GRATs and GRUTs

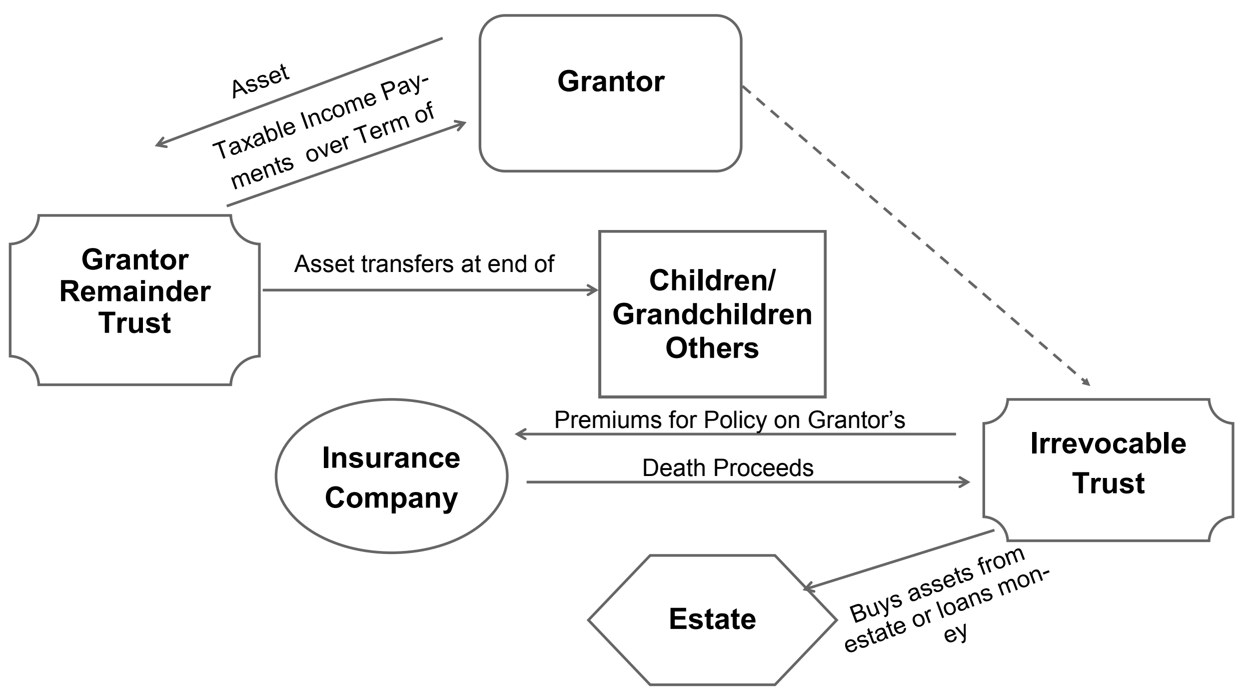
GRATs and GRUTs are irrevocable trusts designed to transfer assets to the next generation at a reduced gift tax value. The current owner/grantor retains the right to receive income payments for a fixed period of years. At the end of the term, the ownership of the assets shifts to a subsequent generation. The difference in the two types of trusts are in their method of determining income payments:

- Grantor Retained Annuity Trust (GRAT) - The grantor has payment of a fixed *amount* for the specified number of years
- Grantor Retained Uni-Trust (GRUT) - The grantor has payment of a fixed *percentage* of trust principal for the specified number of years

The type of trust used depends on the specific situation at the time of transfer including the level of interest rates at that time. Since the beneficiaries do not receive the gift until the end of the income period, the value of the gift is reduced to reflect the interest in the asset that has been retained by the grantor. The longer the income period, the greater the retained interest and the lower the value of the taxable gift. However, the grantor must outlive the specified period in order to exclude the gifted asset from the taxable estate. To replace the shrinkage resulting from potential estate taxes in the event of early death, an Irrevocable Life Insurance Trust applies for a life insurance policy on the grantor.

How It Works:

GRAT or GRUT



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ADVANTAGES

- The value of the gift is reduced by waiting for actual transfer for a number of years. The longer the wait, the lower the value of the gift
- The grantor gets income during the term period typically with the thought that the income will not be needed after the term period has expired
- Since the valuation of the remainder interest is valued at the time the trust is created and the transfer of the asset to the trust takes place, any extraordinary future appreciation of the asset is never reflected in the gift as long as the grantor survives the income period and the beneficiaries get the assets.

OTHER CONSIDERATIONS

- Since this is a gift of a remainder interest gift it will be a “future interest” gift and will not qualify for the annual gift tax exclusion. The value of the remainder interest will reduce the gift and estate tax lifetime exclusions
- If the transferor does not outlive the income term period, the value of the assets will be brought back into his/her estate using the date-of-death value of the assets just as if the trust transaction had never taken place. The gift tax amount used for the transaction will be restored as if the gift had never taken place if this happens
- If the transferor does outlive the term, the recipients of the assets will take on the basis of the transferor. There will be no “step-up” in basis such as occurs at death when the transferor retains property until death