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GENERATION-SKIPPING TRANSFERS AND THE TAX REFORM ACT OF 1976

by William N. Radford

A federal estate or gift tax is usually imposed when property is transferred from one individual to another by gift or upon death. Prior to the Tax Reform Act of 1976,¹ however, it was possible to avoid the imposition of the federal transfer tax on certain generations to which a beneficial interest in the property passed.² This was achieved through the use of generation-skipping transfers by which the fee interest in the property would vest in a generation two or more levels below the grantor, with the intervening generation or generations receiving a more limited interest. The tax benefits of such an arrangement stemmed from the fact that no transfer tax was imposed on the property at the termination of the intervening limited interest.

With the belief that such generation-skipping transfers hindered revenue raising and resulted in inequities in the imposition of the federal transfer tax,³ Congress moved in the Tax Reform Act of 1976 to make the tax consequences of generation-skipping transfers equivalent to those for outright dispositions of property.⁴ To facilitate this objective Congress added chapter 13⁵ to the Internal Revenue Code which imposes a transfer tax on the taxable distributions and taxable terminations of generation-skipping trusts and trust equivalents.⁶ All trusts having beneficiaries assigned to more than one generation younger than the grantor's generation come within the scope of the new provisions.⁷ The new tax is computed at the marginal rate of the deemed transferor,⁸ with certain deductions and credits of the deemed transferor allowed against the tax.⁹ No tax is imposed if the intervening generation has only management rights over the trust assets¹⁰ or a limited power to appoint those assets among the lineal descendants of the grantor.¹¹ In addition, a \$250,000 exclusion per deemed transferor is allowed for gifts to grandchildren of the grantor.¹² This Comment examines these new provisions and their effects on prior law and future estate planning techniques.

1. The estate and gift tax package of the Act was passed on Sept. 16, 1976, by a vote of 405 to 2 in the House of Representatives, and 84 to 2 in the Senate. President Ford signed the bill on Oct. 4, 1976.

2. See G. JANTSCHER, TRUSTS AND ESTATE TAXATION 54 (1967).

3. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 46-47 (1976) [hereinafter cited as HOUSE REPORT]; S. REP. NO. 938, pt. 2, 94th Cong., 2d Sess. 19-20 (1976) [hereinafter cited as SENATE REPORT]. Pages 46-59 of the House Report were accepted by the Conference Managers for the Tax Reform Act as the official explanation of the generation-skipping transfer provisions.

4. HOUSE REPORT, *supra* note 3, at 47; SENATE REPORT, *supra* note 3, at 20.

5. I.R.C. §§ 2601-2622.

6. *Id.* §§ 2601, 2611.

7. *Id.* §§ 2611(a), (b).

8. *Id.* § 2602(a).

9. *Id.* § 2602(c).

10. HOUSE REPORT, *supra* note 3, at 47; SENATE REPORT, *supra* note 3, at 21.

11. I.R.C. § 2613(e).

12. *Id.* § 2613(b)(6).

I. THE BACKGROUND OF GENERATION-SKIPPING TRANSFERS

A. *Use Under Prior Law*

By using generation-skipping dispositive schemes which passed property through one or more limited interests until it finally vested in fee, it was possible to give beneficial interests in property to successive generations without incurring any transfer tax. The concept is illustrated by the following example: *A* transfers by will the income of certain property to *B*, his son, for life,¹³ and then on the death of *B*, fee interest to *C*, *A*'s grandson. Under prior law property so disposed of would be included in *A*'s gross estate, but no transfer tax would be imposed on the termination of *B*'s beneficial enjoyment in the property. Although several methods of transfer could be used to achieve the tax benefits of a generation-skipping disposition, the trust device was most commonly used¹⁴ due to the flexibility which it provided.¹⁵

The tax benefits of the generation-skipping transfer arose from the fact that the property passing through the successive generations was not subject to any estate tax on the termination of the limited interests. This result was attributable to the tax rule which required only property which a decedent could transfer at his death to be included in his gross estate.¹⁶ Because the beneficiary of a limited interest, such as a life estate, had nothing which he could transfer on his death, the property was not subject to taxation in his estate.

It was possible under prior law to convey to the limited beneficiaries substantially greater control over the trust res than merely the right to a life estate in the income of the trust. As long as the beneficiary with a limited interest did not possess a general power of appointment in the property it was not included in his gross estate for taxation. Under the Internal Revenue Code's definition of general power of appointment¹⁷ and the exceptions thereto,¹⁸ it was possible for the intervening beneficiary to be entitled to all the trust's income and to have a power to invade or consume the principal of the trust if that power was subject to an "ascertainable standard relating to the health, education, support, or maintenance" of the beneficiary.¹⁹ The

13. Although the example specifies that *B* should receive a life estate, the same tax benefit is achieved where *B* is given an interest for a term of years in the property.

14. See C. SHOUP, FEDERAL ESTATE AND GIFT TAXES 32 n.1 (1966).

15. See SUCCESSFUL ESTATE PLANNING IDEAS AND METHODS (P-H) ¶ 4109.3 (1971); Comment, *A Survey of Generation-Skipping Transfers—the Present Rule and the Possibility of Reform*, 22 SW. L.J. 482, 486 (1968).

16. See C. LOWNDES, R. KRAMER & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES 27 (3d ed. 1974).

17. The Internal Revenue Code defines general power of appointment as "a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate." I.R.C. § 2041(b)(1). The Code does not define special power of appointment, but the accepted implication is that such a power includes everything outside the ambit of the definition for general power of appointment. A general power of appointment created after Oct. 21, 1942, is taxed in the estate of a decedent in all cases when it has not been exercised. *Id.* § 2041(a)(2). If such a power has been exercised it will be included in the decedent's estate only when such property would be includable in the decedent's gross estate under §§ 2035-2038 of the Internal Revenue Code. *Id.* It is noteworthy that the meanings of general power of appointment and special power of appointment under federal tax law are not the same as the traditional property law definitions given for them.

18. *Id.* §§ 2041(b)(1)-(2), 2514(c), (e).

