

## GRATs Are Powerful Leveraging Tools

Would you like to leave assets to your children, retain an income stream from those assets and reduce your gift and estate tax? Then a grantor retained annuity trust (GRAT) might be right for you.

### Giving a Future Interest Saves Gift Tax

When you create a GRAT, you make an irrevocable current gift of the right to receive assets in the future while you retain the income stream earned by those assets. Why does a gift of a future interest save tax? Because you pay gift tax only on the predicted value of the gift when the recipient will receive it -- which will decrease over time because of inflation.

But if today you could give away the right to receive \$2 million in 10 years, then the actual gift today is only about \$926,000 -- the current value of the right to receive the asset in 10 years at 8%. In 10 years, the recipient will own the entire asset (plus perhaps some asset appreciation), and you won't owe any further gift tax.

### Determining the Value of the Gift

You must retain the right to receive a fixed dollar amount per year to make a current gift of a future interest -- an annuity. The value of the future interest will be determined by valuing the retained annuity and subtracting it from the total assets transferred.

How can this be done? By discounting the retained annuity payments to account for their not being received currently. To discount a future payment, a specific interest rate is assumed that will reflect the predicted rate at which the asset will grow. The IRS publishes this interest rate (called the 7520 rate) monthly. Fluctuations in the rate can greatly affect the gift. Let's say that you're age 65 and establish a GRAT with \$1.5 million, retaining the right to receive a 7% annuity (\$105,000) each year for 10 years.

Depending on the interest rate, your current gift of the future interest will be:

Assets Transferred	7520 Rate	Value of Gift
\$1,500,000	7%	\$ 832,945
\$1,500,000	8%	\$ 861,484
\$1,500,000	9%	\$ 888,144

Of course, a change in the annuity rate will alter the result as well. Assuming the same basic facts as above, if the 7520 rate is at 8%, here is the result:

Assets Transferred	Annuity Rate	Value of Gift
\$1,500,000	7%	\$ 861,484
\$1,500,000	11%	\$ 496,618
\$1,500,000	15%	\$ 131,752

## **Beating the IRS Rate**

How can you further leverage the gift? By contributing assets to the GRAT that are likely to outperform the IRS rate -- such as stock in a closely held company that could be subject to an initial public offering in two or three years.

Also, you may get a double discount if you choose an asset with a minority interest or lack-of-marketability discount, such as S corporation shares that can generate cash flow to pay the annuity or minority limited partnership interests from a family limited partnership.

## **Running the Numbers**

GRATS can be a useful wealth transfer technique. All you have to do is find the right asset, make projections and run the numbers. You will know right away whether this plan can work for your situation. Please call us for more information on GRATs or other estate planning tools. Our professionals will be glad to assist you.