

GRANTOR RETAINED ANNUITY TRUST

While appreciation on assets is generally considered advantageous, every dollar of appreciation on assets in an estate subject to estate taxes results in nearly fifty cents of additional estate taxes. A Grantor Retained Annuity Trust (“GRAT”) is a transfer tool that essentially freezes the value of certain assets while appreciation on those assets transfers to a beneficiary or beneficiaries (typically descendants or trusts for descendants) free of gift or estate tax.

A GRAT is a trust to which the grantor transfers assets and retains an annuity. The annuity is paid for a fixed number of years determined by the grantor (the GRAT term). Upon the expiration of the GRAT term, which the grantor must survive for the GRAT to be “successful,” all property remaining in the GRAT (i.e. the appreciation on the assets) passes free of transfer tax to the beneficiary or beneficiaries designated in the GRAT. In essence, a GRAT splits property into an annuity interest (paid to the grantor) and a remainder interest (which passes to a third party beneficiary).

The annual annuity is valued using current interest rates (called the “7520 rate”, which is determined by the IRS). If the assets in the GRAT outperform the 7520 rate, there will be a remainder in the GRAT at the expiration of the GRAT term. Here, the GRAT has been successful and has transferred assets to the beneficiary or beneficiaries of the GRAT, transfer tax free. If the assets in the GRAT underperform the 7520 rate, there will be nothing left in the GRAT at the end of the GRAT term. In this situation, the grantor is back to where he or she started. For this reason, highly appreciating assets are ideal to make the most out of the GRAT. Additionally, since the 7520 rate is near its historical low, the performance necessary to be “successful” has been greatly reduced.