Grantor retained annuity trust (GRAT):

An asset transfer strategy with potential mutual benefits

Elizabeth Anderson, CFP®, CTFA • Senior Analyst
Amy Theisen, CFP® • Senior Strategist
Client Needs Research

Transferring assets to successive generations is often a priority for high-net-worth individuals. One way to do that is through a grantor retained annuity trust (GRAT). A GRAT can be an effective strategy to gift assets to your beneficiaries while maintaining an interest in those assets for a set period.

How does a GRAT work?

A GRAT is an irrevocable trust through which the creator of the trust (otherwise known as the grantor) executes a trust, transfers assets to it and in return receives an annual payment from the trust's assets during its fixed term. The IRS assumes the GRAT's assets will experience a particular rate of return (commonly referred to as the Sec. 7520 rate),* and that amount is included in the annual annuity payment to the grantor. When the trust's term ends, any assets remaining in the trust (above the annuity amount and the IRS presumed return) will transfer to the beneficiaries designated by the grantor in the trust agreement.

*Rate of return calculated and published by the IRS pursuant to Section 7520 of the Internal Revenue Code.

GRATs are sometimes referred to as an estate-freezing technique. That's because your current taxable estate might not decrease with the creation of a GRAT, but it can remove future appreciation from your taxable estate and pass it along to your heirs.

You might want to consider a GRAT if:

- You will likely have an estate above the federal estate and gift tax exemption amount. In 2024, the lifetime federal gift and estate tax exemption is $13.61 million for an individual (indexed annually for inflation) and, if there are no future legislative changes, it will reduce by half in 2026 to roughly $6.5 million – $7 million per person).

 ©2023 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

- You are interested in mitigating future estate tax liability by removing the appreciation of your assets from your taxable estate.
- You have adequate assets for your current and future spending needs.
- You are reasonably confident that any transferred assets have an opportunity to appreciate above the IRS' assumed rate of return.
- You do not mind passing along access and control of some assets to your beneficiaries.

When are GRATs most effective?

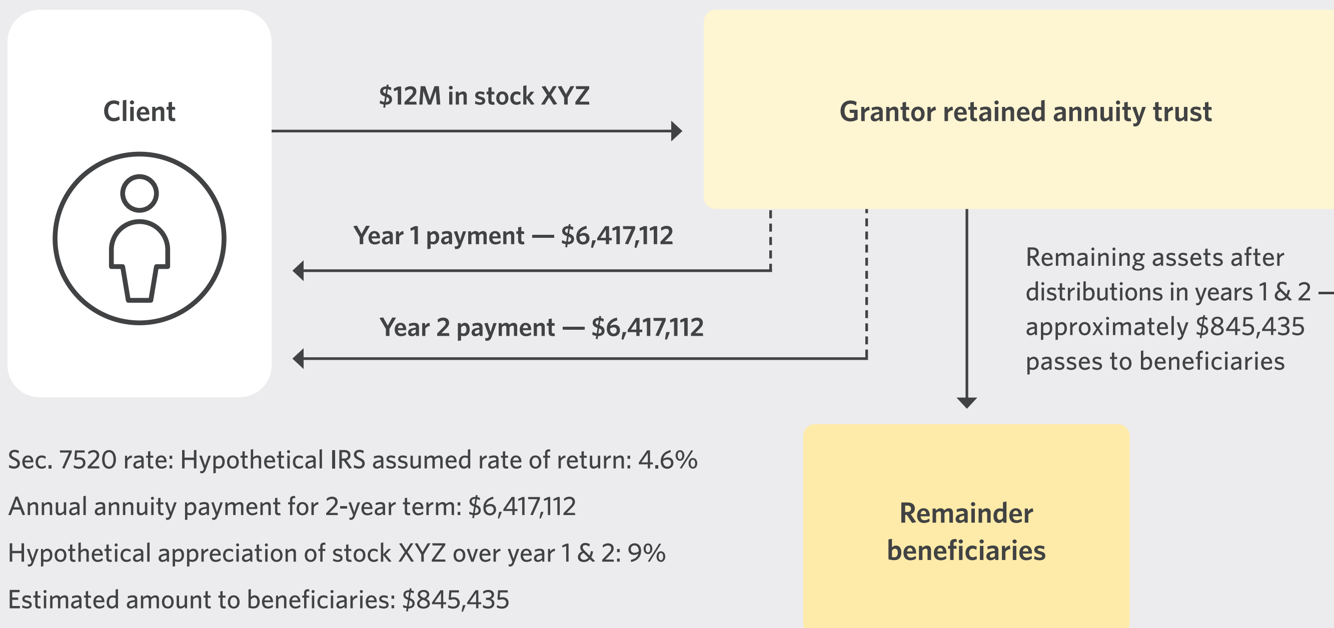
GRATs are generally most popular in low-interest-rate environments but can be beneficial at other times, depending on the potential for asset appreciation. When interest rates are low, GRATs tend to be more attractive, since the corresponding Sec. 7520 rate tends to be low. Asset appreciation above the assumed rate of return will generally remain in the trust for distribution to your beneficiaries.

Special types of GRATs

- A **zeroed-out GRAT** occurs when you create a GRAT in which the value of your annuity payments is equal to the value of the assets transferred to the GRAT (plus the applicable Sec. 7520 rate; hypothetically, we can assume it is 4.6%). As highlighted in the example below, if you transferred $12 million to your two-year GRAT, and your payment for each of the two years was roughly $6 million plus 4.6%, your taxable gift to your beneficiaries would be essentially zero, even though your beneficiaries would receive all assets remaining in the GRAT after the two distributions (generally any growth on the assets above 4.6%).

