



**National Association of  
Estate Planners & Councils  
& The NAEPC Foundation**

**46<sup>th</sup> Annual Conference  
Amelia Island, Florida**

**Edward F. Koren  
Holland & Knight LLP  
November 13, 2009**

**Holland & Knight**

**Exit Strategies From Leveraged  
Gifting Transactions**

**(with particular emphasis on GRATS)**

**You Got Me Into This, Now How Do I Get Out?**

# Value Shifting Techniques

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- GRATs
- QPRTs
- IDITs

# Success Requires

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- Highly Appreciating Assets
- Grantor's Survival

But what if either expectation falters?

- Or if the technique works too well?

# Grantor Retained Annuity Trusts (GRAT)

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Shifting Future Appreciation with Minimal Tax Costs

# Grantor Retained Annuity Trust (GRAT)

## Step One



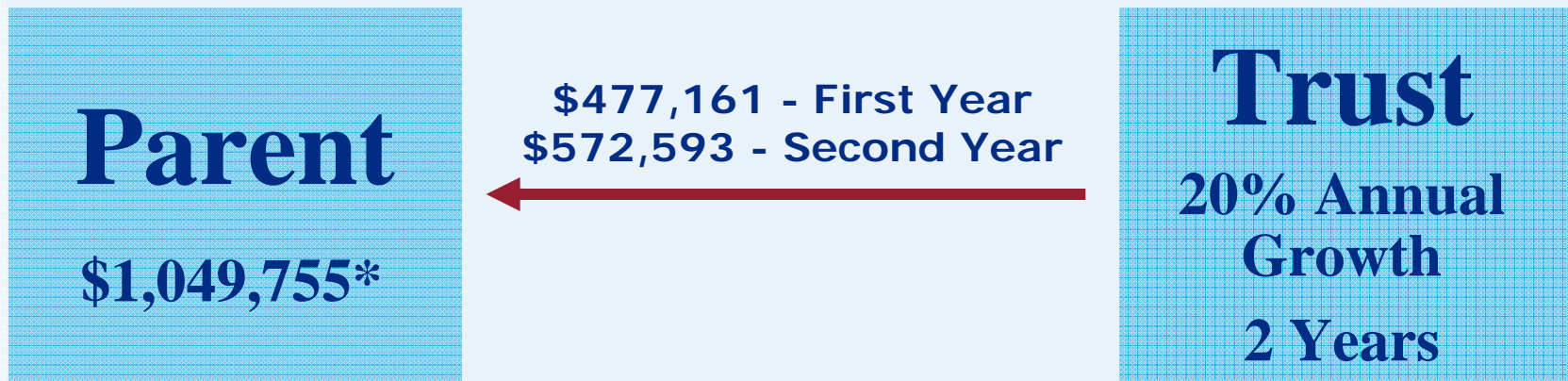
**Step One** →

**Parent gifts appreciating asset to  
GRAT**

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# Grantor Retained Annuity Trust (GRAT)

## Step Two



**Step Two** → **GRAT Trustee pays annual annuity**

\*Value returned to Grantor assuming 3.2% 7520 rate as of October, 2009

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# Grantor Retained Annuity Trust (GRAT)

## Step Three

**Parent**

**\$1,049,755**



**Amount Transferred  
Value of Annuity**

**\$1,000,000.00  
(988,964.00)**

**Value of Remainder (gift)**

**\$11,035.70\***

**Trust**

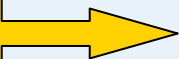
**20% Annual  
Growth 2 Years**



**Child/Trust**

**\$294,813**

**Step Three**



**GRAT terminates  
Remaining assets to Child/Trust**

**\* Less than \$1 if use Walton**

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# Planning Points

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- Can't use for GST (w/o other planning)
- Can't Use Note, etc. (Reg S25.2702-3(b)(i))
- Commutation prohibited
- Can increase annuity 20% annually
- Must pay annually
  - Fiscal year
  - Calendar by April 15th

# Economic Schedule Fiscal Year

<u>Year</u>	<u>Beginning Principal</u>	<u>20.00% Growth</u>	<u>0.00% Ann. Income</u>	<u>Annual Payment</u>	<u>Remainder</u>
1	<b>\$1,000,000</b>	\$200,000	\$0	\$ 477,161	\$722,839
2	<u>\$ 705,702</u>	<u>\$141,140</u>	<u>\$0</u>	<u>\$ 572,593</u>	<u>\$294,813</u>
Summary	\$1,000,000	\$341,140	\$0	\$1,049,754	<b>\$294,813</b>

