

SAVING ESTATE TAXES THROUGH THE USE OF A GRAT

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Have you ever thought about making a gift to a family member? If so, you should consider making it through a grantor retained annuity trust (hereinafter called a "GRAT"). A GRAT allows a person to set aside assets for a family member or friend while they continue to receive income from the assets for a specified period of time. When the Trust ends, the assets pass to your family members at a reduced gift tax cost. The best types of assets to place into a GRAT are real estate, stocks or securities, and stock in a family business.

The Internal Revenue Code contains a unified estate and gift tax structure. An individual can take advantage of his \$5,000,000 exemption either at death, or by making lifetime gifts. Whether property is gifted during lifetime or at death results in the same tax rates. Accordingly, there is little tax incentive to make a lifetime gift unless there is some benefit to be obtained.

A valuable technique to take advantage of a lifetime gift is through the use of a GRAT. A GRAT is an irrevocable trust that reduces the value of the gift to the beneficiaries because they will not receive the gift until the trust ends. Typically, up to half the value of a gift can escape taxation. In addition, the creator of the trust can retain income from the trust assets for a period of time of his choosing. Therefore, the person establishing the trust will be less reluctant to make a gift.

How large can the estate tax savings be? The answer depends on a number of factors. One of these factors is the size of the gift. Another factor is the term of the trust. The shorter the term, the greater the gift since the beneficiaries do not have to wait so long for the assets. It would seem that the grantor would want the trust to last as long as possible because it will result in the smallest gift tax. However, if the trust is still in existence when the grantor dies, the full value of the trust assets are included in his estate and nothing will be accomplished by establishing the GRAT. This is why the life expectancy of the grantor becomes an important consideration.

Another factor in determining the gift tax consequences of a GRAT, involve the rate of return that the grantor seeks from the assets of the Trust. The lower the rate of return to the grantor, the greater the amount of the gift. The Internal Revenue Service requires that a GRAT have a minimum rate of return equal to at least 5%.

The benefits of a GRAT can be illustrated as follows:

Assume that a 65 year old contributes \$500,000 to a GRAT set up to last for a 10 year period of time. The person chooses a 6% rate

of return. At the end of the trust term, the assets of the trust will be distributed to his children equally. After weighing the age of the grantor, the term of the trust and various interest rate factors, the value of the gift is approximately \$320,000.

Accordingly, the individual can transfer \$500,000 to his children without incurring any federal gift tax. His \$5,000,000 exemption will be reduced by \$320,000. However, \$500,000 of assets have been transferred to his children. This removes \$180,000 from his estate and reduces the estate tax by at least \$63,000. Potentially, the tax savings can increase, if the value of the assets of the trust grow during the term of the trust. The growth of the assets during the term of the trust also escape gift tax. In my example, if the \$500,000 contributed to the GRAT doubles in value during the trust term, 1,000,000 will pass to the children free of gift taxes.

Please call to schedule an appointment with our firm to learn more about this valuable tax saving technique.