

GRANTOR RETAINED UNITRUST (GRUT)

(Permits Grantor to retain qualified unitrust interest in trust while transferring remainder to next generation at a discount for estate and gift tax purposes.)

HIGHLIGHTS OF THE PLAN

OVERVIEW

Code Section 2702 requires that retained interests in a split-interest gift be valued at zero unless it is a qualified retained interest. In other words, split-interest gifts of remainder interests must be valued at the full fair market value of the property subject to the split-interest gift unless they are made in the form of a grantor retained annuity trust, grantor retained unitrust, nondepreciable tangible personal property, personal residence trust, or qualified personal residence trust.

A grantor retained unitrust (GRUT) permits the Grantor to transfer property to an irrevocable trust for a fixed term of years and retain an income interest in the form of a unitrust payment. The unitrust payment is calculated as a fixed percentage of the trust assets as valued each year during the fixed term of the trust. The remainder interest is transferred to the next generation at a discount for estate and gift tax purposes if the Grantor lives for the full term of his or her interest in the trust. If the Grantor dies during the term of his or her interest in the trust, the full value of the trust assets will be included in the Grantor's estate for federal estate tax purposes. Life insurance in a life insurance trust should generally be purchased to protect against any estate taxes that might be due if the trust assets are included in the Grantor's estate.

The best assets for use in a GRUT are assets that are likely to appreciate in value. Using such property to fund the trust allows for greater leverage of the transfer tax discount. When using property other than cash or publicly traded securities to fund the GRUT, the Grantor should have the property to be transferred appraised by one or more qualified appraisers.

Grantor retained annuity trusts GRATs are generally more popular than GRUTs because, although a GRUT with a payout rate lower than the applicable federal rate (AFR) can provide a lower remainder interest, and thus a smaller gift for gift tax purposes, a percentage of any appreciation in trust assets is transferred back to the Grantor in the form of higher unitrust payments. Also, the need for an annual valuation of trust assets creates an additional administrative burden and expense.

ADVANTAGES OF A GRUT

1. The grantor or other applicable family member (AFM) keeps a retained interest in the GRUT, a qualified unitrust interest (fixed percentage of trust assets as valued each year) payable at least annually.

2. If the grantor lives for the entire term of the trust, the property placed in the GRUT is transferred at a discount for transfer tax purposes. Properly structured, the value for transfer tax purposes can be near, but not quite, zero.
3. If the grantor lives for the entire term of the trust, all appreciation on trust assets escapes transfer tax.
4. If a GRUT has a "defective grantor trust" provision, such as the power in the grantor to substitute assets in the trust of equal value, the GRUT can qualify to hold S corporation stock.
5. The discount features of a GRUT can be combined with the discount features of a minority interest in a closely held corporation or family limited partnership to multiply the transfer tax discounts. Keep in mind that valuation is always an issue with this kind of property.
6. A GRUT can be structured to pay a unitrust interest to the grantor and successively to the grantor's spouse if the grantor dies during the fixed term of the trust. However, the spouse's share does not qualify as a qualified unitrust interest and is ignored for purposes of calculating the annuity and remainder interests.

DISADVANTAGES OF A GRUT

1. If the grantor dies during the fixed term of the trust, the full value of the trust assets are included in the grantor's estate.
2. Once the trust term ends, the assets will automatically be transferred to the remainder beneficiaries.
3. If assets in the GRUT do not appreciate in value, the transfer tax leverage of removing the growth on the assets from the grantor's estate is lessened.
4. The gift to the remainderman is a gift of a future interest and does not qualify for the gift tax annual exclusion.
5. The assets in the GRUT must be valued every year.
6. Part of the leverage in the GRUT is lost because a percentage of any appreciation in trust assets is transferred back to the Grantor in the form of higher unitrust payments.