

# Money Matters

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## Skloff Financial Group Question of the Month

By Aaron Skloff

**Q:** What is a Grantor Retained Annuity Trust (GRAT) and is it a great vehicle to reduce or eliminate our estate taxes?

Estates larger than \$3.5 million pay federal estate taxes of up to 45%. Estates larger than \$675,000 pay New Jersey estate taxes of up to 16%. That could add up to a 61% tax rate and millions of dollars of tax payments.

The Grantor Retained Annuity Trust (GRAT) is one great vehicle that could eliminate estate taxes by transferring assets out of your estate. While low interest rate environments, like the one we are in are now, present certain challenges, they can enhance the benefits of GRATs.

A GRAT is an irrevocable trust created by a person (the “grantor”), who transfers assets into the trust and receives a stream of annuity payments from the trust for a specified term. At the end of the term the remaining assets of the GRAT are distributed to the named beneficiary (the “remainderman”) or placed into a trust for the benefit of the beneficiary. The grantor can avoid gift taxes from transfers if the GRAT is “zeroed out”. Translation: the full amount transferred in is paid back to the grantor.

The minimum stream of payments for the term of the trust is determined by the Internal Revenue Code 7520 Interest Rate, oftentimes called a “hurdle rate”. The current rate of 3.2% is significantly lower than the 6.2% rate as recent as August of 2006, making the GRAT more appealing now than at many periods over the last 10 years. The primary reason for establishing a GRAT is to remove net profits from the estate, with net profits defined as any excess return above the hurdle rate. The lower the hurdle rate, the easier it is to remove more assets from your estate. Translation: it is easier to earn more than 3.2% than it is to earn more than 6.2%.

If the Grantor dies before the term of the GRAT the entire transfer is added back to the grantor’s estate. This defeats the purpose of the GRAT and is a key reason to consider rolling GRATs. Rolling GRATs commence immediately after the preceding GRAT matured. They are primarily utilized to avoid two problems:

- 1) locking into too high a hurdle rate in a declining hurdle rate environment and
- 2) the penalty associated with a death of the grantor over the course of too long a term.

Hurdle rates are unlikely to remain this low for very long. Establishing a GRAT now, when hurdle rates are low, increases the likelihood you will be able to remove a larger amount of assets from your estate – potentially eliminating your federal and state estate tax obligations. The earlier you establish a GRAT, the greater the potential benefit. Establishing an estate plan with the expertise of your financial advisor and estate attorney can be one of the best investments of your life.

Note. Aaron Skloff, Accredited Investment Fiduciary (AIF), Chartered Financial Analyst (CFA), Master of Business Administration (MBA) is CEO of Skloff Financial Group, a Registered Investment Advisory firm based in Berkeley Heights. He can be contacted at [www.skloff.com](http://www.skloff.com) or 908-464-3060.