



Grantor retained annuity trusts

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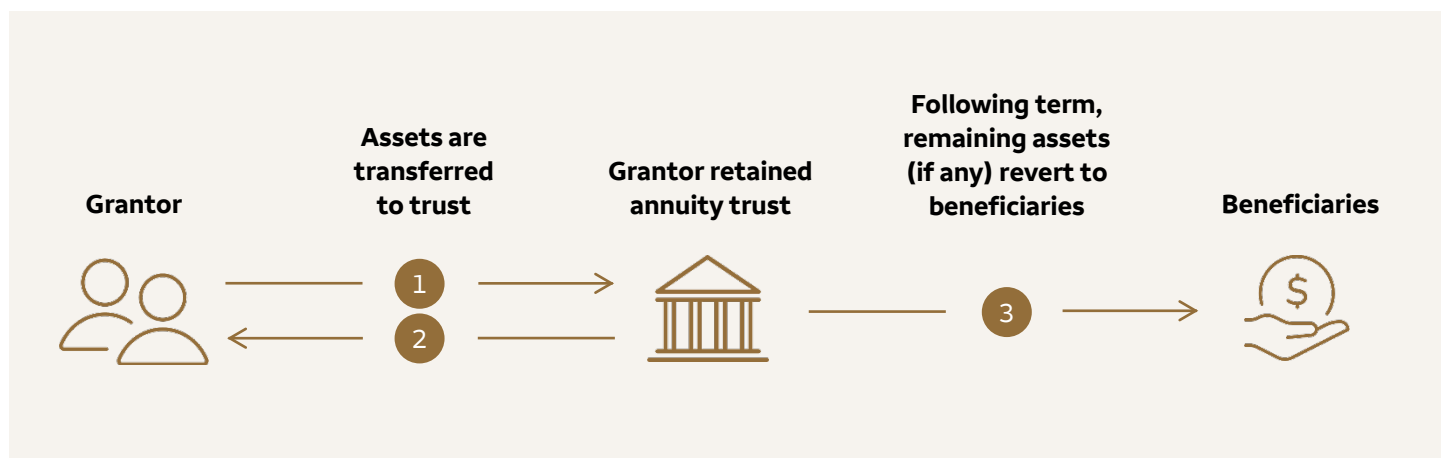
Families seeking to build a legacy by transferring wealth during their lifetimes may want to consider a grantor retained annuity trust (GRAT). This strategy affords donors with the potential to reduce a taxable estate, while retaining an income stream and building a tax-advantaged gift. Many variables exist, but a GRAT can be a particularly attractive option when applicable federal rates (AFRs) set by the IRS are low and gifted assets are expected to appreciate.

Does a GRAT fit my needs?

A GRAT may be a potential strategy to consider for families who:

- Seek an income stream from a portion of their assets for a fixed term
- Expect gifted assets to appreciate
- Desire to transfer assets (like shares in a family business) to the next generation during life of grantor

How does a GRAT work?



Benefits

- Income stream of fixed percentage of funding assets or fixed dollar amount for set term
- Potential to pass assets to the next generation outside of estate with gift tax potentially reduced or eliminated
- Ability to capitalize on asset appreciation in low-applicable federal rate environment

Considerations

- Income and capital gains earned by the trust are taxable to grantor
- If assets underperform the IRS AFR used for trust funding (also known as the discount rate or Section 7520 rate), assets may be exhausted, impacting amount in trust at end of term
- If grantor dies during term of trust, a portion or all of trust assets may be included in grantor's estate

Flexibility

- Term may be set from 2–99 years but should expire prior to death of grantor
- Income structure may be a percentage of funding assets or a fixed amount, paid at least annually
- Zero-out option strategy may be structured to potentially eliminate gift and estate taxes by paying out entire gift plus assumed appreciation at the IRS discount rate

Sample illustration

A GRAT offers the ability to retain an income stream from assets placed into a trust with the potential to transfer wealth to the next generation. To obtain the full benefit of this strategy, the transferred assets must outperform the IRS discount rate as of the beginning of the trust term and the grantor must outlive the term. Careful projections are crucial to the effective use of this strategy. See next page for example.



Situation

Mr. and Mrs. Jones own a family business that generates income. They would like to begin to transition shares in the business to their children over the next five years.

Goals

- The Jones anticipate their business to grow at a rate that will surpass IRS discount rate at funding of trust
- Family also has near-term cash flow need
- Family anticipates federal estate tax liability and would like to limit their exposure



Action

Family creates a GRAT funded with shares in the business valued at \$2,000,000.

Income

Trust generates payout of 20% or \$400,000 annually. Assets are projected to appreciate at 7% with earned income of 2%.

Terms

Annual income stream will continue for a fixed period of five years. Following term, assets transfer to beneficiaries.



Projected outcomes*

Initial gift: \$2,000,000

Annuity: \$2,000,000

Taxable gift amount (assumed growth): \$268,200

Discount rate (IRS minimum assumed appreciation): 5.0%

Remainder interest

End of term transfer to beneficiaries: \$689,916

Projection assumptions

Begins in 2024 and runs five years; value of grantor's retained interest \$1,731,800; appreciation 7%; income 2%; no state income tax; IRS discount rate 5.0% (December 2024); Section 2702 special rules for transfers in trusts to certain individuals applicable

Additional considerations

- Income must continue for at least two years at rate at least as high as IRS discount rate
- Income must be paid annually and may exhaust trust resources
- By naming a trust as beneficiary, it is possible to address additional goals
- Assumptions for interest rates and appreciation of assets will greatly impact outcomes
- It is typical to “zero-out” the transfer to the GRAT so that the net value of the gift will be deemed to be zero for gift tax purposes

Discover more

To learn more about the benefits of a grantor retained annuity trust, please contact your advisor.

*Calculations are for illustration purposes and should not be considered legal, accounting, or other professional advice. Your actual benefits may vary depending on a variety of factors including timing of your gift.

Information sourced from [irs.gov](https://www.irs.gov/businesses/small-businesses-self-employed/section-7520-interest-rates); <https://www.irs.gov/businesses/small-businesses-self-employed/section-7520-interest-rates>

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