19. *Id.* §§ 2041(b)(1)(A), 2514(c)(1).

beneficiary could also have the power to consume annually the greater of \$5,000 or five percent of the aggregate value of the trust assets subject to no standard.²⁰ Finally, the limited beneficiary could even be given the power to appoint the trust assets so long as such power was not exercisable in favor of the beneficiary, his estate, his creditors, or the creditors of his estate.²¹ It is, thus, apparent that it was possible for the intervening beneficiaries in generation-skipping transfers to be given substantial control and enjoyment of the trust property without being subjected to estate taxation.²²

Generation-skipping transfers have, however, always been subject to the restrictions of state property law. The most important of these restrictions, the Rule Against Perpetuities, requires that for an interest in property to be valid it must vest "not later than twenty-one years after some life in being at the creation of the interest."²³ This common law restriction, with its various local interpretations, is operative in the great majority of states.²⁴ The most important of the local variants is the law of Delaware which considers the period of perpetuities for interests created by either limited or general powers of appointment as running from the date the power is exercised.²⁵ Without more, it would have been possible in Delaware, prior to the Tax Reform Act of 1976, to string together an unlimited number of special powers of appointment free of any transfer tax since only general powers of appointment were taxed.²⁶ To obviate such a result, section 2041(a)(3) of the 1954 Code specifies that when there is an exercise of any power of appointment to create another power of appointment which under the local Rule Against Perpetuities can be validly exercised to postpone the vesting in fee of the property "for a period ascertainable without regard to the date of the

20. *Id.* §§ 2041(b)(2), 2514(e).

21. *Id.* §§ 2041(b)(1), 2514(c). Besides the tax advantages accompanying the use of special powers of appointment, the use of those powers also made possible significant non-tax advantages. In particular, the use of special powers of appointment (1) postponed the ultimate disposition of the property, (2) avoided probate, and (3) insulated the property from the donee's creditors. SUCCESSFUL ESTATE PLANNING IDEAS AND METHODS (P-H) ¶ 4109.3 (1971).

22. The Treasury Department's view was that: "The enjoyment of the property by each successive generation is not skipped—it is only the estate tax that is being skipped." U.S. TREASURY DEPT., 91ST CONG., 1ST SESS., TAX REFORM STUDIES AND PROPOSALS pt. 1, at 31 (Comm. Print 1969) [hereinafter referred to as TREASURY PROPOSALS]. Revenue raising problems could arise from the widespread use of generation-skipping trusts. One commentator has noted that if all decedents left all their property in trusts skipping one generation, the tax base would be reduced by one-half, or by two-thirds if two generations were skipped by each trust. C. SHOUP, *supra* note 14, at 33.

23. L. SIMES, FUTURE INTERESTS 263 (2d ed. 1966), quoting the rule as stated by John Chipmann Gray. Even with the restriction imposed by the Rule Against Perpetuities, it is still quite possible for a generation-skipping trust to last eighty to one hundred years. Westfall, *Revitalizing Estate and Gift Taxes*, 83 HARV. L. REV. 996, 1007 (1970). See generally Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638 (1938); Leach, *The Rule Against Perpetuities and Gifts to Classes*, 51 HARV. L. REV. 1329 (1938).

24. The common law Rule Against Perpetuities is not in force in either Idaho or Wisconsin. Both of those states do, however, place limits on the suspension of the power to alienate property. See IDAHO CODE §§ 55-111 (1957); WIS. STAT. ANN. § 700.16 (West 1976). It would appear that perpetual generation-skipping trusts could be validly established in those two states so long as the trustee has the power to alienate the property. Such a disposition would have, prior to the Tax Reform Act of 1976, effectively removed the trust property from federal transfer taxation. For a further discussion of this possibility see A. CASNER, ESTATE PLANNING 675-76 (3d ed. 1961).

25. DEL. CODE tit. 25, § 501 (1975). The majority of states, however, consider the period of perpetuities for special powers of appointment as running from the creation of the power and not from the time of its exercise. See L. SIMES, *supra* note 23, at 292.

26. See Casner, *ALI Estate and Gift Tax Project*, 22 TAX L. REV. 515, 574-75 (1967).

creation of the first power," such exercise is subject to a transfer tax.²⁷ Although this provision was designed specifically to deal with Delaware law, it applies to any person exercising a power of appointment, regardless of which state he resides in.²⁸

B. *Early Proposals for Reform*

Prior to the adoption of new chapter 13, several groups had spoken out in favor of revision in the law surrounding generation-skipping transfers and had submitted proposals to effect such a result. In 1969 the Treasury Department submitted a scheme²⁹ for taxing generation-skipping transfers that imposed a substitute tax on each generation regardless of whether that generation received the property or was passed over in favor of another generation.³⁰ If the transfer was to a person unrelated to the transferor, the transferee would be considered to be more than one generation younger than the transferor if he was more than twenty-five years younger.³¹ The substitute tax was designed to apply if the transfer was via gift or trust.³² The tax was calculated so as to approximate the tax that would have been paid by the skipped generation in an outright transfer.³³ As a result, the tax would be imposed at the arbitrarily chosen figure of sixty percent of the transferor's marginal rate after a grossing-up process.³⁴ The skipped generation could, however, elect to pay the same tax that would have been assessed if the property had been transferred outright and, thus, avoid assessment of the substitute tax.³⁵

The American Law Institute also went on record as favoring the imposition of a generation-skipping transfer tax and approved a proposal for such reform.³⁶ The ALI proposal suggested the assessment of an additional tax only when more than one generation was skipped in a transfer.³⁷ The additional tax would be computed at the average rate of the transferor; the transferor would then be given the option of having the tax levied at the time

27. I.R.C. §§ 2041(a)(3), 2514(d).

28. In the great majority of states the period of perpetuities for special powers of appointment and general powers to appoint by will is measured from the time of the creation of the power. When a donee has a general power of appointment presently exercisable, however, the validity of the appointment is determined by the date of its exercise. See L. SIMES, *supra* note 23, at 291-95. Thus, even the nonresident of Delaware may fall into the trap of transfer taxation under § 2041(a)(3) or § 2514(d) when, after receiving a special power of appointment or a general power to appoint by will, he exercises that power to create a general power to appoint by either deed or will. By so doing, the donee has created another power of appointment which could be validly exercised to postpone the vesting of the interest in the property for "a period ascertainable without regard to the date of the creation of the first power." I.R.C. § 2041(a)(3). For a discussion of the possibility of transfer taxation on the non-resident of Delaware under § 2041(a)(3) see A. CASNER, *supra* note 24, at 710-11. The exposure to § 2041(a)(3) taxation may be avoided by including a clause in the dispositive instrument specifying that the special power of appointment may only be exercised to create other special powers of appointment.

29. TREASURY PROPOSALS, *supra* note 22.

30. *Id.* pt. 3, at 389. It is submitted that to impose a transfer tax on a generation without regard to its contact with the property, as proposed by the Treasury Department, violates basic notions of fairness.

31. *Id.*

32. *Id.*

33. *Id.* at 391.

34. *Id.* This imprecision simplified the tax.

35. *Id.* at 390-91.

