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Summary of Advantages of a
Grantor Retained Annuity Trust (GRAT)

A GRAT is an irrevocable trust to which the Grantor transfers assets and is then paid a fixed dollar amount (annuity) periodically from the trust for a term of years. When the term ends, any remaining assets in the trust are distributed to the remainder beneficiaries of the trust. If the Grantor survives the term, the assets in the trust are removed from the Grantor's estate for estate tax purposes. If the Grantor dies before the end of the term, the value of the trust will be included in the Grantor's estate. The purpose of the GRAT is to remove appreciating assets from the estate of the Grantor with the least amount of gift tax possible. A GRAT is, therefore, an income producing and estate freezing arrangement that permits a senior family member to transfer property to younger family members with little or no gift tax cost, to potentially avoid estate tax on the property, transferred, and to retain cash flow from the property transferred to the GRAT.

The requirements for a GRAT include the following: (1) no distributions from the trust may be made to anyone other than the holder of the qualified annuity during the period of the qualified interest; (2) the payment of the annuity must be made at least annually; (3) no prepayment of the annuity interest may be made; and (4) no additional contributions may be made to the trust.

The transfer of assets to the trust is a gift. The amount of the gift for gift tax purposes is, however, highly leveraged because the future right of the beneficiaries to

the assets transferred to the GRAT will be discounted to reflect the present value of that future right. If the asset transferred to the GRAT are assets that themselves are subject to valuation discounts, such as interest in family limited liability companies, family limited partnerships, or closely held family businesses, the gift can be further leveraged. The method for calculating the value of the gift is to use the value of the initial contribution to the trust plus interest earned on the principal during the trust term based on a theoretical rate determined by IRS regulations, minus the annuity payments that would be made through the end of the term. If the assets in the trust appreciate over the term of the trust at a rate higher than the theoretical rate used for the gift tax calculation, (1.4% for April, 2012) there will be assets remaining in the trust at the end of the trust term and the value of those assets will be larger than the value used to calculate the gift for gift tax purposes.

The retained annuity payable to the Grantor is valued using the low 7520 rate. Consequently, the annuity is undervalued as an economic matter if the assets are expected to produce a return in excess of the 7520 rate. GRAT's produce a benefit for the Grantor's family if trust assets produce a total return in excess of the 7520 rate. Consequently, the GRAT is an ideal estate planning tool to use at the time of low interest rates. The reason that a GRAT is an ideal estate planning tool when interest rates are low is that the lower the interest rate the smaller the annuity the Grantor needs to retain to produce a zero gift for gift tax purposes. Because the annuity is worth more, the gift is worth less.

An example from GRAT expert Larry Katzenstein, is as follows:

> At an 8% 7520 rate (in the past the 7520 rate has been as high as 11.6%) the amount needed to zero-out a ten-year one million dollar GRAT that produces no gift is $149,029.00. In other words, $149,029.00 is the annuity that would have to be paid annually for there to be no gift component. If the 7520 rate is, however, 1.4% (the rate as of January 2012), the annual annuity amount needed to zero-out the same GRAT is $107,861.00, an annual difference of $41,168.00.
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> Therefore, assuming the 7520 rate is 1.4% and the assets in the GRAT produce a return of 4%, at the end of the ten-year term the GRAT will have $185,254.00 remaining in the GRAT (after the annuity payments) to pass on to the trust beneficiaries, usually the Grantor's children. If the assets produce a return of 8% the GRAT will have $596,390.00 to pass on to the trust beneficiaries. If the assets produce a return of 12% the GRAT will have $1,213,024.00 to pass on to the trust beneficiaries! The more the assets appreciate relative to the 7520 rate, the larger the tax free gift to the trust beneficiaries.

A GRAT creates little risk in that if the assets produce a return in excess of the 1.4% current 7520 rate, the Grantor's family is a winner because the assets remaining in the GRAT are transferred tax free to the trust beneficiaries, but if the assets decline in value, the Grantor is not a loser (except for transaction costs) because the GRAT

can be zeroed out and the Grantor has been paid an annuity equal to what was transferred into the GRAT.

A GRAT should be funded with assets that produce a substantial return in excess of the 7520 rate. Ideally the assets in the GRAT would produce enough income to pay the annual annuity payment so that the assets themselves would not have to be returned to the Grantor as the annuity payment.

As described in this brief summary, a GRAT is an ideal estate planning tool in a low interest rate environment.