

Private Client Group

Gift and Estate Planning Technique

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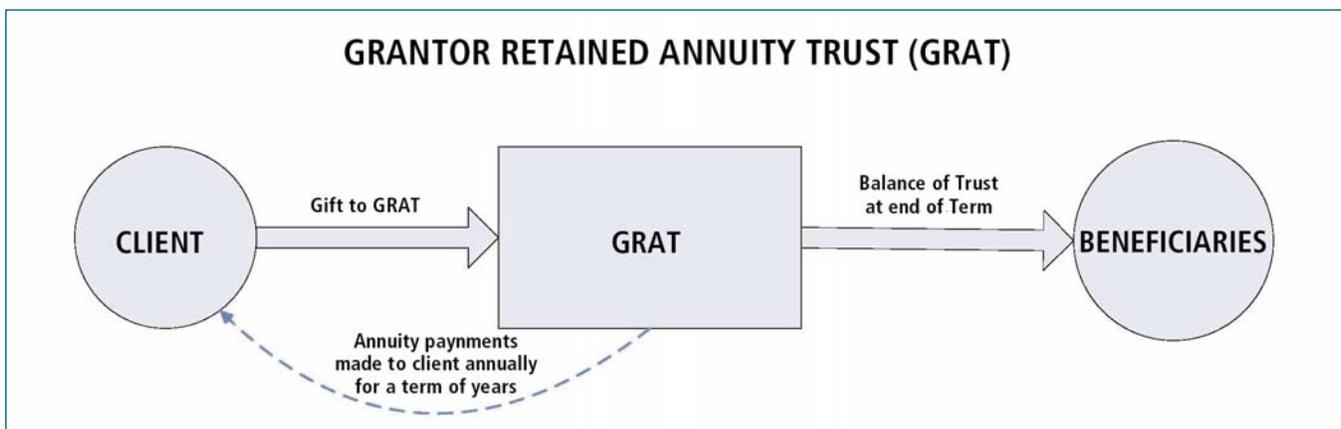
Grantor Retained Annuity Trusts

A Grantor Retained Annuity Trust (“GRAT”) is a gift and estate planning technique which uses IRS-approved discount factors to make gifts that “leverage” your \$1,000,000 lifetime gift tax exemption (\$2,000,000, combined with a spouse). A GRAT is a trust that you create for a specified term of years (the “Term”). During that Term, you will receive from the Trust an annual (or more frequent) annuity payment (expressed as either a fixed dollar amount or the fixed percentage of the initial

fair market value of the property transferred to the Trust). The Trust can pay you the annuity either in cash or in kind, based on the value of the trust property at the time of each payment. At the end of the Term, the remaining principal of the Trust, if any, will be distributed to, or held in further trust for the beneficiaries you have specified in the GRAT.

Your gift to a GRAT is a taxable gift that will utilize some portion of your remaining lifetime gift tax exemption. The

amount of the gift is equal to the fair market value of the property transferred to the GRAT, less the actuarial value of the annuity payments that you will receive from the GRAT. The actuarial value of the annuity payments is based upon several factors, including the IRS interest rate for the month in which the GRAT is funded, the length of the Term, and the size of the annuity payments as a percentage of the initial fair market value of the GRAT’s assets (the “Payout Rate”). A very



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short Term (usually 2–3 years) and a high Payout Rate can actually result in a remainder interest valued at close to \$0. In appropriate circumstances, such a GRAT (a “Zeroed-Out GRAT”) can result in the transfer of significant value without incurring any gift tax. The valuation formula assumes that the GRAT’s assets will grow at an annual rate equal to the IRS interest rate. Therefore, to the extent that the investment performance of the GRAT’s assets exceeds the IRS rate, the excess value will eventually pass to the remainder beneficiaries free of gift tax. On the other hand, if the GRAT’s investments underperform the IRS rate, this benefit will not be realized.

The value of the reportable gift made upon funding a GRAT can be reduced by either increasing the Payout Rate or increasing the Term. However, for Federal estate tax purposes, should you die before the end of the GRAT’s term, all or substantially all of the then-value of the GRAT will be subject to Federal estate taxation. On the other hand, if you survive the Term, the remaining assets of the GRAT will pass to the remainder beneficiaries free of any further gift or estate tax. Therefore, it is generally advisable to structure a GRAT with a Term significantly shorter than your anticipated life expectancy.

During the Term, you will be required to report on your personal Federal income tax return

all of the taxable income (both ordinary income and capital gains) of the GRAT. This tax payment will inure to the benefit of the GRAT beneficiaries but is not considered an additional gift for Federal gift-tax purposes. It is even possible to structure the

GRAT so that you will continue to pay Federal income tax on the income of the GRAT after the Term. These rules do not necessarily apply for state income tax purposes. For example, Pennsylvania requires a GRAT to file its own income tax return and pay its own tax. ■

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The Private Client Group represents clients in all aspects of estate and business planning, estate and trust administration, and estate and tax litigation. Our clients include entrepreneurs, Fortune 500 executives, professionals, and other high-net-worth individuals and their families as well as unmarried couples.

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We view ourselves as “family business advisors,” whose collaborations with our clients’ accountants, investment advisors, financial planners, and life insurance professionals enable us to tailor the most appropriate and tax-effective plan for asset management, business succession planning, and the transmission of wealth to subsequent generations.

Trust and Estate Administration

Our team of experienced attorneys, paralegals, and fiduciary accountants works closely with executors, trustees, and beneficiaries to provide a smooth and orderly administration of trusts and estates.

Trust and Estate Litigation

Blank Rome attorneys handle complex estate-related litigation in Florida, New Jersey, New York, and Pennsylvania.

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