36. ALI FEDERAL ESTATE AND GIFT TAXATION 30-31 (1969) [hereinafter cited as ALI].

37. *Id.* at 31.

the transfer was originally made or when the beneficial enjoyment changed.³⁸

Finally, the possibility of revising the power of appointment provisions already in the Internal Revenue Code³⁹ was raised by some authorities. Much of the discontent with the then existing law arose over the significant incidents of ownership which could be transferred under those statutes without transfer taxation.⁴⁰ Thus, it was reasoned that the objectionable benefits accorded generation-skipping trusts under prior law could be done away with by including all powers of appointment in the gross estate of the decedent or by making their exercise subject to gift tax.⁴¹ Another suggestion was to widen the statutory definition of general power of appointment to restrict the rights of the holder of a non-taxed limited interest with respect to the property held.⁴²

II. NEW CODE SECTIONS 2601-2622

Reasons for Change in the Law. The committee reports from both the Senate and the House of Representatives for the Tax Reform Act of 1976 indicated that the federal estate and gift tax system should not only raise revenue, but should do so uniformly between generations.⁴³ The Committees concluded that such a goal is hampered by the use of generation-skipping transfers to avoid transfer taxation for long intervals.⁴⁴ In addition, the Committees noted that the tax benefits previously available by generation-skipping transfers resulted in certain inequities.⁴⁵ In particular, since generation-skipping dispositions were more valuable to the wealthy and more often used by them, wealthy families were able to pay less in transfer taxes. Thus, the progressivity of the federal estate and gift tax system was eroded by the tax benefits generation-skipping transfers offered.⁴⁶ For these two reasons Congress acted on September 16, 1976, to end the tax advantages formerly associated with generation-skipping transfers by enacting the Tax Reform Act of 1976. As passed by Congress, the bill contains provisions imposing an additional tax on generation-skipping transfers "substantially equivalent" to the transfer tax that would have been imposed had the property passed outright to each successive generation.⁴⁷

The Basic Tax. New section 2601 of the Internal Revenue Code provides that a tax shall be imposed on every generation-skipping transfer. The

38. *Id.*

39. See notes 17-22 *supra* and accompanying text.

40. See Comment, *supra* note 15, at 493.

41. *Id.*

42. See JOINT COMM. ON THE ECONOMIC REPORT, 84TH CONG., 1ST SESS., FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY 864, 870 (Comm. Print 1955). Professor Bittker suggested a complete revision in the power of appointment provisions so that "significant powers held by a person related to the potential takers of the property [would] be subject, as a general rule, to estate and gift tax." *Id.* at 870. For another suggested solution to the generation-skipping dilemma see Westfall, *supra* note 23.

43. HOUSE REPORT, *supra* note 3, at 46; SENATE REPORT, *supra* note 3, at 19.

44. *Id.*

45. HOUSE REPORT, *supra* note 3, at 47; SENATE REPORT, *supra* note 3, at 20.

46. *Id.*

47. *Id.*

taxable event, the generation-skipping transfer, is defined as any taxable termination or taxable distribution with regard to a generation-skipping trust or trust equivalent.⁴⁸ The tax is calculated at the marginal rate of the deemed transferor.⁴⁹

A generation-skipping trust is one having younger generation beneficiaries⁵⁰ assigned to more than one generation younger than the grantor.⁵¹ Although the new provisions do not explicitly say so, the legislative history indicates that the grantor of a trust would be anyone contributing to the res of the trust.⁵² When possible, the question of which generation a beneficiary belongs to is resolved along family lines.⁵³ In this case the generation is determined by comparing the number of generations between the grandparent of the grantor and the beneficiary to the number of generations between the grandparent and the grantor.⁵⁴ When the generation of the beneficiary cannot be fixed by familial levels, an irrebuttable presumption is established that one generation covers twenty-five years.⁵⁵ Thus, anyone more than twelve-and-one-half years younger than the grantor but no more than thirty-seven-and-one-half years younger is in the first generation succeeding the grantor.⁵⁶ Anyone classified as being in more than one generation according to these rules is deemed to be a member of the younger generation.⁵⁷

A logical question that arises in considering the provisions relating to the ascertainment of a beneficiary's generation is: How should the statutory

48. I.R.C. § 2611(a).

49. *Id.* § 2602(a).

50. Chapter 13 establishes a string of interrelated definitions in order to explain who a younger generation beneficiary actually is. First, that person is defined as any beneficiary in a generation younger than that of the grantor. I.R.C. § 2613(c)(1). Whether the beneficiary is in a generation younger than the grantor's is determined immediately prior to the transfer. *Id.* § 2613(c)(2). A beneficiary is anyone having a present or future interest or power in the trust. *Id.* § 2613(c)(3). A person holding an interest is then defined as anyone with the right to receive income or corpus, or one who is a permissible recipient of such funds. *Id.* § 2613(d)(1). The term "power" means the right to change or establish the beneficial enjoyment of the corpus or income of a trust. *Id.* § 2613(d)(2). A person is not, however, deemed to have a power when he may only convey the trust res and income to lineal descendants of the grantor in generations younger than his generation assignment. *Id.* § 2613(e).

51. *Id.* § 2611(b). A simple example of a generation-skipping trust is the dispositive scheme providing trust income to the grantor's child for life, with the remainder going to the grantor's great-grandchildren. This situation would come within the statutory definition because there are two generations of younger generation beneficiaries. See note 50 *supra*. On the other hand, a trust providing a life estate for the grantor's spouse with the remainder going to the grandchildren would not be a generation-skipping transfer because only one generation of younger beneficiaries is involved.

52. The House Committee on Ways and Means Report states that for "purposes of the generation-skipping provisions, a 'grantor' of the trust would include any person contributing or adding property to the trust." HOUSE REPORT, *supra* note 3, at 48.

53. *Id.* Apparently this is only possible when the beneficiaries are lineal descendants of the grandparent of the grantor, married to such an individual or adopted into such a position. See I.R.C. §§ 2611(c)(1)-(2), (4).

54. The number of generations between the grantor's grandparent and the grantor will always remain constant. Presumably, the reason such a comparison was incorporated into the new provisions was to insure that lineal descendants of the grantor's grandparents would be divided into generations according to the family scheme of § 2611 rather than under its statutory presumption discussed in the text accompanying note 55 *infra*.

55. I.R.C. § 2611(c)(5).

56. To prevent the circumvention of the generation-skipping provisions by the use of organizational entity beneficiaries, those persons sharing in the trusts through such entities are assigned to generations just as any ordinary individual beneficiary would be. *Id.* § 2611(c)(7).