Creating a zeroed-out GRAT can be particularly helpful if you have little or no remaining lifetime gift and estate tax exemption.

Example of a zeroed-out GRAT



 ©2023 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

- You might use **rolling GRATs** if you have very little need for the assets you transfer to the GRAT and are open to engaging in frequent, ongoing estate planning. If that's the case, you can create a new short-term GRAT after you receive an annual payment from an existing short-term GRAT and transfer the annuity payment to the new GRAT. By continually creating new short-term GRATs from the payments from previous GRATs, you can effectively remove a substantial amount of the appreciation on the GRAT's assets from your taxable estate.
- If you would prefer not to designate a particular dollar amount for the annuity payment of your GRAT, you could choose to create a **grantor retained unitrust (GRUT)**. A GRUT allows you to choose a percentage amount of the assets you will receive with each annual payment. A GRUT's annual payments will fluctuate, depending on the performance of its assets each year during the trust's term.

Key considerations when creating a GRAT

If you're interested in a GRAT, you should work closely with your estate-planning team to evaluate your situation and determine whether a GRAT is appropriate for your goals. If so, it's important to partner with your trusted professionals as you implement the plan. Your CPA or attorney can run scenarios that will illustrate the impact of different-sized transfers, varying asset performance and options for trust length to aid you in choosing the appropriate terms in light of the applicable IRS assumed rate of return. These calculations will also provide insight into the value of the taxable gift (if any), considering your remaining lifetime estate and gift tax exemption.

Long-term or short-term GRAT?

- **Longer-term GRATs** (e.g., 10+ years) run the risk of the death of the grantor. If you pass during the term of your GRAT, all the GRAT's assets will be considered part of your taxable estate, and the beneficiaries of your GRAT will not receive any distributions.
- **Shorter-term GRATs** could be more likely to fail because of either depreciation or slow growth of the GRAT's assets. (Slow growth would be considered growth at a rate lower than the IRS' assumed rate of return.)
- **The failure of a GRAT** does not incur any penalties. Instead, the failure merely results in the loss of the costs of setting up and administering the GRAT (legal fees, tax preparation fees, valuation costs, trustee fees, etc.).

How much should I transfer to a GRAT?

In considering how much to transfer, you should closely review your current and future spending needs as well as your cash flow. You should also consider your anticipated net worth in relation to current and predicted future estate tax exemption amounts. Transferring assets to a GRAT will tie up those assets in an irrevocable trust. Although you will receive annual payments, you cannot take additional distributions if a need (e.g., an emergency) arises before the next payment. In addition, you're removing some of the appreciation on the assets from your taxable estate. That appreciation will never be available to you for any future needs.

 ©2023 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

Which assets should I use to fund a GRAT?

Generally, you would fund a GRAT with assets that have significant potential for appreciation during the GRAT's term. That might mean choosing assets with greater appreciation chances when in a higher-interest-rate environment, because the assumed rate of return will also be higher. The effectiveness of the GRAT depends on the appreciation of its assets being greater than the Sec. 7520 rate. Depreciating assets or assets without much growth are not an effective choice for funding your GRAT. If assets do depreciate or grow slowly, there is no penalty for the ineffective GRAT beyond your costs of establishing and administering it. In the case of an unsuccessful GRAT, where you still believe the assets have an opportunity to appreciate in the future, you might consider using rolling GRATs to remove the future appreciation from your taxable estate.

Keep in mind the ease and costs of valuation when selecting assets. While difficult-to-value assets might have more potential for appreciation, the assets will require annual valuation to properly structure the trust's distributions, which could be difficult or costly.

Transferred assets should be in the grantor's sole name without any restrictions or associated debt. You should also understand that the assets above the rate of return will be irrevocably transferred after the term of the GRAT, meaning you will lose all access to and control of those assets.

Finally, you should think about the liquidity of the assets you do not transfer to the GRAT to ensure your retained assets are adequate and accessible for your spending needs.

Benefits of a GRAT	Trade-offs of a GRAT
Removes appreciation of assets above assumed rate of return from future taxable estate.	Asset depreciation, slow growth or death of grantor can cause the GRAT to fail.
Transfers can be accomplished with reduced or no use of gift tax exemption.	Costs could include legal, accounting, trustee and annual valuation fees. (Costs are incurred without regard to success or failure of the GRAT.)
Grantor receives annuity stream from trust assets.	Grantor loses permanent access to and control of assets above annuity payments.
	There is a need to monitor legislative activity because of recent proposals to eliminate zeroed-out GRATs or require a minimum 10-year term.

GRATs have received attention in recent years because of legislative proposals to change some of the provisions of the Internal Revenue Code related to them.

- One of these proposals suggested creating a minimum term for GRATs. (Most of the proposed legislation suggested 10 years.) Increasing the minimum trust term would increase the chances a GRAT will fail because of the grantor's death.
- Another suggestion was a requirement that the remaining interest be greater than zero, effectively limiting zeroed-out GRATs.

Although there have been proposals regarding GRAT requirements for more than 10 years, it's important to note that none of the proposed changes to the rules surrounding GRATs have been enacted.

This content should not be depended upon for other than broadly informational purposes. Specific questions should be referred to a qualified estate-planning professional. Edward Jones, its employees and financial advisors cannot provide tax or legal advice. You should consult your attorney or qualified tax advisor regarding your situation.

 RES-16863A-A EXP 31 MAR 2025 ©2023 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD