Rolling GRATS and Shelf GRATS: Time To Lock In Low Interest Rates

by James F. McDonough, Jr. on July 25, 2013

A practitioner commented many years ago that the effectiveness of a tax planning technique can be measured by the strength of government opposition to it. One need only look at the President's tax plan and the Treasury's *General Explanations of the Administration's Fiscal Year 2013 Proposals* (page 80) to see that Grantor Retained Annuity Trusts (GRATs) are effective.

A GRAT is a trust to which the Grantor transfers property in exchange for an annuity to be received for a period of time selected by the Grantor. The transfer to the GRAT is reported as a gift at the fair market value of the property reduced by the annuity. A transfer is assumed to grow at a rate of interest set by the IRS. Taxpayers hope the property transferred will appreciate in value or earn more income than the assumed interest rate, which is 1.4% in July. Where a GRAT earns income or appreciates in value in excess of 1.4%, the excess is not taxed as part of the gift. If $100 is assumed to grow, at 1.4%, to $102.82 in two years, any increase in value in excess of $102.82 escapes the gift tax calculation. It is easy to understand why Treasury dislikes GRATs; however, the irony is that GRATs are creatures of regulation drafted by Treasury.

If a grantor dies during the initial term, the property in the GRAT is restored to the estate of the grantor. The Treasury proposal would require that GRATs have a minimum term of ten years. The proposal would increase the likelihood of estate taxation of GRATs and minimize the effectiveness of the technique.

A rolling GRAT is a technique whereby the annuity received by the grantor from the GRAT is re-contributed to a new GRAT. Rolling GRATs are designed to reduce the size of one's estate by not retaining the annuity payments received each year.

In August, the §7520 rate is projected to increase to 2.0% from 1.4% thereby making it a bit more costly to transfer wealth. A Shelf GRAT is created to lock in the use of the lower interest rate for use in future years. The technique requires a more detailed explanation than I can provide here; however, taxpayers planning for the future should act now before Treasury's proposals are implemented.