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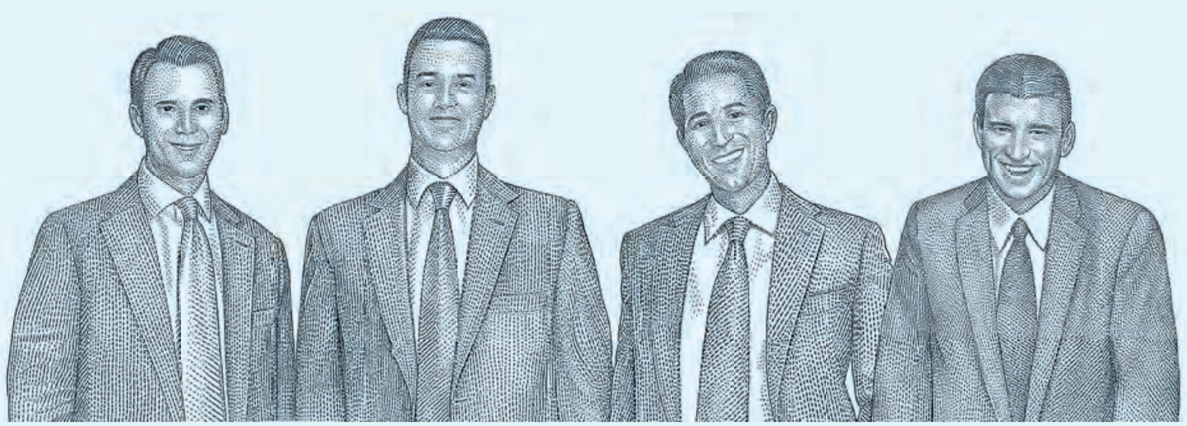
Is a grantor retained annuity trust right for you?

BY STEPHEN A. SCHWARTZ, CFP®, AEP®, PARTNER



Left to right:
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Many financial and legal practitioners have been advocating the usage of grantor retained annuity trusts (GRATs) for the past several years. This widely used estate-planning strategy has gained in popularity as the U.S. economy has embarked on a repressed interest-rate environment which has helped provide a boost to household net worth.

The general overview of a GRAT can be explained as follows: An individual, referred to as the "grantor," creates an irrevocable trust, transfers assets to it and retains an annuity from the trust for a specified term. GRATs have a minimum term of two years but can be longer in duration. To avoid a gift tax, the retained annuity is designed to equal the value of the assets transferred, based upon the term of the trust and an assumed growth rate established by the Treasury department. The rate set forth by the Treasury is known as the "7520" rate. Should the total return on the assets placed into the trust outperform the 7520 rate, the excess value passes to the next generation free of gift and estate taxes. Many tax professionals will refer to this as a successful GRAT or a GRAT that's "in the money."

An individual may gift a substantial amount of wealth utilizing a GRAT, while retaining an income interest for a specified period of time. Given the retained interest, there's a significant reduction and, in some cases, elimination of any taxable gift.

One can choose to also place assets such as marketable securities, private stock or a portion of the family's business into a GRAT. Once this gift has been made, it's irrevocable, meaning these assets are there for good or until the GRAT terminates and the assets pass to the designated beneficiaries.

Generally speaking, assets that have the potential for greatest gain should be considered. Upon gifting such an asset, the post-appreciation will be excluded from one's estate and passed on to the next generation without incurring estate taxes. Investors should also consider placing nonmarketable assets, such as a family business or private stock, which can result in a valuation discount due to lack of marketability.

The GRAT technique does carry some risk. Should the grantor die prior to the expiration of the term, the GRAT is deemed to be unsuccessful. If this situation were to occur, the entire value of the trust would be included in the taxable estate. To reduce this mortality risk, many advisors recommend shorter-term GRATs for elderly individuals or those families who have health concerns. Jay Rivlin of McDermott Will & Emery LLP says: "Clients who have systematically utilized GRATs have transferred significant wealth over the years. It usually only takes one 'winner' to make a GRAT program very worthwhile."

GRATs remain a viable and effective tool for wealth-transfer planning. To effectively examine whether a GRAT is right for your family, you should consider a sum of all the financial parts and consult a qualified advisor or tax professional for the implementation of such a plan. ●

> "GRATs remain a viable and effective tool for wealth-transfer planning."

ABOUT US

PIONEER FINANCIAL AT NORTHWESTERN MUTUAL PROVIDES FINANCIAL SERVICES TO HIGH NET WORTH AND EMERGING HIGH NET WORTH INDIVIDUALS, FAMILIES AND BUSINESS ENTERPRISES. Pioneer Financial's team of 20 associates/staff serve clients nationwide from their Park Avenue office in New York City. Kevin R. Luchetta, Stephen A. Schwartz and James L. DiNardo are wealth-management advisors and CERTIFIED FINANCIAL PLANNER™ practitioners. The practice is focused on assisting clients through comprehensive financial planning that includes asset management, retirement funding, risk management, estate preservation and distribution. ●

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