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GRANTOR RETAINED ANNUITY TRUST

A Grantor Retained Annuity Trust (“GRAT”) is an irrevocable trust in which the grantor retains the right to receive a set amount of income for a specified term of years (an annuity). At the end of the term of years, the trust property is paid to remainder beneficiaries – typically the grantor’s children or trusts for their benefit. The purpose of a GRAT is to avoid estate taxes.

A Gift Going In

Because a GRAT is irrevocable, the grantor is making a gift to the remainder beneficiaries at the time the GRAT is set up. The value of the gift, however, is not the fair market value of the property being transferred to the GRAT. Instead, the value is the remainder beneficiary’s right to the property at the end of trust term. So, the value of the gift is discounted by the *value* of the stream of annuity payments. The longer the term of years and the higher the annuity payment, the smaller is the value of the gift. It is possible to establish a GRAT so that there is no gift for gift tax purposes.

Tax Free Coming Out?

Whether the property in a GRAT is included in the grantor’s estate depends on whether the grantor survives the term of the trust. If the grantor survives, then the property bypasses the grantor’s estate and passes to the trust remainder beneficiaries without further tax.

If the grantor fails to survive the annuity period, the GRAT property will be included in the grantor’s estate for estate tax purposes, with a credit given for any gift tax paid when the trust was established. The tax consequence of including the GRAT in the grantor’s estate can be reduced or delayed by having the trust remainder paid to the grantor’s spouse in a manner that qualifies for the marital deduction—and after the spouse’s death paid out to other beneficiaries such as children. Technically, this could be done by inserting marital disposition language in the trust instrument itself or inserting reversionary language that allows the marital disposition to be made in the grantor’s Will.

Valuation

The first thing for the grantor to consider is the amount of the annuity and the term of the trust. Obviously, the *best* term ends shortly before the grantor’s death (i.e. *before* death so the trust is not included in the grantor’s death and *shortly before* so as to lengthen the trust term and thereby reduce the value of the gift). The value of the gift is also impacted by the government’s “table rate” (IRS interest rate) in the month that the trust is established. The table rate changes every month.

Summary

A GRAT is fairly complex; however, it is a great estate planning device in certain circumstances. It is not for everyone, but if an individual is in a situation where the federal estate tax is a concern, then a GRAT may substantially reduce the estate tax burden for that individual. We are available to help you evaluate this planning option.