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GRANTOR RETAINED ANNUITY TRUST

CAUTION:

The purposes of this memorandum are to assist the client and the trustee of a grantor retained annuity trust ("GRAT") in:

1. Creating the GRAT and transferring assets to the trust;
2. Maintaining records for the trust; and
3. Filing any required tax returns.

This memorandum can only provide *general* information, and does not address any client's specific situation.

INTRODUCTION

This memorandum discusses the documents that are required to create an irrevocable trust. The most important of those documents is the trust agreement, but there are other documents that must be signed and filed. The purpose of a GRAT is usually to own property for the benefit of the grantor, his or her descendants and other beneficiaries, and to remove the trust property from the grantor's

taxable estate. To obtain this estate tax advantage, there are a number of formalities that must be observed, both in the creation of the trust and in the continuing administration of the trust.

Trust Agreement

A separate summary is often prepared outlining the terms of a particular GRAT trust agreement. In general, the agreement tells the trustee how to administer the trust property. The grantor cannot change the trust or any of its terms after it is executed and funded. It must be *irrevocable* in order to give the grantor the advantage of not having the property transferred to the trust taxed in the grantor's estate at death, assuming that the grantor lives beyond the annuity term.

Trust Registration Statement

Because the trust is irrevocable, the trustee is required under Colorado law to register the trust with the district court of the county in which the "principal place of administration" is located. The principal place of administration is where the trustee usually keeps the records pertaining to the trust, such as the trustee's usual place of business or the trustee's residence. The purposes of the trust registration statement are to give the current beneficiaries notice of the creation of the trust, and to establish the court that has jurisdiction to hear any dispute concerning the trust. The filing fee is \$126.

If the trust is not administered in Colorado, this form will not be used, and the law of the state where the trustee is located will control any registration requirements.

Taxpayer Identification Number

Because the trust should be considered a "grantor trust" under the IRS rules, the grantor's social security number can be used as the taxpayer identification number for the trust during the grantor's lifetime. The grantor should sign an IRS form W-9 to give his or her social security number to the trustee. The grantor's social security number should be used for any separate bank or investment accounts opened in the name of the trust. All income received by the trust and deductible expenses paid by the trust will be reported by the grantor on his or her individual Form 1040. The trustee is required to give the grantor a statement of income and expenses each year so that the grantor can prepare his or her returns.

Transfer of Property to the Trust, and Acquisition of Property by the Trust

In general, the grantor should use this format for titling assets in the name of the GRAT:

The _____ [name of your trust], dated _____.

No property may be transferred to a GRAT after the initial funding. Thus, the following discussion applies primarily to the initial transfer of property to the GRAT.

Identification of Trustees

When the trustee acquires or sells property in the name of the trust, he may be asked to provide evidence of who the trustees are, and who can sign for the trust. The grantor or the trustee may, of course, provide a copy of the trust agreement to show that information. However, the grantor may not want the trustee to disclose the entire trust agreement.

Usually an institution such as a bank or brokerage house will be satisfied with simply receiving copies of the first page and signature pages of the trust agreement, rather than the whole document. Alternatively, a copy of the Statement of Authority may be provided, discussed below under "real estate."

Real Estate

Real estate can generally be transferred to the trust by signing and recording a deed. Colorado law allows real property to be titled in the name of the trust itself (without naming the trustee in the deed), so long as a Statement of Authority is also recorded in the real estate records to show the identity of the trustee(s). If there is a change of trustees, a new Statement of Authority should be recorded to reflect the change before the property is conveyed by the trustee.

Before any real estate is transferred to the GRAT, there are several special issues that should be considered:

- ◆ If the real estate is subject to any debt (that is, if there is a deed of trust or mortgage against the property), the note and deed of trust or mortgage documents should be checked to see whether there are any restrictions on transferring the property. Those documents may contain a “due on transfer” clause, allowing the lender to accelerate the balance due on the loan if the grantor transfers the property. In such a case, the grantor should ask the lender if it will waive its right to accelerate the loan with respect to the transfer to the GRAT. If a waiver is obtained, be sure it is in writing.
- ◆ If real estate located in a state other than Colorado is transferred to the trust, the grantor will have to comply with the real estate laws of the state where the property is located. An attorney in that state should be contacted.

Stocks and Bonds

Stocks and Bonds Held in Brokerage Accounts to Be Transferred to Trust

If the grantor has stocks or bonds that are not registered directly in his or her name, but are held for the grantor by a brokerage firm (sometimes called a “street name account”), it is not necessary to transfer the individual stocks or bonds into the trust. Instead, the brokerage account will be transferred to the trust. The broker will have his or her firm’s forms to title the account in the name of the trust.

Registered Stocks or Bonds

If the grantor deals regularly with a stock broker, he or she should be able to help the grantor handle the paper work to transfer stocks or bonds that are registered in the grantor’s name in certificate form into the name of the GRAT.

For publicly traded stocks or bonds, the grantor’s signature on the assignments will need to be guaranteed. A bank or brokerage firm can usually guarantee a signature, but sometimes there are limits on value. A signature guarantee is not the same as a notary statement.

There may be buy-sell agreements or other restrictions on the grantor’s right to transfer stocks or bonds, especially if the company is “closely held.” If there are restrictions, it is often possible to obtain a waiver for a transfer to a GRAT.

Gift (and Generation-Skipping) Tax Considerations

Before transferring property to the trust, the grantor must determine the value of the property. Because the trust is irrevocable, any property transferred to the trust is usually treated as a completed gift (depending on the trust terms), minus the retained interest. IRS tables are used to determine the value of the gifted remainder interest, as opposed to the annuity interest retained by the grantor.

A gift tax return must be filed for each calendar year in which a gift is made. The gift tax return is made on IRS Form 709, is filed with the Internal Revenue Service, and is due by April 15 of the year following the calendar year in which the gift is made. Therefore, you need to file a gift tax return for the year in which the GRAT is funded. Any extensions of the grantor's individual income tax return (IRS Form 1040) will also automatically extend the due date for the 709.

Generation-skipping tax exemption can only be allocated to a GRAT upon the termination of the initial trust term, and not on the gift tax return reporting the gift of property to the trust. Generally, generation-skipping involves providing benefits to persons who are two or more generations younger than the grantor, such as grandchildren. If the remainder beneficiaries include grandchildren, then, when the annuity term ends, the grantor should consider whether the GST exemption should be allocated at that time on a gift tax return filed for the year in which the annuity term ends.



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