HOW GRANTOR RETAINED ANNUITY TRUSTS CAN BE USED TO ELIMINATE ESTATE TAXES ON INCOME PRODUCING REAL ESTATE AND BUSINESS INTERESTS

by Neil R. Lubarsky, Esq.

In the low interest environment in which we find ourselves, a Grantor Retained Annuity Trust, commonly known as a "GRAT", is probably the most effective technique available for eliminating estate taxes on income producing business interests and income producing real estate. Such a trust allows a person to transfer assets out of his or her estate in a manner resulting in the assets being valued, for gift and estate tax purposes, at as little as 10% of their true value. The trust not only allows, but in fact requires the person transferring assets to retain a stream of income or other payments from the transferred assets for a fixed number of years. Grantor Retained Annuity Trusts should be considered for use by anyone who expects to be worth in excess of the federal estate tax exemption upon his or her death.

Examples of typical tax savings from the use of such a trust follow: Let's say that you have a business worth $4,000,000 which is, or can be, owned through an S Corporation, through a partnership, or through an LLC. Assume that this business is providing you with approximately $440,000 in annual distributions. Assume that you would be comfortable continuing to receive such $440,000 per year in distributions from the business for the next ten years. By putting your business interests into a Grantor Retained Annuity Trust which will pay you the desired income stream, you may, depending on your age and the current government interest rate, be able to reduce the business' gift and estate tax value to a relatively insignificant amount that could be as little as $400,000, thereby effectively reducing its value by as much as 90% for estate and gift tax purposes. If, instead of putting business assets into a Grantor Retained Annuity Trust, you continued to hold the business interests in your own name for ten years, they would be valued in your estate, assuming no further appreciation, at $4,000,000, instead of being valued at only $400,000. Setting up such a Grantor Retained Annuity Trust will save you, if you survive the ten year term of the Grantor Retained Annuity Trust, the estate tax that would have been due on the difference between the $4,000,000 true value of the business and the $400,000 amount deemed transferred to the children pursuant to the terms of the Grantor Retained Annuity Trust. This calculates, at an assumed 50% estate tax rate, to savings of approximately $1,800,000 of estate taxes. In addition, any appreciation on the business would also end up passing to the children free of any estate taxes, resulting in substantial further estate tax savings.

Another situation where a Grantor Retained Annuity Trust works wonders in our low interest rate environment is in reducing the estate and gift tax value of income-producing real estate. Assume that you own real estate worth a total of $2,000,000 that currently provides you with an income stream of 10 % of its current value, or $200,000 per year. If you wish to continue to retain this income stream of $200,000 per year from your real estate for the next ten years, and are willing to ultimately give up the remaining interests in the property to your children, the property should be placed in a Grantor Retained Annuity Trust. Establishing such a trust, assuming that you were to live for the entire term of the trust, would result in the real estate effectively being valued at only about $300,000 for gift and estate tax purposes. If, instead, you were to continue to hold the property in your own name for the full ten-year period, and if the property were to appreciate at 4% per year, you would end up with a property worth close to $3,000,000 in your hands. Under this set of circumstances, putting the real estate in a Grantor Retained Annuity Trust, as opposed to leaving the real estate in your own name, would likely save your family estate taxes in the amount of 50% of the $2,700,000 which effectively disappeared from your estate, amounting to a savings of $1,350,000. Even without any property appreciation occurring over the ten year period, the Grantor Retained Annuity Trust would likely save the family $850,000 in estate taxes, since it would have converted a property truly worth $2,000,000 into an asset worth only $300,000 in the eyes of the authorities, thereby eliminating estate taxes on the $1,700,000 difference.

Grantor Retained Annuity Trusts work best in low interest rate environments because when interest rates are low, the government allows us to take the position , for gift and estate tax valuation purposes, that the income stream being retained by the Grantor will be primarily coming out of the trust's principal; and therefore what will be left for the children when the trust terminates will be worth only a small fraction of the full value of the real estate or business interests originally placed in the trust.

With interest rates as low as they now are, now is a great time to take advantage of the opportunity to reduce potential estate taxes by utilizing a Grantor Retained Annuity Trust.

Grantor Retained Annuity Trusts are a great estate planning tool for your income producing assets, since you can use them to potentially avoid huge amounts of estate taxes while simultaneously receiving an ongoing stream of income.

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