

# The GRAT: A Powerful Tool for Tax-Free Wealth Transfer

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# The Grantor Retained Annuity Trust (GRAT):

*A Powerful Tool for Tax-Free Wealth Transfer*

## Key principles:

- The Grantor transfers specific investment assets (“X”) to a GRAT for a set term of years (the “GRAT term”).
- The IRS projects that a certain amount of appreciation (“Y”) will occur during the GRAT term based on a rate of return published monthly by IRS (the “hurdle rate”).
  - Since 2009 the hurdle rate has ranged from 0.4% to 3.4%.
  - The hurdle rate in effect during the month the GRAT is created applies for the entire GRAT term.
- The GRAT must pay X+Y back to the Grantor during the GRAT term in annual installments.
- Any appreciation on X above Y during the GRAT term will pass to designated beneficiaries at the end of the GRAT term as a *tax-free gift*.

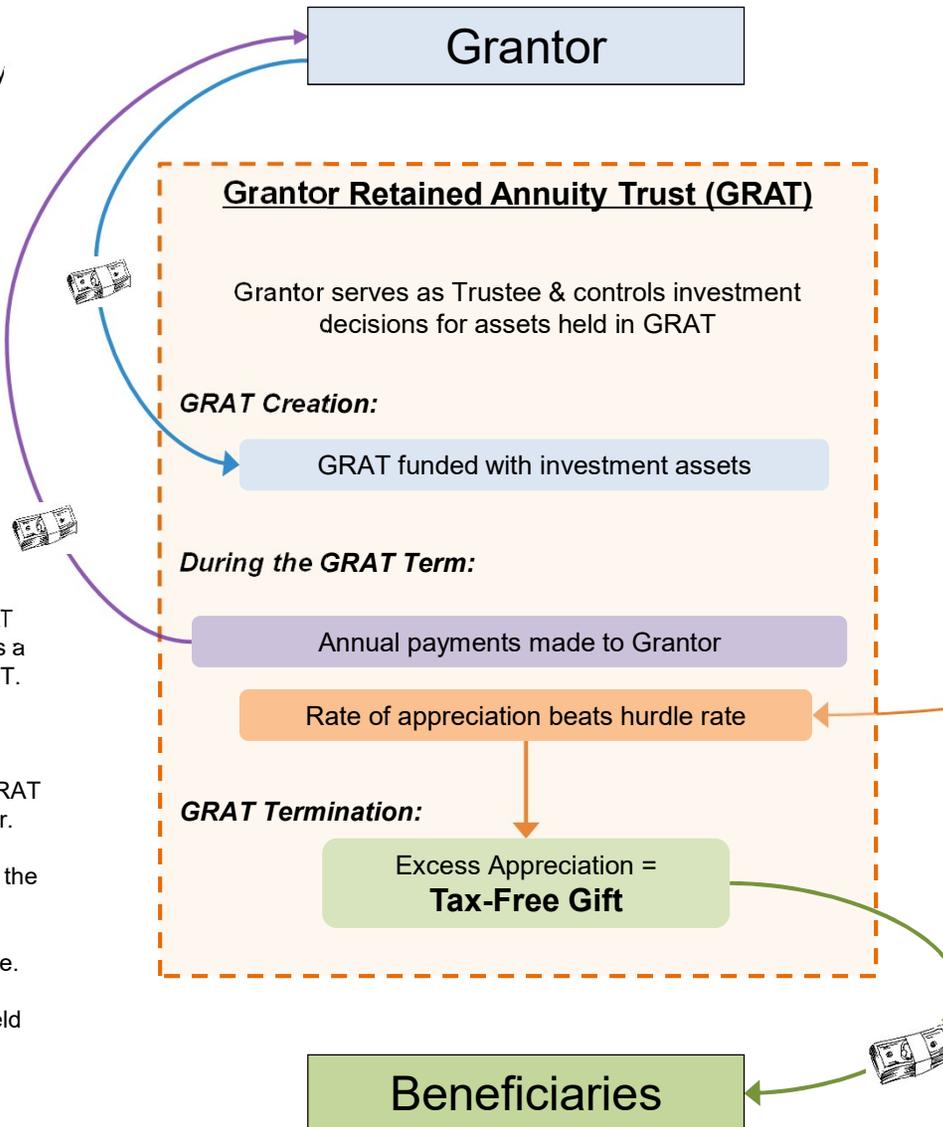
## During the GRAT Term

### 1. GRAT Creation

- Grantor funds the GRAT with investment assets, most typically publicly traded securities or private company shares.
- Grantor chooses length of GRAT term (2 - 5 years is common).
- Grantor must survive the GRAT term or else the tax benefits of the GRAT are lost.
- The Grantor typically serves as Trustee of the GRAT.

### 2. Annuity Payments During the GRAT Term

- On each anniversary of the GRAT during the term, Grantor receives a specified payment from the GRAT.
- The payment can be made with cash, if available, or in kind by transferring assets held in the GRAT (e.g., shares) back to the Grantor.
- There are no restrictions on how the assets held in the GRAT can be invested during the GRAT term. The goal is to beat the hurdle rate.
- If private company shares are held in the GRAT, the Trustee retains voting control over the shares.