57. *Id.* § 2611(c)(6).

determination be made when there are multiple grantors representing different generations? The problem centers around which grantor's life is to be used as the measuring rod. There are several alternatives: (1) measure by the oldest grantor, (2) measure by the grantor bearing the closest affinity to the beneficiary, or (3) measure by both grantors. Under the third alternative it could be argued that by being assigned to more than one generation, the beneficiary should be deemed to be a member of the younger generation.⁵⁸ The importance of which grantor is chosen to determine the beneficiaries' generations stems from the fact that without beneficiaries more than one generation younger than the grantor, there is no generation-skipping trust and, thus, no generation-skipping transfer tax. Much of the impact of the new provisions might be obviated by allowing a person in a generation younger than the oldest grantor to be the sole bench mark for the determination of generations.⁵⁹ Since there is an absence of legislative history on this question, there is no evidence as to what the intent of Congress was and no guidance for the Internal Revenue Service to follow in promulgating the relevant regulations and rulings.⁶⁰

The generation-skipping transfer tax is only imposed when there is a taxable termination or taxable distribution from a generation-skipping trust.⁶¹ A taxable termination occurs when the interest or power of a younger generation beneficiary, in a generation older than that of any other younger generation beneficiary, comes to an end.⁶² There is, however, no taxable termination when the mere future interest of a beneficiary is extinguished.⁶³ Complicating the taxable termination concept is the fact that when two or more beneficiaries are in the same generation no taxable termination is deemed to occur until the last of such beneficiaries' powers or interests terminates.⁶⁴ When the beneficiaries' interests in the trusts are "identifiable and separate," however, they are to be treated as interests in separate trusts according to the regulations to be formulated by the Internal Revenue Service.⁶⁵ Similarly, when one beneficiary has both an interest and a power, or more than one interest or power, there is no taxable termination until the last of these ends.⁶⁶ When there is a beneficiary with a present

58. *See id.* Acceptance of this argument would be equivalent to following the first alternative of measuring by the oldest grantor.

59. A determination of whether or not a disposition is a generation-skipping trust which only considers the position of the donees with respect to the younger grantor would seem somewhat in conflict with the intent of I.R.C. § 2611(c)(6). The latter provision considers a beneficiary to be a member of the younger generation when assigned to more than one.

60. *See* I.R.C. § 2622 which gives the Secretary the power to formulate the necessary or appropriate regulations to carry out the generation-skipping transfer tax. It should be expected that the Secretary will at least provide some type of strictures to prevent the use of sham grantors to escape the new generation-skipping transfer provisions.

61. *Id.* §§ 2601, 2611(a).

62. *Id.* § 2613(b). In the common situation where the grantor conveys a life estate to his spouse, there will be no taxable termination on her death since she is deemed to be in the same generation as her spouse and thus not a younger generation beneficiary. *Id.* § 2611(c)(2).

63. *Id.* § 2613(b)(1).

64. *Id.* § 2613(b)(2)(A). The House Committee recognized that this provision could be used as a tax evasion device and thus encouraged the Internal Revenue Service to prescribe regulations preventing its use "primarily for the postponement of tax." HOUSE REPORT, *supra* note 3, at 50-51. The Committee's encouragement leaves the Service much leeway.

65. HOUSE REPORT, *supra* note 3, at 51. The separate share rules to be promulgated by the Service will presumably be substantially similar to those under I.R.C. § 663(c).

66. I.R.C. § 2613(b)(2)(B).

interest in the trust⁶⁷ that is in the same or older generation than the grantor there will be no taxable termination; but powers and interests may terminate among younger generation beneficiaries until the power or interest of the older beneficiary concludes.⁶⁸

A taxable distribution is any distribution which is not from trust income and is made to any younger generation beneficiary when there is another younger generation beneficiary that is a member of an older generation.⁶⁹ The Committee on Ways and Means Report illustrates this concept by describing a situation in which the trustee of a discretionary trust makes transfers from the income of the trust to the grantor's child and from the corpus to the grantor's great grandchild.⁷⁰ The conveyance of corpus to the grantor's great grandchild is a taxable distribution since there is a younger generation beneficiary, the grantor's child, in a generation older than the beneficiary receiving the transfer. In addition, when the disposition is made out of both income and corpus to multiple generations, the income portion is attributed to the older generations first.⁷¹ The result is that such transfers are considered taxable distributions to the maximum extent possible. Recognizing that loans made by trustees from trust assets may be substantially equivalent to distributions, the House Report specifically authorizes the Internal Revenue Service to impose reporting requirements for such transactions.⁷² The problem of equating loans with taxable distributions is certain to foster a considerable amount of case law due to the variety of factual settings in which loans may be made.

The terms "taxable termination" and "taxable distribution" do not include those transactions which are subject to federal gift and estate taxation by other Code provisions.⁷³ For example, if a general power of appointment is included in the decedent's estate for estate taxation, the termination of his power in a generation-skipping trust would not be a taxable termination.⁷⁴ In addition, taxable termination and taxable distribution do not include transfers to the grantor's grandchildren to the extent such transfers do not exceed \$250,000 per "deemed transfer."⁷⁵ This is one of the most important exclusions from taxation in the new generation-skipping trust provisions. The amount which may be transferred without taxation does not depend on the

67. The beneficiary in the older generation may hold his present interest at the time of the termination or as a result of that termination. *Id.* § 2613(b)(2)(C), (D).

68. *Id.* § 2613(b)(2)(C). This situation would be the only one where an unusual order of termination would occur under § 2613(b)(2)(C) so as to postpone the imposition of the transfer tax. *Compare id.* § 2613(b)(1) with § 2613(b)(2)(C).

69. *Id.* § 2613(a)(1).

70. HOUSE REPORT, *supra* note 3, at 51-52.

71. I.R.C. § 2613(a)(2). The attribution discussed in the text should have no effect on how the character of the distribution will be allocated for income tax purposes. There is, however, nothing in the new statute or its legislative history that specifies that this will be the result. *Compare id.* § 2613(a)(2) with § 662.

72. HOUSE REPORT, *supra* note 3, at 52.

73. I.R.C. §§ 2613(a)(4)(B), (b)(5)(B).

74. This example is given in the Committee on Ways and Means Report. HOUSE REPORT, *supra* note 3, at 52.

75. I.R.C. § 2613(b)(6). For a discussion of the term "deemed transferor" see notes 87-90 *infra* and accompanying text. Whether or not the § 2613(b)(6) exclusion applies to transfers to grandchildren of the grantor by legal adoption is not clear. Neither the new statutes nor their legislative history address this problem.

number of grandchildren a grantor has, but rather on the number of deemed transferors.

