST Tax

The GST Tax is computed by multiplying the highest estate tax rate (currently 55%) by the taxable gift, distribution, or termination. A lifetime exclusion of \$1 million of taxable gifts is available to every taxpayer.

If the transfer is to a trust and a portion (or all) of the GST \$1 million exemption is allocated to the trust, an "inclusion ratio" is computed at the time of the gift. The computation is detailed in Sec. 2642 and Temp. Reg. 26.2601-1(b)(1)(iv). Its effect, though, is to determine the taxable fraction of the trust. For example, if \$750,000 of an exemption is allocated to a \$1 million gift in trust, three-quarters of any trust distribution to a skip person or trust termination will be tax free (i.e., \$750,000/\$1,000,000).

### Reporting Requirements

**Direct Skip.** For *inter-vivos* transfers to direct skip individuals or trusts, the U.S. Gift Tax Return (Form 709) must be filed, and any GST Tax paid, within 3½ months of the taxpayer's year end (April 15 for a calendar year taxpayer). Unless otherwise elected on Form 709, the \$1 million exemption will automatically be allocated to direct skips. The tax is payable by the donor.

**Example 4:** Continuing Example 1, if the grandfather chooses not to utilize any of his exemption on Form 709 a tax of \$55,000 (55% of \$100,000) must be paid by the grandfather by April 15 of the year following the gift.

Direct skips that are non-taxable (generally the \$10,000 annual gift tax exclusion or certain gifts to minors' trusts) are not subject to the GST Tax. However, gifts in trust that are not direct skips are *not automatically exempt* [Sec. 2642(c)(2)]. A common example is the gift to a trust that utilizes the Crummy provision. This transfer may not be exempt. If so, Form 709

must be filed if part of the exemption is to be utilized.

If the direct skip occurs not during life, but at death (for example, the gift in the above example is made as a testamentary bequest), the decedent's Federal Estate Gift Tax Return (Form 706) would report the transfer and the application of any unused GST exemption.

**Termination.** If a termination has occurred, a Generation Skipping Transfer Tax Return For Terminations, Form 706GS(T), must be completed by the trustee and the GST Tax paid with the form. As noted earlier, generally a termination occurs when all non-skip interests in a trust have ended. The difficult task for a trustee is to determine how much of the termination value is taxable (the "inclusion value"). The instructions to this form provide more specific definitions, exemptions and transitional rules. This form and the associated tax is due April 15 of the year following the termination. The tax is paid by the trust.

**Distribution.** If a distribution (either income or principal) is made from a trust to a skip person, the trustee must report the distribution to the skip beneficiary and the IRS using the Notification of Distribution From a Generation Skipping Trust, Form 706GS(D-1), a sort of generation skipping K-1. The trustee must include the description of the property distributed, the date of distribution, the "inclusion ratio" of the trust and the value of the distribution on this information form.

The skip beneficiary, in turn, uses the information on Form 706GS(D-1) to file Generation Skipping Transfer Tax Return for Distributions, Form 706GS(D). The computed GST Tax is paid by the beneficiary with this return.

#### Due Dates

Forms 709, 706GS(D), 706GS(D-1) and 706GS(T) are due on the 15th day of the fourth month following the year the termination or distribution occurs (normally April 15 for calendar year taxpayers).

Transfers at death are reported on Form 706, which is due nine months after death.

Although technically required since 1987, two IRS announcements delayed the filing due date for terminations or distributions occurring after September 25, 1985 and before January 1, 1990 until August 15, 1990. The tax should also have been paid by this date. If trust distributions or terminations occurred during this period, the applicable tax return [Form 706GS(D) or 706GS(T)] or information return [Form 706GS(D-1)] should be filed immediately.

#### Playing with Fire

It is imperative that tax practitioners and trustees be aware of these complex filing and payment requirements. Trust beneficiaries can be hit especially hard because their distributions are tax inclusive, that is, the tax must be paid from the distributions. For the uninformed or unwary the high rate of tax on generation skipping transfers insures hefty liabilities, interest and possible penalties.  $\Omega$

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