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ESTATE PLANNING UPDATE:

Grantor Retained Annuity Trusts

Since the passage of the American Taxpayer Relief Act of 2012 (ATRA) on January 1, 2013, most commentators have naturally focused their attention on what changes have taken place as a result of the Act. We think the most significant aspect of the new law in the trusts and estates area is what *did not* change. One area where a threat of change was not realized was with respect to the use of Grantor Retained Annuity Trusts (GRATs).

A GRAT is created by transferring one or more high-yield assets, or assets with significant potential for appreciation, into an irrevocable trust and retaining the right to an annuity interest for a fixed term of years. When the retention period ends, the assets remaining in the trust (including all appreciation in excess of the "hurdle rate") pass to the named "remainder" beneficiaries tax free. Thus, a GRAT is an effective way for an individual to transfer any appreciation in the assets transferred to the GRAT to family members with essentially no gift or estate tax consequences.

One of the advantages of a GRAT is that the assets contributed to the GRAT are valued at their current fair market value and the annuity paid to the Grantor is based on that value. Therefore, the GRAT "freezes" the value of the amount to be paid to the grantor and passes the appreciation on the property to the GRAT beneficiary. (That is why we often recommend that clients transfer to the GRAT assets that have significant potential for appreciation.)

In addition, the GRAT is a "grantor" trust for income tax purposes. This means the Grantor continues to be taxed on income and realized gains on trust assets even if these amounts are greater than the trust's annuity payments. In essence, one is effectively allowed to make tax-free gifts of the income taxes earned on the GRAT

assets. This further enhances the GRAT's effectiveness as a family wealth-shifting and estate-tax-saving device.

The GRAT technique has historically been – and continues to be – an area of estate planning often the subject of proposed IRS restrictions. The two most common restrictions include (i) requiring the GRAT term to exceed ten years (our practice is to provide for the minimum required two-year term) and (ii) eliminating the ability to "zero-out" the trust (a mechanism used to avoid gift taxes).

The ink of ATRA has barely dried and already there is buzz that new legislation with proposed restrictions on the GRAT technique is in the works. Accordingly, we wish to remind you of this gifting tool so that you can take advantage of its benefits before it is too late.

If you have any specific questions about GRATs, or would like to discuss implementing this endangered tax planning technique, please do not hesitate to contact us. We would be pleased to meet with you and discuss your options.