Computation of the Tax. When there has been a taxable distribution, the amount subject to the generation-skipping transfer tax is the fair market value on the date of distribution of the transferred property.⁷⁶ In computing this tax base the amount of transfer tax on the distribution, regardless of whether paid by the beneficiary or trustee, is included.⁷⁷

In the event of a taxable termination the tax base is the fair market value of the property in which the beneficiary had a power or interest.⁷⁸ The legislative history of the new provisions indicates that when a beneficiary has more than one interest, or an interest with a power, or more than one power in the trust assets, resulting in a taxable termination only on the passing of the last such power or interest, the tax base is the cumulative value of the terminated interests.⁷⁹ Although the use of the cumulative sum in computing the transfer tax on taxable terminations of multiple powers or interests is quite logical, the Code provisions do not explicitly provide for this result.⁸⁰

The tax on generation-skipping transfers is determined by subtracting one tentative tax from another.⁸¹ The first tentative tax is computed in accordance with the normal estate tax rate on the sum of (1) the amount of property subject to the generation-skipping transfer tax,⁸² and (2) the amount of other taxable transfers made by the deemed transferor.⁸³ The second tentative tax is calculated in the same manner, but only on the latter of these amounts,⁸⁴ and it is then subtracted from the first tentative tax to give the actual tax on the generation-skipping transfer.⁸⁵ According to the Committee on Ways and Means Report, the result of all these mathematical gymnastics is "that the generation-skipping transfer is taxed at the marginal transfer tax rate of the deemed transferor."⁸⁶ The actual effect of the prescribed computation might be more precisely described as taxing the transfer at a marginal rate determined by adding the taxable transfers of the deemed transferor to the value of the property subject to the generation-skipping transfer tax.

For purposes of calculating the transfer tax chapter 13 establishes the new concept of deemed transferor.⁸⁷ The generation-skipping transfer tax is imposed through the various mathematical calculations discussed above as if that person had transferred outright the property subject to the new tax.

76. See I.R.C. § 2602(a)(1)(A); HOUSE REPORT, *supra* note 3, at 53.

77. HOUSE REPORT, *supra* note 3, at 53.

78. *Id.* Section 2602 provides that the new tax is computed by using "the fair market value of the property transferred." I.R.C. § 2602(a)(1)(A).

79. HOUSE REPORT, *supra* note 3, at 54. The result discussed in the text could be construed as a slight extension of I.R.C. § 2602(a)(1)(A).

80. Neither the section specifying the tax base to be used nor the provision for the postponement of this transfer tax explicitly state that multiple interests or powers should be aggregated. I.R.C. §§ 2602(a)(1)(A), 2613(b)(2)(B). *But see id.* § 2602(b).

81. *Id.* § 2602(a).

82. *Id.* § 2602(a)(1)(A).

83. *Id.* § 2602(a)(1)(B)-(D).

84. *Id.* § 2602(a)(2).

85. *Id.* § 2602(a).

86. HOUSE REPORT, *supra* note 3, at 55.

87. I.R.C. § 2612.

The deemed transferor is ordinarily that parent of the transferee most closely related to the grantor.⁸⁸ When neither parent of the transferee is related to the grantor, the deemed transferor is that parent having the closest affinity to the grantor.⁸⁹ The determination of which parent has the closest affinity to the grantor will, however, prove to be no easy task. The House Report understates the potential problem by summarily concluding that the parent with the closest affinity will usually be the person named in the will or trust instrument or the person having the intervening interest in the trust.⁹⁰ This overlooks the problem that both parents may be mentioned by the will or jointly share an intervening interest.

In keeping with its intent to impose a tax substantially equivalent to that which would have been imposed had the property been transferred outright, the new law allows certain benefits available under the federal estate and gift tax laws to property passing in an outright transfer in computing the generation-skipping transfer tax.⁹¹ Thus, it is possible for the generation-skipping trust to utilize the unused portion of the unified credit available to the estate of the deemed transferor.⁹² A charitable deduction is allowed if part of the trust property passes to charity.⁹³ The previously taxed property credit is also available.⁹⁴ In addition, the taxable termination or taxable distribution may be included in certain instances to determine the deemed transferor's gross estate in computing the available marital deduction.⁹⁵ Certain expenses attributable to the generation-skipping transfer may be deducted,⁹⁶ and a credit is allowed for state inheritance taxes paid with respect to any property included in the generation-skipping transfer.⁹⁷

Miscellaneous. It is anticipated that the transfer tax will be paid from the proceeds of the trust.⁹⁸ The trustee is personally liable for any transfer tax incurred because of a taxable termination.⁹⁹ Such personal liability, however, is not imposed for any additional tax found to be due after the trustee has relied on information solicited from the Internal Revenue Service regarding either the transfer tax bracket of the deemed transferor or the extent to which the grandchild exclusion¹⁰⁰ has been utilized with respect to the deemed transferor.¹⁰¹ In addition, the distributee in a taxable distribution is

88. *Id.* § 2612(a)(1). The only exception to this rule occurs when such parent is not a younger beneficiary and there is another ancestor of the transferee who is a younger generation beneficiary and related to the grantor by blood or adoption. *Id.* § 2612(b)(1).

89. *Id.* § 2612(a)(1).

90. HOUSE REPORT, *supra* note 3, at 56. There are no other expressions of legislative intent as to how the affinity should be determined beyond the simple statement mentioned in the text.

91. See HOUSE REPORT, *supra* note 3, at 54-55.

92. I.R.C. § 2602(c)(3). In those cases where the deemed transferor's estate is not large enough to require the filing of an estate tax return determination of the unified credit available to the generation-skipping trust will not be an easy task. See R. COVEY, GENERATION-SKIPPING TRANSFERS IN TRUST 87-88 (1976).

93. I.R.C. § 2602(c)(2).

94. *Id.* § 2602(c)(4).

95. *Id.* § 2602(c)(5)(A).

96. *Id.* § 2602(c)(5)(B).

97. *Id.* § 2602(c)(5)(C). Alternate date valuation is also permitted. *Id.* § 2602(d).

98. HOUSE REPORT, *supra* note 3, at 57.

99. I.R.C. § 2603(a)(1)(A).

100. *Id.* § 2613(b)(6).

101. *Id.* § 2603(a)(2).

personally liable, to the extent of the fair market value of the property which he receives, for the transfer tax on such distribution.¹⁰² The transfer tax imposed is a lien on the property transferred until the tax is paid in full or the tolling of the statute of limitations makes it unenforceable.¹⁰³ It is expected that the imposition of personal liability on trustees will make potential trustees more reluctant to handle generation-skipping trusts and will increase the fees charged for acting in such capacity. Unless some form of personal liability is imposed by the regulations to be formulated by the Secretary, there will be no personal liability on the taxable terminations of trust equivalents such as life estates and remainders and estates for years.

Property transferred under a generation-skipping transfer before the death of the deemed transferor receives a step-up in its basis equal to that amount of transfer tax which is attributable to the excess of the property's fair market value, immediately preceding the transfer, over its adjusted basis.¹⁰⁴ In the event the property is transferred at the same time as the death of the deemed transferor, it is given a basis under amended Internal Revenue Code section 1023.