# Annual Payment Calendar Year

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<u>Period</u>	<u>Payment</u>
12/1 – 12/31/01	\$ 39,763
1/1 – 12/31/02	\$ 437,398
	<u>\$ 47,716</u>
	\$ 485,114
1/1 – 11/30/03	<u>\$ 524,877</u>
<b>TOTAL</b>	<b>\$1,049,754</b>

# Major Benefits

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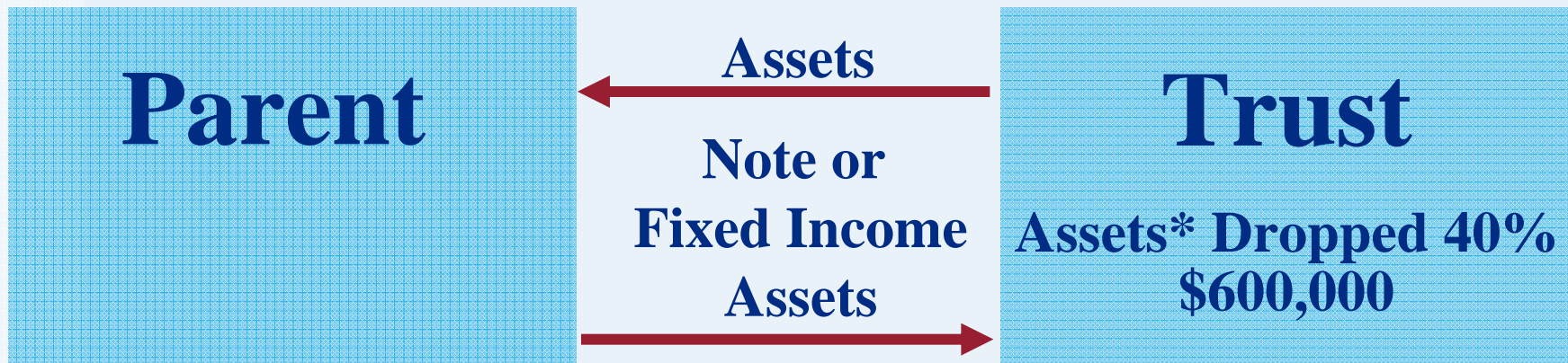
- Can Use Hard-to-Value Assets
- Can minimize gift
  - Significantly (Cook)  
(But new Regs say otherwise)
  - Or a lot! (Walton)
- Greater appreciation provides greater benefit

