



# Agent and Advisor Guide to Advanced Markets Concepts



## GRAT

- A Grantor Retained Annuity Trust (GRAT) is often used when transferring highly appreciating or income producing assets to subsequent generations. It is also effective in planning to terminate premium financing of life insurance, private financing of life insurance, and economic benefit arrangements.
- The client (grantor) creates an irrevocable trust, transfers highly appreciating or income producing assets to the trust, and retains the right to an annuity payment for a specified term (or for the shorter of a specified term or life).
- The assets remaining in the trust automatically go to the beneficiary after the annuity period is finished. The assets remaining will consist of the assets originally transferred to the trust plus the appreciation on those assets plus the income produced by those assets minus the annuity paid to the grantor.
- Transfer taxes:
  - Any gift tax implications are determined at transfer date.
  - The gift tax value is determined by subtracting the “present value” (PV) of the annuity interest retained by the grantor from the assets’ value at transfer date.
  - If the grantor and beneficiary of the trust are unrelated parties, then the annuity is valued using the §7520 rate in effect at transfer date and subtracting from the asset’s total value.
  - If the grantor and beneficiary are related, then the §2702 rules may apply. If §2702 applies, then the PV of the annuity interest is valued at zero – thus the gift tax value is the full value of the transferred assets. However, the §2702 valuation rules will not apply if the retained annuity interest is a “qualified interest”. A qualified interest includes:
    - The right to receive a fixed dollar amount at least annually (qualified annuity interest);
    - The right to receive at least annually a fixed percentage of the annually determined fair market value of the assets (qualified unitrust interest); and
    - A noncontingent remainder interest following a qualified annuity or unitrust interest (qualified remainder interest).
      - The grantor cannot use his/her annual exclusion amount (\$12,000 for 2008) to shield any gift tax consequences associated with a GRAT because the beneficiary has a “future” not “current” right to the asset.
      - The trust should be considered a “grantor trust” for INCOME tax purposes. This means that any income tax consequences experienced by the trust will pass through to the grantor.
- “Zeroed-Out” or Walton GRAT
  - The IRS acquiesced that a client can establish a “zeroed-out” or nearly “zeroed-out” GRAT. This essentially means that a client can establish a GRAT, fund the GRAT, and elect an annuity interest with a present value equaling the initial asset value – thus all income and appreciation from the asset above the required annuity payments is passed free from gift tax consequences.
- If the grantor does not survive the term of the GRAT, the GRAT assets (or at least a portion of the assets) will be included in his/her estate for ESTATE TAX purposes.
  - A life insurance policy may be good additional planning to cover the estate tax caused by inclusion.

The preceding summary is intended to be a general discussion of the topic presented, and is based on our current understanding of applicable tax laws, regulations and rulings. In actual practice, the transaction discussed may be more complex and will require the attention and expertise of professional advisors. In no way should this summary be construed to constitute tax or legal advice. **For agent use only.**