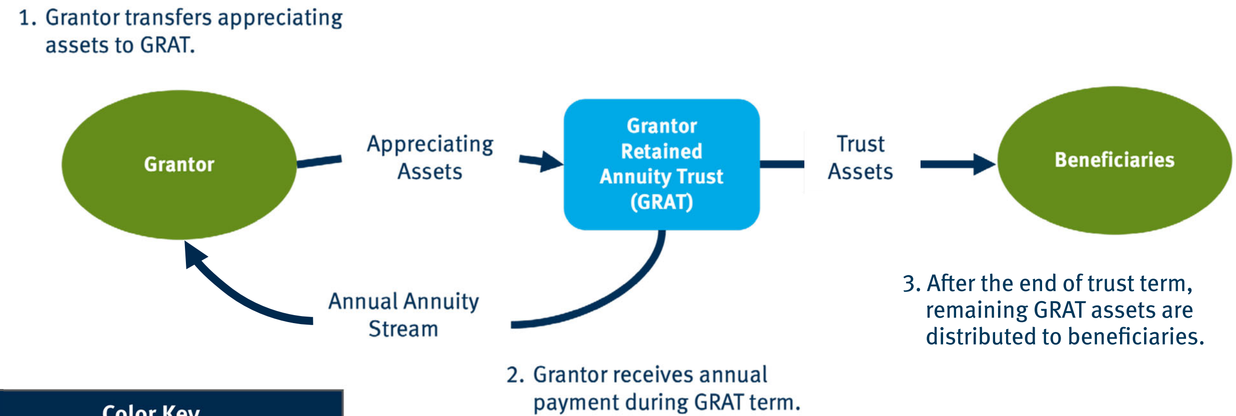
Reducing Estate Tax Exposure With a Grantor Retained Annuity Trust (GRAT)

Wealth Planning | Estate and Tax Planning

A GRAT is a potentially powerful estate tax planning strategy that removes future appreciation on assets from one's estate. A primer on GRATs is provided below.



Color Key	
Green	Assets subject to probate, included in taxable estate, and eligible for a step-up in cost basis.
Blue	Assets avoid probate, not included in taxable estate, and not eligible for a step-up in cost basis.

Irrevocable Trust
A GRAT is an irrevocable trust established for a term of years in which the grantor (creator of the trust) transfers assets in exchange for a fixed annual payment stream. Other similar trusts can be structured to provide a payment stream based on a percentage of trust assets or trust income.

Minimum Annual Payment
The annual payment to the grantor is based, in part, on a rate published monthly by the IRS known as the Section 7520 rate ("Hurdle Rate").

Save Estate Taxes on Appreciation of GRAT Assets
The grantor does not pay estate tax on the growth of assets in excess of the annual annuity stream. Essentially, for the GRAT to be effective, the growth of the assets needs to be substantially more than the Hurdle Rate. As a result, a GRAT is most effective when it owns highly appreciating assets, which can include publicly traded securities, interests in a privately held business, or real estate.

Grantor Must Outlive GRAT Term
If the grantor dies during the GRAT term, there is no estate tax benefit, as the GRAT assets are included in the grantor's estate.

Beneficiaries
Upon expiration of the GRAT term, trust assets are distributed to the beneficiaries named in the GRAT. However, GRATs are not an effective strategy for multi-generation wealth preservation and transfer.

Creditor Protection
GRAT assets are generally protected from creditors of the grantor and the beneficiaries.

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Income Taxes

The grantor is responsible for paying the income tax consequences generated by the GRAT. As a result, the actual annual payments to the grantor are not income taxable. Such payments are considered a return of principal.

Potential No Use of Estate Tax Exemption

A zeroed-out GRAT means establishing GRAT terms so that the grantor uses none of the grantor's estate tax exemption ($13.99 million in 2025) when funding the GRAT. Accordingly, the grantor can implement a GRAT even if the grantor has fully used his or her federal estate tax exemption.

Continuation of GRAT Strategy

Rolling GRATs is a term used to describe a strategy in which the grantor rolls the annual payment of one GRAT into another GRAT. Moreover, the grantor can stop the process of rolling GRATs at any time, but the longer rolling GRATs continue, the more appreciation may be removed from the grantor's estate.

For more information about the benefits of a GRAT, contact your local attorney and Stifel Financial Advisor.