WHAT IS A GRANTOR RETAINED ANNUITY TRUST (GRAT)?

A GRAT allows you to transfer an asset's growth or appreciation out of your estate to your children (or any other non-charitable beneficiary) with little to no estate and gift tax consequences. Here's how it works:

(1) You transfer assets with potential for significant appreciation to the GRAT, while retaining the right to receive annual income payments (annuity) from the trust for a fixed number of years or term.

(2) You receive your original contribution in the form of annual annuity payments for the term of the trust. The amount of the annuity is calculated using approved interest rates. Because of the way the annuity is calculated, if the assets in your GRAT only provide a return equal to the approved interest rate, all of the assets will be returned to you in the form of annual annuity payments, and your beneficiaries will receive nothing at the termination of the trust. This makes it possible for the value of the gift to your beneficiaries to be $0 for gift-tax purposes.

(3) If the assets in your GRAT provide a return (either income or appreciation) that is greater than the approved interest rate, your beneficiaries receive the appreciation estate and gift-tax free, as long as you survive the term of your GRAT.

For example, John creates a GRAT for the benefit of his children. John transfers $1,000,000 in marketable securities to the GRAT for a 5-year term. The trustee of the GRAT returns the $1,000,000, plus some interest, to John over a 5-year period. The $1,000,000 grows to $1,500,000 over the 5 years. The $500,000 of growth remains in the GRAT for the benefit of John's children.

John receives the value of the marketable securities originally transferred to the GRAT back into his estate, but the $500,000 of growth is not included in his estate.

If you are interested in this planning technique, please call our office to schedule an appointment to discuss if this is an appropriate addition to your estate planning.

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