### 3. Assets Appreciate During the GRAT Term

- If the assets in the GRAT appreciate at a rate greater than the hurdle rate, the GRAT will succeed.
- If the assets in the GRAT do not beat the hurdle rate, the annual payments will deplete the GRAT by the end of the term. In that case, the Grantor receives back all assets he or she contributed to the GRAT and is no worse off than if the GRAT had never been created.

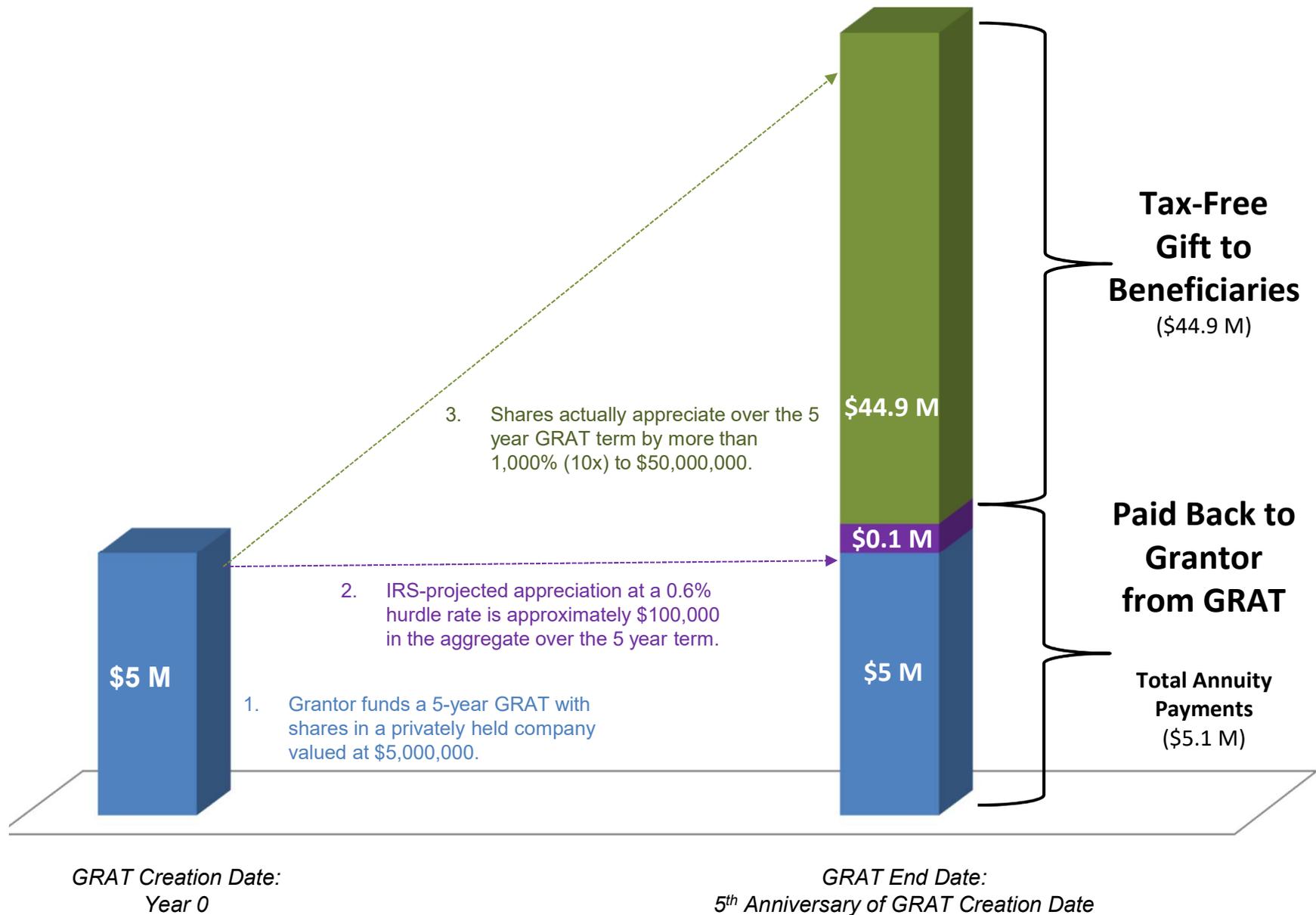
The most dramatic success is often achieved when a private company whose stock is held by the GRAT is acquired or goes public during the GRAT term.

### 4. GRAT Termination

- If the GRAT succeeds, after the final payment is made to the Grantor any excess appreciation will pass to the designated beneficiaries (outright or in trust, as designated by the Grantor at the beginning of the GRAT).
- The designated beneficiaries (or remainder trust) will receive the excess appreciation without payment of gift tax (or income tax) and without requiring the Grantor to use any of his or her lifetime gift exemption.

Note that GRATs are not "aggressive" from a tax point of view. They are not the type of transaction that is likely to be challenged by the IRS. GRATs are well known and frequently used, and do not depend on novel interpretations of tax rules.

## Illustration of a GRAT Funded with Stock in a Privately Held Company



Dollar & year figures are included to illustrate example. Illustration not to scale.