Grantor Retained Annuity Trust

A Strategy to Secure Your Descendants' Future

July 10, 2020

Grantor retained annuity trusts as part of an integrated estate plan, enable the family's next generation to receive assets outright or in an irrevocable trust, and slows estate growth, increasing the wealth passed on.

Many high-net-worth households have enough assets to sustain their lifestyle and meet their personal goals during their lifetime, creating the opportunity to pass assets down to loved ones. However, their net worth could already be greater than the current lifetime gift and estate tax exemption. And if assets rapidly appreciate, that gap is projected to grow significantly after 2025 when the expectation is for the exemption amount will drop to pre-2018 levels.

With today's lower valuations, low Section 7520 interest rates used to value particular charitable interests in trusts, and the potential for strong asset growth in the coming years, these households are searching for a planning technique that optimizes gift and estate benefits.

Trust Structuring Example

Consider a married couple with a net worth of $15 million today, with a projection to grow to $25 million by 2035. Assuming a downward-reverting combined lifetime exemption of $15 million and a combined federal/state estate tax rate of 50%, the estimated estate costs rise to $5 million by 2035 upon the death of the second spouse.

A $5 million gift to a grantor retained annuity trust (GRAT) in the current year could materially reduce these estate costs without any usage of the couple's lifetime exemption amounts. Assuming that the $5 million is the fastest-growing asset on the couple's balance sheet, doubling by 2035, the entire $5 million of growth in the asset could be distributed to the couple's children over those 15 years. The savings are substantial: 50% of the $5 million growth of the asset — $2.5 million —ultimately passed on to the children.

Potential Benefits of a Structured GRAT Strategy:

- To eliminate exemption usage, the trust can be designed as a "zeroed-out" GRAT, where the remainder interest is near zero.
- If the growth rate of assets in the GRAT does not exceed the IRS rate for the GRAT's term, the remaining GRAT principal merely passes back to the grantor at the end of the term.
- Earnings on assets transferred to a GRAT more than the low current hurdle rates may create a tax-free transfer of wealth to the trust beneficiaries.
- A guaranteed stream of income is provided to the grantor during the trust term.
- The grantor pays the income tax on the trust's income: Paying the taxes is not considered a taxable gift.

Other Considerations Behind a GRAT Strategy:

- Carryover basis applies to the assets being received by beneficiaries, which is not advantageous for those who prefer the step-up basis of assets at death with no taxable estate.
- The generation-skipping tax exemption cannot be allocated until the end of the trust term.
- The GRAT must be structured in a manner authorized in the IRS Code and regulations.

The Next Generation Secured-- an Estate Protected

Using a GRAT for estate planning can enable the family's next generation to receive assets outright or in an irrevocable trust for their benefit. The grantor slows the growth of the estate, which increases the wealth ultimately passed on to descendants. And the annuity payments to the grantor at the end of each year can be made in kind, eliminating the need to pay capital gains taxes on stocks, bonds, or other financial assets.

For more information, please contact your Key Private Bank Advisor.

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