The federal estate and gift tax rules will continue to apply as long as they are not inconsistent with the new generation-skipping transfer provisions.¹⁰⁵ Should the deemed transferor be alive at the time of the transfer, the gift tax statutes will be applicable.¹⁰⁶ If he is not, then the estate tax provisions will be relevant.¹⁰⁷ It is expected that such a rough overlay of the new statutes over the old will create some conflict, resulting in new case law to reconcile the old and new rules.

III. ESTATE PLANNING UNDER THE NEW LAW

One of the most important factors to consider when planning an estate under the new law is the statute's effective date. New chapter 13 basically applies to all generation-skipping transfers made after April 30, 1976. The transfer tax does not, however, apply to trusts which were irrevocable as of April 30, 1976, except to the extent that transfers are made from corpus added to the trust after April 30, 1976.¹⁰⁸ For wills and revocable trusts in existence on April 30, 1976, and not thereafter amended in a manner which would create or increase a generation-skipping transfer, no transfer tax is imposed if the grantor dies before January 1, 1982.¹⁰⁹

102. *Id.* § 2603(a)(3).

103. *Id.* § 2603(b). The statute refers to "lapse of time" rather than the statute of limitations.

104. *Id.* § 2614.

105. *Id.* § 2621(a).

106. *Id.* § 2621(a)(2).

107. *Id.* § 2621(a)(1).

108. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2006(c), 90 Stat. 1879. The language of the statute specifically states that trusts which were irrevocable on April 30, 1976, are exempt from the new transfer tax "but only to the extent that the transfer is not made out of corpus added to the trust after April 30, 1976." *Id.* To give full effect to the transfer tax it would be necessary to interpret this to mean that the non-exempt portion of such an irrevocable trust is that portion of corpus, plus its appreciation and income, contributed after April 30, 1976. It is expected that the Internal Revenue Service will urge such an interpretation. In any event, it is certain that segregation problems will arise with respect to this provision.

109. *Id.* If the grantor was under a mental disability as of April 30, 1976, the date of death requirement does not expire until two years after he regains his competence. *Id.*

Any pre-April 30, 1976, generation-skipping transfer should be preserved if at all possible. The pre-April 30, 1976, irrevocable trust is obviously worth maintaining because of its tax exempt status. Even if the transfer is through a revocable will or trust, however, the preservation of that instrument is important since the grantor could die prior to January 1, 1982. Should the property subject to the dispositive instrument lose its exempt status because the grantor lives beyond January 1, 1982, the estate plan of the grantor can be changed at that time. By prolonging the change in dispositive schemes, the grantor receives the dual benefits of additional time to formulate amendments to his estate plan and five and one-half years of legal interpretation on the new provisions.¹¹⁰

In dealing with trusts established before April 30, 1976, it should be remembered that additions to the res of irrevocable trusts will generally not be exempt from transfer taxation.¹¹¹ Additions to an irrevocable trust may be made without transfer taxation, however, to the extent the trust qualifies for the \$250,000 grandchild exclusion.¹¹² Revocable trusts and wills, on the other hand, cannot be amended in any way which would result in the creation of, or an increase in the amount of, any generation-skipping transfer without losing their conditional exemption.¹¹³ Thus, the revocable trust or will may be amended to change the beneficiaries or the amount of a beneficiary's share, but not to expand the number of younger generations and increase the generation-skipping span. It seems, however, that additions may be made to the corpus of the revocable trust without being subjected to chapter 13 when such additions can be made without amendment.¹¹⁴

As discussed above, taxable terminations and taxable distributions do not include transfers to grandchildren to the extent they do not exceed \$250,000 per deemed transferor.¹¹⁵ This exclusion should not be overlooked in a comprehensive estate plan. The total amount of exclusion available depends on the number of deemed transferors. As the number of children of the grantor who have children grows larger the greater the exclusion may be.¹¹⁶

110. During this interim period case law and the Internal Revenue Service's position with respect to the new transfer tax will at least begin to emerge.

111. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2006(c), 90 Stat. 1879; *see* note 108 *supra* and accompanying text.

112. I.R.C. § 2613(b)(6).

113. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2006(c), 90 Stat. 1879.

114. This conclusion is supported by a comparison of subsections 2006(c)(2)(A) and 2006(c)(2)(B) of the Tax Reform Act. The former deals with irrevocable trusts and only exempts transfers from post-April 30, 1976, additions to the trust corpus. The latter provision, dealing with wills and revocable trusts, specifies that they lose their exempt status only if amended in a prohibited manner.

115. I.R.C. § 2613(b)(6); *see* note 75 *supra* and accompanying text. An important question, for estate planning purposes, left unanswered by the new statutes, is whether after a taxable termination occurs the deemed transferor becomes the grantor in the subsequent application of ch. 13. An affirmative answer would mean that the § 2613(b)(6) exclusion could possibly be utilized by a single trust in transfers to more than one generation. It has been suggested that this should be the outcome since the trust property is treated by ch. 13 as transferred by the deemed transferor. *See* R. COVEY, *supra* note 92, at 21. A literal reading of § 2613(b)(6), however, does not imply that this should be the result.

116. Unless all of the children of the grantor have children, maximum use of the § 2613(b)(6) exclusion cannot be obtained. This is illustrated by the following example. Grantor has two children, A and B; A has children, but B does not. The grantor sets up separate trusts for A and B for life with the remainder of both to go to A's children. In this case only \$250,000 may be excluded from transfer taxation because A is the only deemed transferor. A is the deemed

There is nothing in the statute or its legislative history to indicate that when it is possible for the grantor to pass property to the grandchildren by way of more than one deemed transferor, there must be a separate trust set up for each deemed transferor. Thus, one trust may be set up from which all the transfers to the grandchildren are made. If the grantor desires to make maximum use of the grandchild exclusion and still divide the property equally among the children of a deemed transferor, he may establish a trust funded to the extent of the maximum exclusion, with a dispositive clause dividing that sum by the number of the deemed transferor's children living and to be born in the future.¹¹⁷

One of the most important new transfer tax provisions for estate planning is section 2613(e) which states that an individual does not possess a present or future power in a trust if he has only the power to convey trust res or corpus to the lineal descendants of the grantor in a generation younger than that individual.¹¹⁸ The practical importance of this provision may be illustrated by the trust arrangement wherein the grantor conveys one of these limited powers of appointment to his son, who later transfers the property to the grandchildren of the grantor. Without the section 2613(e) proviso such a disposition would be classified as a generation-skipping transfer since there are younger generation beneficiaries in more than one generation younger than the grantor.¹¹⁹ Under section 2613(e), however, there is no generation-skipping transfer since the grandchildren are the only generation of beneficiaries younger than the grantor.¹²⁰ The use of this provision should be carefully considered as it provides a method whereby flexibility can be integrated into an estate plan while still avoiding transfer tax. Specifically, the person holding the right to affect the beneficial enjoyment of the trust res may appoint it among the lineal descendants of the grantor of the trust according to their needs. On the other hand, the person holding the limited power of appointment may be provided for by an outright gift from the transferor or by a separate trust.

