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GRAT EXPECTATIONS

By Daniel C. Gasink

What is a GRAT

A Grantor Retained Annuity Trust (GRAT) is a planning device used to give assets to beneficiaries while minimizing Estate & Gift Taxes. Given today's extremely low interest rates, those with estates large enough to worry about the Federal Estate Tax should investigate using a GRAT to reduce their death taxes. As there is no Generation-Skipping Transfer Tax in 2010, this year is ideal for shifting wealth to grandchildren in particular.

Estate Tax Planning: a very quick primer

First, remember that Estate Taxes are due upon your death on any value your estate holds over the Federal Exemption (\$1,000,000 in 2011). Second, to prevent families from simply getting rid of assets before death, the Federal Government also treats large lifetime gifts (in excess of \$13,000) as an advance against the Estate Tax Exemption.

The key to Estate Tax planning is to make the fullest and best use of that \$1,000,000 Exemption and \$13,000 annual exclusion during life. While an 'A/B' (Estate Tax plan) Revocable Living Trust is the simplest first step for a married couple to take to avoid Estate Taxes, vehicles like GRATS, ILITS (see last month's issue for a detailed discussion), and other more complex trusts and entities form the second tier of tax planning for those who are single and for those whose Estate Tax problem cannot be entirely mitigated by a simple Revocable Living Trust.



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How a GRAT works

A Grantor makes a gift to an Irrevocable Trust (the GRAT). The GRAT then holds the money for a set term, making annuity payments back to the Grantor. At the end of the term, all the remaining assets in the GRAT pass to named beneficiaries. For the purposes of the IRS, the value of the gift to the beneficiaries is the initial gift plus interest minus annuity payments. When calculating the interest, one uses a rate set by the IRS, which is currently a bit over 2 % (October 2010). The Grantor expects the assets to grow at a substantially higher rate and so the grantor wins two ways: he reduces his estate and does so in a way that makes the gift value more than the taxable value. That difference in valuation means he will pay less in estate and gift taxes (at a 41-55% rate in 2011). Determining the term and rate of a GRAT is both complicated and very individualized so it should be done only after a thorough consultation with your lawyer, financial advisor, and tax advisor. **If calculated properly, a GRAT can give substantial assets to beneficiaries with little or no gift tax impact.**

Why not create a GRAT

Those whose estates are below the Federal Estate Tax exemptions and those who have arranged for an ILIT to provide sufficient liquidity to pay taxes at death have no reason to create a GRAT. A GRAT is an irrevocable trust and therefore it should not be created unless the Grantor is certain that there will be no changes in terms or beneficiaries. Also, for a GRAT to get assets out of a Grantor's estate, the Grantor must survive the GRAT term (a minimum of two years). If the Grantor dies before the end of the term, then the trust assets are included in his estate for Estate Taxes. While this means that the Grantor

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"The willingness with which our young people are likely to serve in any war, no matter how justified, will be directly proportional to how they perceive the veterans of earlier wars were treated and appreciated by their country."

-George Washington

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Have you discussed your estate plan with your chosen executor/trustee and/or beneficiaries? Consider having a family estate document review meeting with your trusted JGB Attorney

is merely in the same situation as if he had not created a GRAT, it can be frustrating to go through the effort of creating a GRAT and not be able to receive a benefit. Finally, the trust is designed to give assets away. Grantors who want to keep holding on to their assets should not set up a device that gives them away.

Who should set up a GRAT

Individuals and couples with taxable estates should investigate setting up a GRAT. This includes all singles who have an estate larger than the exemption (\$1,000,000 in 2010) and couples whose estate exceeds double the exemption (\$2,000,000 assuming the couple has already set up an 'A/B' Revocable Trust). In particular, those who have investigated ILITS and charitable giving and still have Estate Tax issues should look into GRATs.

When to do a GRAT

Many people can avoid the Federal Estate Tax through simpler means. For those who need its sophistication, a GRAT should be set up as soon as the Grantor is comfortable with the trust. Time is of the essence for three reasons:

- 1) The interest rates are now at historic lows;
- 2) The Grantor should start the term as soon as possible to maximize the likelihood that he will survive for the life of the GRAT; and
- 3) Congress has tried to eliminate GRATs in the past. A law banning GRATS would only apply to future GRATs and existing GRATs would be grandfathered.

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How do I start looking into a GRAT

Call your Estate Planning lawyer and ask them for their input. The attorneys of Johnson, Gasink & Baxter, LLP are always happy to talk to their clients and meet with prospective clients to review existing plans in light of changes in the tax laws and changes in a client's life. There are many types of grantor retained-interest trusts and deciding which, if any, is right for you is a personalized decision.

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Do not hesitate to contact us to schedule an appointment at 757-220-9800, or email us at lkn@JGBLLP.com.

ABOUT THE AUTHOR:

Dan lives in Williamsburg with his wife, Ginny, their young children, and their yellow lab, Lucy. Moving around much in early years, his family settled in Northern Virginia where he attended high school. At William and Mary, he majored in history, minored in religion, and received a teaching certificate. Upon graduating, he taught high school social studies in Hampton before returning to William and Mary for a law degree. He practiced Estate Planning law in the Washington D.C. metropolitan area until he married Ginny (another William and Mary alumna) in 2005 and they soon returned to Williamsburg. Dan has been in private practice in Williamsburg since that move and enjoys speaking as an Estate Planning expert and as a continuing education (CE) teacher. His hobbies include playing music and relaxing at Sandbridge, Virginia Beach.



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