



Grantor-Retained Annuity Trust Planning

By: Marianne Coulton, Esq. & Ryland Mahathey, MBA, LL.M., Esq.



The primary benefit of a Grantor Retained Annuity Trust (“GRAT”) is to “freeze” the value of a property transferred to the trust, typically business interests, securities, or real estate, so that the future appreciation on such property will pass estate tax-free to the Grantor’s beneficiaries. This strategy can significantly reduce future estate tax liability.

The IRC Section 7520 rate, which is published monthly by the IRS, is used to determine the present value of an annuity, life estate, or remainder interest. A GRAT is particularly effective when the Section 7520 rate applicable to the GRAT is low. This is because a GRAT is successful when the earnings and appreciation on the property placed in the GRAT outperforms the Section 7520 rate. The June 2008 Section 7520 rate applicable to GRATs is 3.8%. If the investment performance of property contributed to the GRAT exceeds the Section 7520 rate over the annuity term, then the GRAT will be successful and the remainder in trust at the expiration of the annuity term is distributed estate tax-free to the trust beneficiaries.

How the GRAT Works

In a GRAT, the grantor contributes property to a trust and retains the right to be paid an annuity for a specified term of years. The required annuity payment is based on the Section 7520 interest rate, mentioned above. Due to the retained annuity, the GRAT can be structured so there is no gift, or a very small gift, for gift tax purposes. This is referred to as a “zeroed-out GRAT”. The amount of the taxable gift is calculated by the subtraction method. The value of the annuity interest retained by the grantor, which is not a taxable gift, is subtracted from the value of the property transferred to the GRAT. At the end of the annuity term, the remainder interest, if any, is distributed to the trust beneficiaries.

GRAT Example

A \$1,000,000 zeroed-out GRAT created based on the June 2008 Section 7520 rate of 3.8% will pay an annuity of \$223,369 to the Grantor for five years. If the trust earns 3.8% or less each year, the Grantor will receive the entire trust property and there will be nothing left after five years for the remainder beneficiaries. Although the GRAT just described will not be successful, the Grantor will be in the same position as if the GRAT was never created. If, however, the trust outperforms the IRS rate by earning a 10% annual return, the Grantor will receive the annuity payments and there will also be \$246,822 distributed to the remainder beneficiaries free of estate and gift tax after the trust term ends. If the trust return is 15% the “tax-free” remainder would be \$505,321.

Advantages of GRAT Planning

The appreciation and future income on property distributed to remainder beneficiaries of a GRAT is removed from the Grantor’s taxable estate reducing future federal estate tax;

A zeroed-out GRAT can be structured so there is little or no taxable gift upon creation; A GRAT generates cash flow for the grantor in the form of an annuity; and Several short-term GRATs can be used in conjunction with one another, each holding a different type of asset in an effort to isolate individual assets that could produce a high return to be distributed to beneficiaries.

By Marianne Coulton and Ryland F. Mahathey of Redgrave & Rosenthal LLP, Boca Raton, Florida.

Marianne and Ryland practice in the areas of advanced estate planning and asset protection. Marianne is an honors graduate of Northwestern University School of Law. Ryland is a C.P.A. and holds an LL.M. in Taxation from University of Florida.