# What if Little (Or No) Appreciation?

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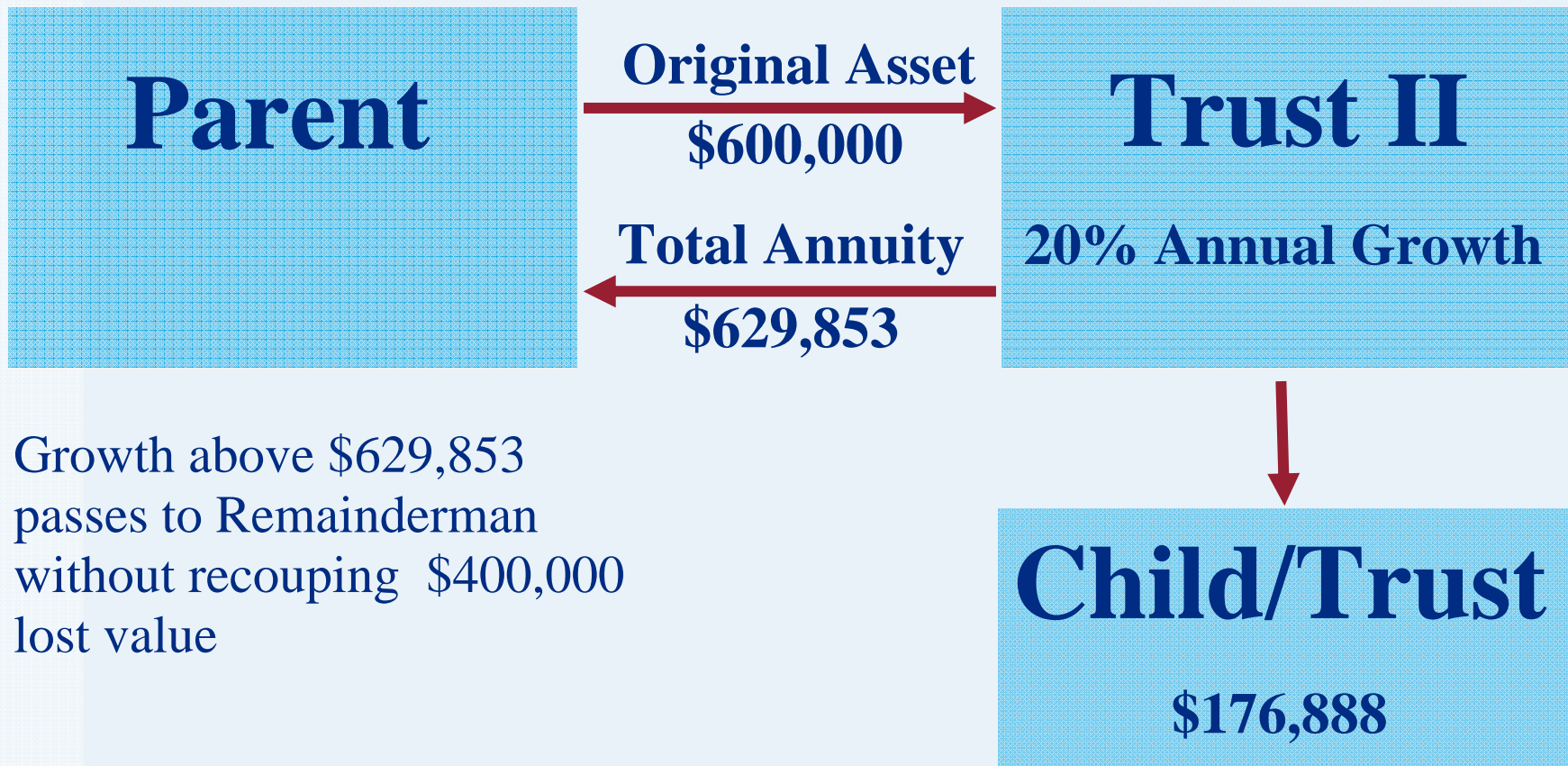
- Limited “Bailout” by paying annuity ASAP
  - Can sell assets and reinvest
  - Create GRAT at lower value
  - Use “GAP GRAT” Approach
  
- Increase performance
  - By selling and reinvesting
  - By non grantor loans and cash payouts

