

Grantor Retained Unitrust (GRUT)

A grantor retained unitrust may be an effective means for a client who wants or needs to retain all or most of the income from a high-yielding and rapidly appreciating property to transfer the property to a child or other person with minimal gift or estate tax. GRUTs are particularly indicated where the client has one or more significant income-producing assets that he or she is willing to part with at some date in the future to save federal and state death taxes, probate costs, to obtain privacy on the transfer, and to protect the asset against the claims of creditors.

A GRUT is created by transferring one or more high-yield assets into an irrevocable trust and retaining the right to an annuity interest for a fixed term of years or for life. When the retention period ends, assets in the trust (including all appreciation) go to the named “remainder” beneficiary (ies). In some cases other interests, such as the right to have the assets revert back to the transferor’s estate in the event of the transferor’s premature death, may be included.

GRUTs provide an annuity payment equal to a fixed percentage of the current value each year of the assets in trust. In this sense, a GRUT is similar to a variable annuity. The payout rate is fixed, but since the value of the assets can be expected to vary year to year, the dollar annuity payout also varies year to year.

For example, if \$100,000 is placed in trust and the annuity payout rate is 5 percent, the trust would pay \$5,000 the first year. If the values of the assets in trust increase to \$110,000 in the subsequent year, the payout would be \$5,200, 5 percent of \$110,000. If income earned on the trust assets is insufficient to cover the annuity amount, the shortfall in payments will be made from principal. All income and appreciation in excess of that required to pay the annuity accumulate for the benefit of the remainder beneficiary(ies). Consequently, it may be possible to transfer assets to the beneficiary(ies) when the trust terminates with values that far exceed their original values when transferred into the trust and, more importantly, that far exceed the gift tax value of the transferred assets.

The gift tax value of the transferred assets is determined at the time the trust is created and funded using the “subtraction method.” The gift tax value is determined by subtracting the value of the annuity interest (and, in some cases, other retained interests, such as the right to have the assets revert back to the transferor’s estate if he or she does not live the entire term of the trust) from the fair market value of the assets transferred in trust.

Grantor Retained Unitrust (GRUT) (cont.)

How the annuity interest and any other retained interests are valued depends on who the remainder beneficiary(ies) is (are) and who retains the annuity and other interests relative to the transferor.

If the transferor-annuitant survives the term of the GRUT, the assets transferred in trust are not included in the transferor's gross estate and escape estate taxation. Since the GRUT permits payment of both income and trust principal to satisfy the transferor-annuitant's unitrust annuity payments, the GRUT should be treated as a grantor trust for income tax purposes. This means the transferor-annuitant is taxed on income and realized gains on trust assets even if these amounts are greater than the trust's unitrust annuity payments. This further enhances this tool's effectiveness as a family wealth-shifting and estate-tax-saving device. The transferor-annuitant is effectively allowed to make gift-tax free gifts of the income taxes that are attributable to assets backing the remainder beneficiary's interest in the trust.

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