



CAN AN INTEREST IN A CLOSELY HELD BUSINESS BE TRANSFERRED TO A GRAT?

Yes. The GRAT can be an effective method of “freezing” the value of the business. It can also minimize any risk from a valuation of the business interest transferred to the GRAT that is challenged by the IRS. For example, if a 55 year-old business owner’s interest in his business is valued at the amount of the owner’s remaining gift tax exemption (assume \$5,000,000), the business owner may be able to make an outright gift of the interest to his children and avoid gift tax by using his lifetime exemption. But if the value of the interest is doubled (\$10,000,000) upon audit of the business owner’s gift tax return, gift tax will be due equal to the gift tax rate multiplied by the amount of the gift that exceeds the business owner’s remaining gift tax exemption (in our example, the additional gift tax would be \$2,000,000). If the interest is instead transferred to a “zeroed-out” GRAT to pay him for 20 years an annuity equal to 7.6211% of the initial value of the property contributed to the trust (\$762,113), then assuming an IRS interest rate of 4.4%, the value of the taxable gift will be \$10.48. If the value of the business interest is increased upon audit by the IRS, the annuity payments required to be paid to the Donor would increase, but there would be no appreciable increase to the taxable gift. That being said, because there is an absolute obligation to make the annuity payment every year, it is important to fund the GRAT in a manner that will preserve the ability to make these payments.. In other words, funding a GRAT with illiquid or difficult to value assets will be more complicated.