Previously existing federal estate and gift tax law cannot be ignored in exercising 2613(e) limited powers of appointment since such law is still

transferor of his own trust because he is the parent of the transferees and a younger generation beneficiary. *A* is also the deemed transferor of the *B* trust. Although *A* is not a younger generation beneficiary of the *B* trust, he is the parent of the transferees and the transferees have no ancestor that is a younger generation beneficiary of that trust. See I.R.C. § 2612(a).

117. For such a dispositive clause see 4 J. RABKIN & M. JOHNSON, CURRENT LEGAL FORMS WITH TAX ANALYSIS 9-1020-21 (1977). If after-born grandchildren of the grantor are provided for, their interests must vest at or before the time they reach 21 years of age in order to avoid transgressing the Rule Against Perpetuities.

118. I.R.C. § 2613(e). That section states:

For purposes of this chapter, if any individual 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 who are lineal descendants of the grantor assigned to a generation younger than the generation assignment of such individual, then such individual shall be treated as not having any power in the trust.

Whether or not the phrase "lineal descendants" used in section 2613(e) includes those persons adopted into such positions is not clear. One commentator suggests that the phrase should be construed to include legally adopted individuals. See R. COVEY, *supra* note 92, at 16.

119. The son would be a beneficiary except for § 2613(e) because he holds a power in the trust. I.R.C. § 2613(c)(3). The grandchild would be a beneficiary by virtue of the fact that he is a permissible recipient of the income or corpus of the trust. *Id.*

120. See note 51 *supra* and accompanying text.

applicable except when inconsistent with chapter 13.¹²¹ If care is not exercised, it is possible for the holder of the limited power to appoint to become subject to transfer taxation under section 2041(a)(3). That provision¹²² imposes an estate tax to the extent of any property over which the decedent exercises a power of appointment, to create another power of appointment, which under local law may be exercised to postpone the vesting of the property for a period ascertainable without regard to the date of the creation of the first power. A holder's exercise of his section 2613(e) limited power of appointment to create a presently exercisable general power of appointment, although transfer tax free under new section 2613(e), would result in the anomalous situation of subjection to estate taxation under section 2041(a)(3).¹²³

Should a generation-skipping disposition be chosen by the grantor in establishing a will or trust after April 30, 1976, the tax burden of chapter 13 may be reduced by the effective use of the provisions which allow that tax to be postponed.¹²⁴ When there are two or more beneficiaries in the same generation, no tax will be imposed until the last of such beneficiaries' powers or interests end.¹²⁵ Similarly, when an individual beneficiary has more than one interest or power in the trust, taxation will not occur until the last of these terminates.¹²⁶ The former rule will presumably encourage grantors to select several beneficiaries from the same generation. Emphasis will be placed on selecting some beneficiaries who will be as young as possible while still within the generation.¹²⁷ If this is done, it will be possible to delay the collection of the tax for a significant period of time.

Considering all the provisions of chapter 13 together, a careful estate planner should first examine any existing trusts and wills to determine if they result in transactions coming within the definition of generation-skipping transfer.¹²⁸ If the trust or will was in existence on April 30, 1976, emphasis should be placed on maintaining it, and using the permissible amendments and additions.¹²⁹ Wills and trusts drawn after April 30, 1976, should be drafted, when possible, to take full advantage of the grandchild exclusion and limited power of appointment provisions.¹³⁰ By using these

121. I.R.C. § 2621(a); see notes 106-07 *supra* and accompanying text.

122. See notes 25-28 *supra* and accompanying text.

123. The trap of taxation under § 2041(a)(3) or § 2514(d) may successfully be avoided by including a restrictive provision in the dispositive instrument prohibiting the creation of any power of appointment by the holder of the § 2613(e) power except for special power of appointment. See note 28 *supra*.

124. I.R.C. § 2613(b)(2)(A)-(B).

125. *Id.* § 2613(b)(2)(A); see note 64 *supra* and accompanying text.

126. I.R.C. § 2613(b)(2)(B).

127. See note 64 *supra*. Because the House Committee expressed a desire for the service to formulate regulations preventing the use of § 2613(b)(2)(A) "primarily for the postponement of tax" and suggested the use of "separate share" rules where the interests of the beneficiaries are "identifiable and separate," the use of the technique developed in the text must necessarily remain uncertain until the Service's new regulations are announced. HOUSE REPORT, *supra* note 3, at 50-51; see I.R.C. § 2622.

128. See note 48 *supra* and accompanying text.

129. See notes 108-14 *supra* and accompanying text.

130. See notes 50, 75, 115-22 *supra* and accompanying text. When the use of these two techniques is not sufficient to avoid entirely the imposition of the generation-skipping transfer tax, consideration should be given to the creation of separate trusts for each generation level of beneficiaries. Through the use of separate trusts property may be transferred without subjection to the ch. 13 tax. See R. COVEY, *supra* note 92, at 136 for a brief discussion of this process.

latter two alternatives, much of the harsh effect of chapter 13 may be obviated in intra-family transfers within two generations of the grantor. If a post-April 30, 1976, generation-skipping disposition is established, consideration should be given to the use of the alternatives available for delaying the imposition of the tax.¹³¹

IV. POLICY CONSIDERATIONS FOR THE NEW LAW

An evaluation of the new tax laws must begin with a consideration of the goals of the transfer tax system. Because the formulation of such objectives is subjective by nature, they are always open to debate. The following goals, however, present a good starting point for assessing the merits of the generation-skipping transfer statutes.¹³² They are: (1) to provide tax law that is easily understandable in the routine transfer situation; (2) to de-emphasize the impact that the form of a transfer has on its tax consequences; (3) to treat those taxpayers similarly situated alike; and (4) to produce a tax system that will be considered fair.¹³³

The new statutes fail to provide a tax system that is readily understandable in routine transfer situations.¹³⁴ A life estate with a remainder is a transfer which is neither new nor novel. The Internal Revenue Code, however, now provides a morass of definitions¹³⁵ and legal fictions,¹³⁶ never

131. See text accompanying notes 124-27 *supra*. If a generation-skipping transfer is chosen in the end, or is unavoidable, care should be exercised in selecting the assets to go in the actual trust. In general it would not be wise to put in assets that are likely to appreciate greatly since this will only increase the tax bill later. When possible, closely-held business interests should not be used because I.R.C. §§ 6166 and 6166A are unavailable. *Id.* § 2621(b).

