

# GRATs: Planning for Assets That May Appreciate Can Yield Tax Benefits

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Investors acquire assets with the hope and expectation that those assets will increase in value in the future. High-net-worth individuals and families are often uniquely positioned when it comes to investing. Given the dollar values involved, and the potential future tax implications, investing in new assets presents a planning opportunity on multiple levels, assuming that the investors and their advisors are proactive in execution.

Estate planning can be overwhelming and wrought with potential pitfalls. Regardless of the nature of the assets involved and the individual's unique set of circumstances, there are certain challenges that arise consistently. The estate-related tax topic at the forefront of almost every high-net-worth individual's mind is the obvious: transferring assets tax-efficiently to provide the most benefit with the least amount of burden. While at times complicated, there are numerous options available to the planner depending on the nature, type, and value of the underlying assets they are looking to bequeath to the next generation.

Picture a situation where an individual has an asset that they believe will appreciate

significantly in the future, has no intention of selling it for personal use in the short or long term, and sees the asset as an opportunity to create wealth for future generations. In this case, the individual already has a sizable estate but wants to avoid paying unnecessary estate tax where possible. With no shortage of estate planning vehicles, which options should be considered?

Enter the Grantor Retained Annuity Trust, more commonly referred to by its acronym, GRAT. A GRAT is an estate planning tool that allows taxpayers to remove the future benefit portion of assets from their estate by effectively transferring them to a trust in exchange for an annuity at predetermined rates. Ownership is relinquished, and the remaining assets in the trust at the end of the trust term are not includable for estate calculation purposes.

The process begins with an individual, or grantor, selecting an asset or pool of assets that they believe will appreciate significantly in value over time. The asset is then transferred to the GRAT, which should be established with the help of an experienced trusts and estates attorney, in exchange for an annuity at a predetermined rate of interest with payment amounts and dates specifically laid out in the GRAT formation documents. As long as the GRAT makes the requisite payments on time, the residual value of any appreciated assets left when the GRAT reaches its term is effectively removed from the grantor's estate. If structured so that the present value of the annuity equals the fair market value of the trust assets contributed, which is based on IRS actuarial tables, then there is no gift deemed and the appreciated remainder will exit the estate forever. Since a GRAT is a grantor trust, any taxes are deemed earned and paid by the grantor, leaving the pure pre-tax appreciation amount of the asset intact.

The immediate and obvious benefit of a GRAT is avoiding the estate tax on appreciated assets. However, other benefits also exist and can dovetail nicely with other facets of estate and financial planning. The client is relinquishing the assets through a transfer rather than a gift. Therefore, as long as the GRAT performs as intended, they are getting tangible assets back in return, either in the form of cash or equivalent assets. Often times GRATs pay grantors back with the very same assets that they contributed in the first place as long as the fair market value of the asset being transferred is equal to the predetermined installment payment amount.

Transferring to a GRAT can also avoid eroding one's lifetime gifting exemption, which can be material if the grantor's has already been used. A number of high-profile company founders, including Facebook and Walmart have used GRATs as part of their estate planning.

GRATs do have some downside potential. First, they can be costly to set up and administer. There is also an administrative burden associated with record keeping and ensuring the terms of the trust are adhered to, including making payments on time. The grantor does not realize any immediate tax benefits, as all income generated by the GRAT's assets flow through to the grantor. There is also the risk of a GRAT failing or not performing as intended. If the underlying assets do not appreciate as expected, the client has limited benefit with little to no tax advantage. There is also the risk of the grantor dying before the term of the GRAT, which may lead to some of the underlying assets being included in the grantor's estate after all.

GRATs are not for everyone, but certain circumstances provide good opportunities to employ them. Hedge fund investors and company founders commonly use GRATs as part of their estate planning, as they have an expectation of dramatic upside in their company stock. [Angel investors](#) or those who have shares in vehicles that are early investors in potential 'home run' stocks may receive stock distributions which carry an extremely low basis. Rather than selling outright and generating a large capital gain, a GRAT can be used to shelter that tax and shift it out of their estate. If a GRAT is executed correctly and funded with appropriate assets, it can be used to help individuals or families who wish to shift an asset out of their estate in a tax-savvy manner.

GRATs remain a powerful and useful tool when deployed correctly. Sanctioned by the IRS, they are a clean and effective way to mitigate potential estate tax while allowing the family to retain control of the assets. Other factors to consider involve proper valuation of assets, length of the GRAT, and eventual goal of what the underlying assets will be used for, all of which merit professional judgment and care in deciding. GRATs can be used as part of a broader estate plan and potentially allow an individual to avoid doing the one thing that most estate planning revolves around: paying unnecessary taxes.

*For more information or to discuss potential implementation of GRATs or other planning strategies, contact your Anchin Relationship Partner, or [Sean Miller](#), a Senior Manager in Anchin's Private Client Group.*