# Sell or Substitute Assets



*\* Original value \$1,000,000*

# RE GRAT

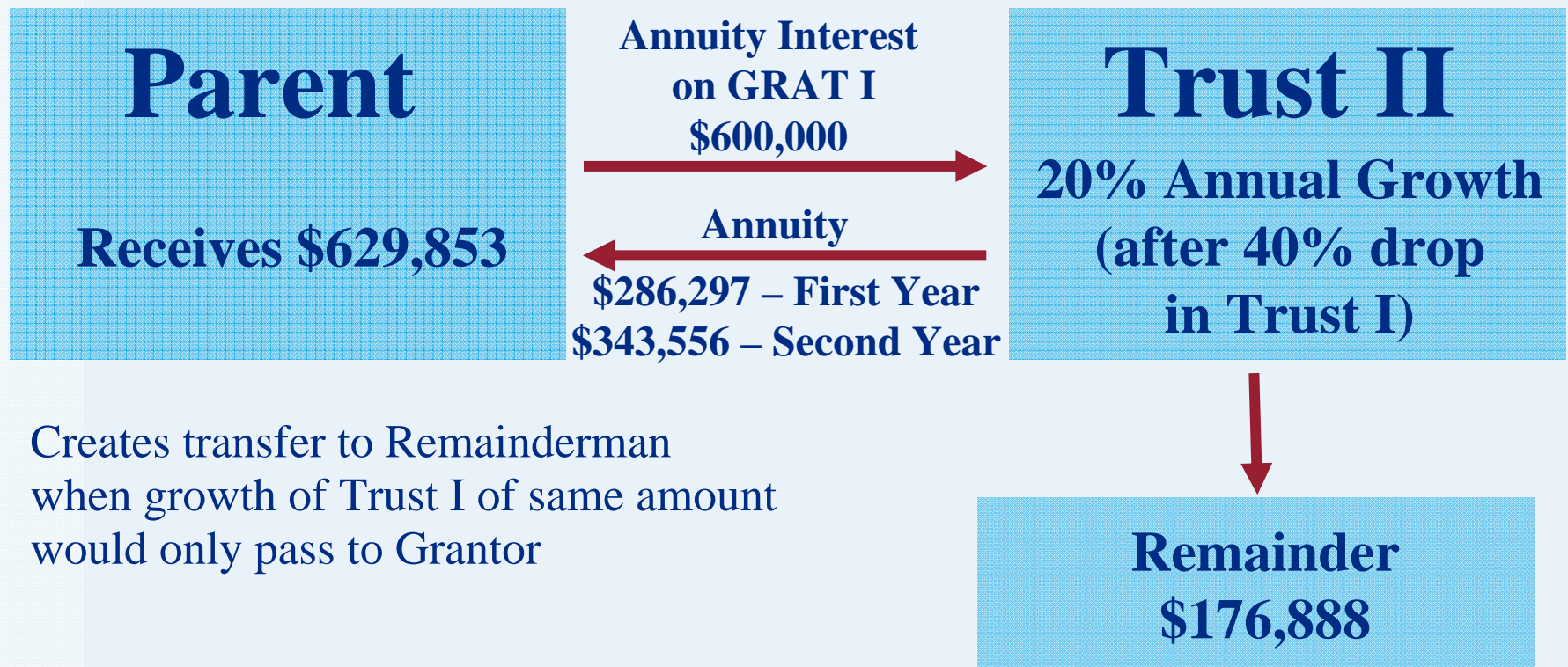


# Concerns

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- Insufficient assets to make swap
- Potential incorrect valuation of GRAT I assets
- Possible Section 16(b) securities concerns for insider

# “GAP GRAT”



# “GAP GRAT” CONCERNS

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- Valuation – value of GRAT I annuity should not exceed value of assets. Reg §25, 752D-3(b)(2)
- Assignment of GRAT I payments okay if no spendthrift clause in GRAT I.

# What If Too much Appreciation?

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- Sell and reinvest (including to Grantor)
- Also pay amounts ASAP
- Or determine in advance and cap amount to Remainderman

# What if Grantor's Death is Imminent?

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- Sell and reinvest
- Pay annuity in cash
- Limited benefit of transfer of retained interest
- But what of purchase of remainder?

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**Qualified Personal Residence  
Trust (QPRT)  
GRAT for the Personal Residence**

# What if Appreciation Limited?

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- Unlike GRAT, still some benefit, although gift taxes paid may be greater than benefit
- Could acquire new residence with greater appreciation potential
- Sell and convert to GRAT
- Sell and collapse QPRT

# What if Grantor's Death is Imminent?

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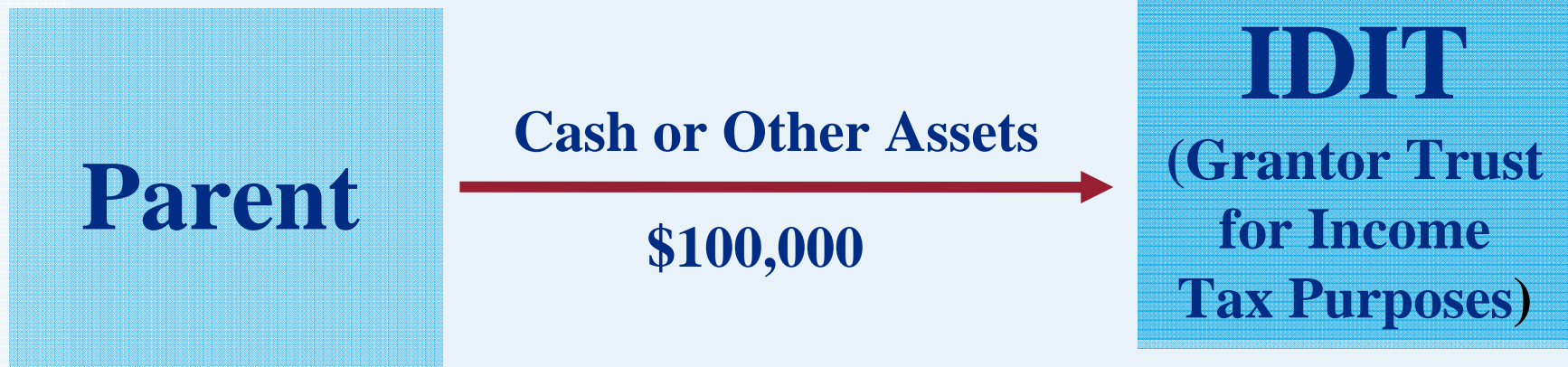
- Swap residences
- Sell and convert to GRAT with cash
- Sell residence to beneficiaries
- But can't purchase remainder

