

# GRATs

The Grantor Retained Annuity Trust (GRAT) has been getting quite a bit of attention from estate planners recently. The reason is that low market interest rates create a window of opportunity for passing assets to heirs without incurring much, if any, estate or gift tax.

The GRAT is established for a set number of years. During the term of the trust, the grantor is paid an annuity, a fixed dollar amount, every year. When the trust terminates, the assets left in the trust pass to the grantor's heirs. A gift tax, due when a GRAT is funded, is imposed upon the actuarial value of what the heirs will receive when the trust terminates. Estate planners can use two factors to reduce that tax exposure almost to zero: They can lengthen the term of the GRAT, or they can increase the annuity retained by the grantor.

The value of the retained income interest and the value of the remainder for the heirs must take current interest rates into account. If the trust earns more than the IRS tables predict it will earn, the excess will pass to the heirs free of estate or gift tax. During a period of very low interest rates, such as we have today, the chance of beating the IRS interest rate is very good.

On the other hand, if the trust's investments underperform, it may be exhausted before the end of the term, leaving nothing for the heirs. Finally, if the grantor dies before the trust comes to an end, the assets will be included in the grantor's estate, defeating the estate planning objectives.

## Future considerations

The advantages of GRATs have become so pronounced in the current market environment that the President's tax proposal to Congress earlier this year included a new restriction for such trusts in the future. They will have to have a trust term of at least ten years in order to be effective for federal tax purposes.

If such a change to the tax code is made, it very likely will be part of a larger estate tax reform plan that keeps the federal exempt amount at \$3.5 million, freezing the estate tax rates at 2009 levels. For married couples, that means \$7 million can be sheltered from federal estate tax with some basic planning. Such a move could limit the need for more sophisticated strategies, such as GRATs, for wealthier families.

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