Life Insurance: Your Blueprint for Wealth Transfer Planning

Grantor Retained Annuity Trusts and Installment Sales to Grantor Trusts

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Grantor Retained Annuity Trusts and Installment Sales to Grantor Trusts

Grantor Retained Annuity Trusts (GRAT) and Installment Sales to grantor trusts can be effective tools for leveraging the future growth of assets to create transfer tax savings through an "estate freeze." These techniques can be used alone or as exit strategies in conjunction with a premium financing or loan arrangement.

GRATs and Installment Sales are similar concepts

Both techniques rely on the creation of a grantor trust, also referred to as an "intentionally defective grantor trust," to receive assets in exchange for an income stream—structured alternatively as an annuity (GRAT) or as a loan with principal and income payments (Installment Sale).

In each case, the value of the income stream is set at a level that will not result in gift taxes. While the income stream comes back into the grantor's estate, any appreciation in the assets in excess of the amount used by the IRS to measure the initial value of the income stream has been transferred to the trust free of any estate or gift taxes. Because these assets end up inside the trust, both techniques can be good "exit strategies" for individuals purchasing life insurance with borrowed premiums.

Advantages of GRATs and Installment Sales

GRAT

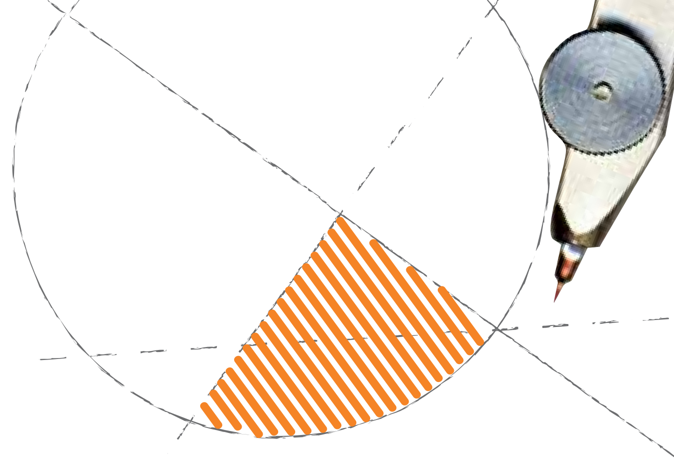
- Provides an opportunity to "freeze" estate values—assets that are expected to produce income and/or greatly increase in value can be removed from an individual's estate (provided the individual survives the term) based on today's values.
- No need to pre-fund trust with "seed" money.
- Provides flexibility for hard-to-value assets since payment stream is defined as a percentage of assets contributed to the trust.
- Because the trust is set up as a grantor trust, there are no income tax consequences to the sale of assets to the trust. Moreover, the grantor can make further tax-free gifts to the trust beneficiaries by paying income taxes for the trust and thus preserving the trust asset values.

Installment Sale

- Provides an opportunity to "freeze" estate values—assets which are expected to produce income and/or greatly increase in value can be removed from an individual's estate based on today's values.
- The income stream can be structured flexibly—payments can be set for a term of years or structured as interest-only payments with a balloon payment.
- There is no risk of estate inclusion if the grantor dies prior to the end of the term of the Installment Sale. Only the value of the promissory note is included in the grantor's estate.
- Because the trust is set up as a grantor trust, there are no income tax consequences to the sale of assets to the trust. Moreover, the grantor can make further tax-free gifts to the trust beneficiaries by paying income taxes for the trust and preserving the trust asset values.

A Case Study:

The Jones Family Plan



Client: John and Jane Jones

Age: 55

$2 million in shares of ABC Corporation

Problem:

John and Jane Jones want to transfer their shares in the ABC Corporation to their children free of gift and estate taxes. They are especially concerned about getting the rapid growth of these shares (projected at 15 % per year) outside of their estates.

Solution:

After a discussion with Mr. and Mrs. Jones, their advisor recommended they consider using either a GRAT or an Installment Sale as an "estate freeze" technique. Here's how each works:

GRAT

- John and Jane transfer $2 million of ABC shares to their grantor trust in exchange for an annuity stream of 12.45% per year over 10 years.
- The trust pays the Jones $249,000 per year for 10 years.
- At the end of 10 years, the trust holds $3,150,982 in ABC shares outside of the estate. No lifetime gift exemptions were used.

Installment Sale

- John and Jane gift $200,000 worth of ABC shares to their grantor trust.
- John and Jane sell their remaining shares (worth $1.8 million) to their grantor trust in exchange for a note requiring payments of principal and interest over 10 years at 4.68% interest rate.
- The trust pays the Jones $229,500 per year for 10 years.
- At the end of 10 years, the trust holds $3,431,420 in ABC shares outside of the Jones' estate. John and Jane have each used $100,000 of their lifetime gift exemptions.

Comparison of Techniques:

	GRAT	Installment Sale
Payments required?	Yes	No. Can make balloon payment at end
Able to "zero-out"?	Yes	Yes, except for down payment, if any
Need seed money?	No	Probably yes
Able to unwind transaction?	No	Yes, can prepay
Survival required for future growth to escape estate tax?	Yes	No
GST exemption available?	No	Yes
Can make future transfers?	No	No
Double income tax?	No	No

Note:
The hypothetical investment results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required.

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