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## CLIENT ALERT

In the alphabet soup of estate planning techniques where different wealth transfer strategies are identified by capital letters (GRIT, QPRT, QSST, CRT, etc.), none has received more deserved attention than the GRAT (“Grantor Retained Annuity Trust”). Its popularity probably lies in the fact that it is virtually foolproof and risk free. Indeed, it has been called the most popular and powerful planning device in the estate planner’s arsenal.

the GRAT is derived directly from the Internal Revenue Code (Sec. 2702), it is mentioned means to transfer wealth from one generation to the next at minimal or no transfer tax cost, meaning little or no gift tax and absolutely no estate tax.

A GRAT is created by a grantor transferring property (such as marketable securities or any other property likely to appreciate over time) to a trust while retaining the right to receive a fixed annuity payment for a certain number of years. By fixing the annuity at a significant amount, the value of the annuity will be subtracted from the value of the property transferred to the trust in determining the gift.

For example: the grantor transfers \$5,000,000 of securities to a GRAT having a term of two years and the grantor retains the right to receive a payment of \$2,727,173 at the end of year 1 and \$2,727,173 at the end of year 2. When the trust terminates, all remaining property will be transferred to the grantor’s children. For gift tax purposes, the actuarial value of the two payments to be made to the grantor amounts to \$4,999,999.89 which is subtracted from the initial gift leaving a net taxable gift of \$0.11.

In the above example, the computation is based upon the IRS monthly “hurdle” interest rate for July, 2006 of 6.00%. If the trust investments have income and appreciation greater than that rate, all of the excess belongs to the children, free of gift tax and free of estate tax. Assume in this example that the investments earned 10% in each of the two years, the amount passing to the children at the end of the second year would be \$322,935.

A “rolling GRAT” is a refinement in which the grantor, upon receiving the payment at the end of year 1, creates a second GRAT and deposits the amount received in a second trust. In the above example, if the \$2,727,173 received by the grantor at the end of the first year is transferred to a new GRAT which also has a 10% rate of appreciation, when that GRAT ends the children will receive \$176,140 and the grantor will have received total annuity payments from the second GRAT of \$2,974,989.

During the term of the GRAT, the grantor is considered the “owner” of the trust and pays all income taxes on the GRAT’s income and capital gains. This in effect creates another tax-free gift by the grantor to the children by paying the income taxes on assets they will later receive.



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The only “downside” of a GRAT is if the grantor dies during the trust term. In that event, the entire trust is subject to estate tax, but this is the same situation that would apply to the assets in the GRAT if the grantor had not created the GRAT. Nothing is lost but the cost of creating the trust.

Because a GRAT is more likely to be successful if the investment performance of its assets exceeds the “hurdle rate”, currently 6.00%, the use of a GRAT should be considered while we are still in a relatively low interest environment .

If you would like more information or an illustration of a GRAT tailored to your specific situation, please contact us.

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