132. Chapter 13 may have not been drafted with the goals dealt with here in mind. It is submitted, however, that these are reasonable objectives for the federal transfer tax system. Thus, a review of the provisions of the new statutes in light of these goals is not unfair.

The House Report indicated that the estate and gift tax provisions of the Tax Reform Act were designed to (1) provide relief for modest-sized estates, (2) remove tax avoidance devices, (3) relieve the liquidity problems of estates composed mainly of farms or closely held businesses, and (4) produce a balanced tax structure that would maintain or increase current revenues. The generation-skipping transfer provisions were intended to achieve the goal of raising revenue in a manner which has a similar effect on each generation. HOUSE REPORT, *supra* note 3, at 3, 46.

133. These are four of the goals that the ALI was guided by in its formulation of proposals for estate and gift tax reform. ALI, *supra* note 36, at 78; see notes 36-38 *supra* and accompanying text. The ALI felt that it was also important for a transfer tax system to produce revenue and to impose reasonable restrictions on the inheritance of wealth while not creating disincentives to the accumulation of wealth. See ALI, *supra* note 36, at 78.

134. Learned Hand's description of the Internal Revenue Code given thirty years ago holds true as a description of ch. 13 today. Hand said:

[T]he words . . . merely dance before my eyes in a meaningless procession: cross reference to cross reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible invasion . . .

Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947).

135. Chapter 13 contains ten new definitions in its imposition of taxation on generation-skipping transfers. I.R.C. §§ 2611(a) (generation-skipping transfer); 2611(b) (generation-skipping trust); 2611(d) (generation-skipping trust equivalent); 2612 (deemed transferor); 2613(a) (taxable distribution); 2613(b) (taxable termination); 2613(c)(1) (younger generation beneficiary); 2613(c)(3) (beneficiary); 2613(d)(1) (interest); 2613(d)(2) (power).

136. The ALI rejected the difficult legal fiction of deemed transferor in its tax proposals for generation-skipping transfers "because of the complications that developed in dealing with all the ramifications of the problem." ALI, *supra* note 36, at 30. Apparently, the United States Congress felt differently.

before seen, which make the taxation of the simple life estate and remainder and its variations a highly complex legal operation. Compounding the confusion created by the new statute is the fact that the provisions, drafted with trust terminology, are applicable to trust equivalents.¹³⁷ The application of trust terminology to other kinds of transfers is a hindrance to the clarity of the law. Finally, leaving the prior estate and gift tax law in effect except when inconsistent with the new provisions¹³⁸ is an imprecise mode of integrating the new with the old. What is inconsistent will have to be decided by case law and regulations.

Although the new law may have reduced the effect which the form of the transfer has on the imposed tax, it has not been eliminated. This is highlighted by the fact that considerable transfer tax savings may be achieved, especially in intra-family transfers, by choosing the right form. As discussed above, taxes may be saved in the traditional grantor to child to grandchild conveyance by establishing two trusts, with the child the sole beneficiary of the one and given a limited power to appoint under section 2613(e) in the other.¹³⁹ By using the separate trusts instead of a single trust, approximately equivalent amounts of property may be transferred to the same people but with significantly different estate tax consequences.

New chapter 13 also fails to treat those taxpayers similarly situated in the same manner. A full realization of this objective is prevented to the extent that the form of a disposition can still affect the tax consequences.¹⁴⁰ In addition, the section 2613(b)(6) exclusion for gifts to the grandchildren of the grantor does not give equivalent treatment to taxpayers sharing similar circumstances. Grantors with the same number of children and grandchildren may establish generation-skipping trusts for their grandchildren which will be entitled to substantially different exclusions, depending on how the grandchildren are distributed among the grantor's children.¹⁴¹

At least some authorities believe that the general principle of imposing a transfer tax on generation-skipping transfers is a fair objective.¹⁴² Acceptance of this principle, however, does not dictate the conclusion that the specific provisions of chapter 13 will operate fairly. The new law's failure to impose a reasonably understandable tax structure violates basic notions of fairness. Fault may also be found in the statutes' indiscriminate treatment of powers and interests. By imposing the same tax treatment on all powers and interests, chapter 13 unfairly imposes a tax without taking into consideration the donee's contacts with the property.¹⁴³

137. I.R.C. § 2611(d)(3).

138. *Id.* § 2621(a).

139. See notes 118-20 *supra* and accompanying text.

140. See notes 114-16 *supra* and accompanying text.

141. See notes 116-17 *supra*.

142. Professor Casner described the position of this principle within the ALI: At an early date in the consideration of generation-skipping transfers, there was fairly general acceptance by those participating in the American Law Institute's Estate and Gift Tax Project of the view that a transfer tax system does not rest on a sound foundation if the tax can be avoided, to the extent now possible, by the creation of various types of powers of appointment.

Casner, *supra* note 26, at 575. See also Kinnebrew, *Estate and Gift Tax Reform: A Compendium of Thought*, 24 Sw. L.J. 608-23 (1970).

143. The tax imposed on a taxable termination is determined without regard to the nature of

The examination of the new statutes in light of the proposed goals for the federal transfer tax system results in the conclusion that those provisions leave much to be desired. Chapter 13 does not fully satisfy any of the suggested objectives. Its failure to provide understandable tax law is so overwhelming that it overshadows some of the new law's other shortcomings.

V. CONCLUSION

Prior to the Tax Reform Act of 1976 the federal tax law surrounding generation-skipping transfers was unsound. That law allowed the tax consequences of a disposition to turn on its form and not on its substance. It was possible under the former law to bestow many of the incidents of full ownership on a beneficiary without subjecting the property to transfer taxation.

The United States Congress has now responded to this problem by devising and implementing a highly complex scheme designed to tax the property in generation-skipping transfers as if it were passing under outright conveyances. The preoccupation of Congress with making the tax as closely equivalent to that which would be imposed on outright transfers is curious in light of the fact that limited interest beneficiaries never really have a complete fee interest in the property.

As with any new legislation, time and case law will be necessary to define the parameters of the statutes. Given the complexity and confusion in the new tax law, however, these two elements will be required in unusually large amounts. Compounding this problem is the fact that the lack of legislative history and the abundance of problems not statutorily addressed will allow the Service in effect to legislate in promulgating the regulations. These factors, it is expected, will result in unsettled and unpredictable conditions in the area of generation-skipping transfers for years to come. Eventually the area will become settled, but without substantial revision it is not likely that it will ever be easily understood. Any tax system which is too complex and too confusing to be understood by those governed has a fatal flaw.

the terminated interest. Considered irrelevant in this calculation are the duration of the interest and whether the interest is wholly discretionary with the trustee or absolute. R. COVEY, *supra* note 92, at 8. This is mitigated somewhat by the fact that the generation-skipping transfer tax is imposed only once a generation. See I.R.C. § 2613(b)(7)(B).

