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# Have Your Cake, Eat It and Leave Some for the Next Guy

## Strategies for Maximizing Gifts to Your Heirs

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In the world of financial planning, few things are “no-brainers.” Most approaches have obvious major drawbacks or contingencies. However, there’s one strategy that we have found consistently useful. If you want to ensure that your heirs get the maximum benefit from an asset – such as a marketable security or real estate – you intend to leave them, you might consider forming a Grantor Retained Annuity Trust (GRAT) or a similar instrument.

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### THE LOST VALUE PROBLEM

Many of my clients worry that their heirs will not be able to maintain or keep a particular asset due to taxes. This often comes up when the asset is an unexpected windfall. In one case, a client had inherited a valuable piece of real estate and wanted to ensure that her daughter was able to keep it and enjoy the income from it. In other cases, long-held stocks in private companies can dramatically increase in value when the stock goes public.

In such cases, the tax burden can be crushing on the heirs and can often force the sale of the asset, which is not what you intended at all. An asset that could have provided significant benefits for your heirs suddenly becomes an administrative burden and a financial drain.

### PROTECT AND PRESERVE

By putting your asset into a GRAT or similar irrevocable trust, you can continue

to enjoy the benefits of use or income from the asset and the asset will continue to appreciate normally. The trust is established for a period of years, normally five to ten. The trust pays you an annuity, which is typically calculated to draw down the appreciation.

You pay the gift tax up front on the determined present value of the remainder of the trust when it ends. This is calculated using an assumed rate of return established by the IRS (hurdle rate or 7520 rate). For fast-growing assets, this rate is normally considerably below the actual growth rate, but you still get credit for creating a “zeroed out” trust if you do this properly.

There is one small hitch: you have to outlive the period of the trust. Otherwise, the total asset goes into your estate and is taxed accordingly. But even this just leaves you where you started, minus some negligible transaction costs.

## LIKELY SUSPECTS

How can you tell what would make a good candidate for a GRAT? There are two issues you should examine: the grantor and the assets.

Several asset classes that are expected to appreciate in value typically are good candidates for GRATs, including hedge funds, private equity, real estate and stocks. The more the asset is likely to appreciate in value, the more significant the benefit from creating a GRAT.

We typically create GRATs or similar trusts for people aged 50 and older, although we typically do not recommend them for very old people. For younger people, it is sometimes advisable to create a rolling GRAT that renews periodically, leaving the asset in the trust's name – and assigning the appreciation to the trust creator.

## RUNNING THE NUMBERS

How does this really work? A recent article in *The Wall Street Journal* cited the following example:

- ❖ A person puts assets worth \$1 million into a GRAT with a term of five years.
- ❖ She chooses a 23.6% annuity, which gives her an annuity payment of \$236,106 over the term of the trust.
- ❖ Regular and capital gains tax are paid each year by the person establishing the trust.
- ❖ At the conclusion of the five years, the assets are transferred to her designee.
- ❖ Gift tax on the \$236,106 is avoided.
- ❖ 2007.

## VARIANTS

There are several variants of the GRAT intended to accomplish essentially the same thing. Most of them are known by equally unappealing acronyms:

- ❖ **GRIT:** grantor retained income trust.
- ❖ **GRUT:** grantor retained unitrust.
- ❖ **CRAT:** charitable remainder annuity trust.
- ❖ **QPRT:** qualified personal residence trust.

The exact form of trust you use depends on your assets and your goals for them.

## THE BOTTOM LINE

If you are at all concerned about making sure your heirs get the maximum value from a rapidly-appreciating asset, a GRAT or variant makes good sense. There is virtually no downside; if the you fail to outlive the term of the trust, the asset reverts to your estate and is taxed accordingly. The only thing you lose is the fees your accountant and attorney will charge to set up the trust and make the requisite annual filings. If everything works according to plan, you will have paid no more taxes than usual, your heirs will save tens of thousands of dollars in gift taxes and the asset will be delivered to them whole and unencumbered.

If you would like to discuss this or other multi-generational wealth preservation strategies, please call me at 212.382.0404.



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