Grantor Retained Annuity Trust (GRAT) & Retained Unitrust (GRUT)

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GRATs and GRUTs have much in common with the qualified personal residence trust. The main difference is that a GRAT or GRUT lets you transfer any asset (not just your home) out of your taxable estate. And, with a GRAT or GRUT, you receive an income, instead of continuing to live in your home, for a set number of years.

When you set up a GRAT or GRUT, you transfer an income-producing asset (like a family business, stocks or real estate) into an irrevocable trust for a set number of years. During this time, the trust pays you an income.

If the income you receive is a set dollar amount and does not fluctuate each year, the trust is a GRAT (Grantor Retained Annuity Trust). If the income is a percentage of the trust assets and the amount of income you receive fluctuates each year, the trust is a GRUT (Grantor Retained UniTrust).

At the end of the trust term, the asset will be owned by the beneficiaries of the trust (usually your children) and will not be included in your estate when you die. However, depending on the duration of the trust, if you die before the trust term is over, some or all of the asset may be taxed as part of your estate.

Like the qualified personal residence trust, the beneficiaries will not receive the asset until sometime in the future (when the trust term is over). So the value of the gift you are making (transferring the asset to the trust is considered a gift) is reduced. This uses less of your federal gift and estate tax exemptions than if you had kept the asset (and any future appreciation) in your estate.

A GRAT or GRUT can be a great way to save estate taxes by transferring an asset (especially a business) and any future appreciation, to your children at a discounted value, especially if you want (or need) the income.

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