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**Intentionally Defective  
Irrevocable Trust (IDIT)  
A GRAT Alternative**

# Intentionally Defective Irrevocable Trust (IDIT)

## Step One



# Intentionally Defective Irrevocable Trust (IDIT)

## Step Two



### Step Two

- Asset sold to IDIT
- No income tax consequences
- IDIT trustee pays for asset with installment note

# Intentionally Defective Irrevocable Trust (IDIT)

## Step Three

**Parent**

Note Payments\*

\$455,069 (2 yrs)\*\*

or

\$ 66,811 (20 yrs)

**IDIT**  
(Grantor Trust  
for Income  
Tax Purposes)

**Step Three**

- IDIT trustee pays note payments with income from asset
- Parent pays all taxes on income
- Sometimes use balloon note; consider using death-terminating note (Moss v. Comm.)
- October, 2009 short term rate 0.75%; long term rate 4.1%

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# Intentionally Defective Irrevocable Trust (IDIT) Summary

**Parent**

**\$910,138**

Income Tax on Dividends Only

**IRS**

**Caution**

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**IDIT**  
(Grantor Trust for Income Tax Purposes)

Remaining Dividends (Tax-Free)  
Plus All Stock Appreciation

**Children/  
Grandchildren**  
**\$438,848\***

*If parent dies before note paid in full, possible income tax consequences.*

*\* If 2 year note; \$25,864,713 if 20 year note*

# Comparison of GRATs and IDITs

Attribute	GRAT	IDIT
Payout (of midterm rate; 3-9 years)	120%	100%
*Term	At Least 2 Yrs. Fixed	Flexible
Mortality Risk	Must Survive	Flexible
Tax Questions		
*Statutory Authority	Direct	Indirect
Amount of Spousal Gift	Uncertain	N/A
*(Additional Taxable Transfer)	None	10-15% Taxable Gift
Valuation	Minimal Risk	High Risk
Income Tax/Capital Gains		
Lifetime	Some	Some
Death	None	Possible (20% Rate (Madorian))

## Comparison of GRATS and IDITS (cont'd)

Attribute	GRAT	IDIT
GST	Children Only	Grandchild can Be Beneficiary
Taxability of Trust in Estate	Yes	Probably Not (Installment Note Included)
Transfer to Younger Generation	Less	More

# Effect of Lower Appreciation

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- With lower interest rate, less appreciation needed
- But if “Underwater” then gifted “Seed Money” could return to Grantor
- Can minimize risk by providing longer term

# If Appreciation Is Limited?

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- Can sell and convert
  - If third party, Grantor pays capital gain
  - Not if to Grantor
- Can convert note to SCIN (DTIN)

# What if Grantor's Death Is Imminent?

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- If SCIN, then...
- If not, balance in gross estate
- Prepay to fund annual exclusion gifts
- Swap note for other assets

# Alternate Valuation Date (“AVD”)

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Terms of Will/Trust

- Marital Formula Gift
- Residuary Credit Shelter

Date of Death Value – \$10M

AVD Value – \$6M

# Disclaimer Impact Fractional Marital No Disclaimer

Marital Share  
\$6M

Credit Shelter  
0

## \$1,000 Disclaimer and AVD Election

Marital Share  
\$2,499,000

Credit Shelter

Credit Shelter Amount	\$3,500,000
Disclaimed Amount	1,000
Estate Taxes	<u>(450)</u>
Net	\$3,500,550

# Disclaimer Impact Fractional Marital No Disclaimer

Marital Share  
\$3,900,000

Credit Shelter  
\$2,100,000

## \$1,000 Disclaimer and AVD Election

Marital Share  
\$2,499,000

Credit Shelter  
Credit Shelter Amount \$3,500,000  
Disclaimed Amount 1,000  
Estate Taxes (450)  
Net \$3,500,550



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