The Effective Use of GRITs To Reduce the Gross Estate

By LOUIS S. HARRISON

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According to the author, the grantor retained income trust, if properly drafted, remains a viable approach to reducing estate taxes. He discusses how the practitioner may use GRITs in a number of different situations.

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The Elements of a Grantor Retained Income Trust and Its Estate and Gift Tax Consequences

A grantor retained income trust (GRIT) is an irrevocable trust established by the grantor (the "contributor" of funds to the trust) in which the grantor retains the right to the income from the trust for a term of years (or for a period ending on the first to occur of the grantor's death or the expiration of the term of years). At the expiration of this term, the funds are then distributed outright or continue to be held in trust for the named beneficiaries (designated by the grantor at the establishment of the trust). If the grantor dies prior to the expiration of the grantor's income interest, the funds may revert to the grantor's estate or be subject to a general power of appointment held by the grantor.[1]

Because the trust is irrevocable and the grantor retains no right to alter the terms of the trust, the transfer of funds to the trust is a com-

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[1] See infra regarding Section 2036(c) and retained reversions and general powers of appointment.

pleted gift.[2] The value of this gift for gift tax purposes is the value of the property transferred minus the value of the grantor's retained interests (i. e., the grantor cannot make a taxable gift to himself or herself).[3] The grantor's retained interests are the right to receive the income for a certain number of years (or for a period ending on the first to occur of the grantor's death or the expiration of the term of years) and a reversion of or general power of appointment over the property if the grantor dies prior to the expiration of that certain number of years. Both interests are valued pursuant to Reg. § 25.2512-5 and Section 7520 of the Internal Revenue Code. The greater the number of years of the retained income interest, the greater the value of the grantor's retained interests and the lesser the value of the taxable gift.

> *Example (1). A,* age 60, transfers $1,000,000 to an irrevocable trust in which he retains the income interest for five years. *A*'s brother, *B,* is the trustee. During the month of transfer, the federal midterm rate is 6.2 percent. What is the gift consequence to *A*? How about if *A* retained an income interest for 10 years?
>
> The gift consequences to *A* are calculated assuming an interest rate equal to 120 percent of the federal midterm rate in effect during the month of the transfer.[4] Using IRS Publication 1457,[5] the value of an income interest for five years under an assumed interest rate of 8.2 percent equals .325684 of the property transferred,[6] or $325,684. The value of an income interest for 10 years under the same assumption equals $545,297.[7] Hence, the value of the gift in the first situation equals $1,000,000 − $325,684 (the retained interest), or $674,316; the value of the gift in the second situation equals $1,000,000 − $545,297 (the retained interest), or $454,703.

If the grantor survives the term of years during which he or she has the income interest, the remaining property in the trust passes to the beneficiaries, free of additional gift or estate tax cost.[8] The only estate or gift tax cost is the gift tax at the time the trust was established.[9] If the grantor dies prior to the expiration of his or her income interest, all of the property is included in the grantor's gross estate pursuant to Section 2036(a) since the transfer was initially a transfer with a retained income interest.[10]

Estate and Gift Tax Savings

The reduction in estate and gift taxes associated with a GRIT can be mathematically traced to four sources:

(1) An assumed interest rate which may be greater than the actual inflationary/interest rate;

(2) A discount in the value of the remainder to account for the risk that the property may not vest in the remainderman (e. g., if the grantor's reversion were to occur);

(3) The transfer of potential appreciation; and

(4) The payment of gift tax.

Assumed Rates for Gift Tax Purposes. First, the initial gift is calculated under an assumed interest rate to determine the discounted present value of the remainder interest for gift tax purposes.[11] For example, if the grantor retains an income interest for five years, the gift issue focuses on the present worth of the dollars transferred which are not to be received until five years in the future (under an assumed interest rate). If the assumed interest rate is greater than the actual interest rate experienced during those five years, then the gift tax value will be less than the actual value of the remainder interest transferred.

> *Example (2).* The present worth of $1 to be received five years in the future during a period of interest at *X* percent can be calculated by the following algebraic formula: 1/(1 + .X)5. If the assumed interest rate pursuant to Section 7520 is 10.20 percent, whereas the actual, average interest rate

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[2] Reg. § 25.2511-2.

[3] For gift tax purposes, a gift is technically incomplete as to that portion of the interest transferred which is retained by the grantor. Id.; see also Reg. § 25.2511-1(e) and Reg. § 25.2511-1(h)(7).

[4] IRC Sec. 7520.

[5] Alternatively, the income interest can be derived by using the following formula: $1 - 1/(1 + x)t$, where x equals the interest rate and t equals the number of years the income interest is retained.

[6] See IRS Publication 1457, p. 3-16, col. 3.

[7] Id.

[8] But see Section 2036(c) and the discussion infra beginning at note 24.

[9] Technically, the gift is of the remainder interest, which is a future interest. Therefore, the gift does not qualify for the gift tax annual exclusion. IRC Sec. 2503(b).

[10] Note that there is no three-year rule pursuant to Section 2035 of the Code when the grantor's income interest expires. This is because there is no "transfer" at that time; it is merely treated as a "lapse."

[11] Reg. § 25.2512-5.

experienced during those five years is 8.20 percent, then the following results occur: (1) The value for gift tax purposes of the remainder interest transferred equals .6153 of the value of the interest transferred; (2) The actual value of the remainder interest to the beneficiaries equals .6743 of the value of the interest transferred; and (3) The tax savings equals .0590 of the interest transferred. If $2,000,000 were transferred, $118,000 would have passed free of gift tax.

This is a fair result from a tax policy perspective. The potential for abuse is small, as illustrated by the above calculations. Moreover, there is a risk that the actual interest rate will be greater on average than the assumed rate. In that instance the grantor would have owed a gift tax on more property than was actually transferred.

Risk That Remainder Will Not Vest in Third Parties but Will Return to or Be Subject to a Power Held by the Grantor. The gift tax value will be further reduced if in addition to retaining an income interest for a term of years, the grantor retains a reversion in or general power of appointment over the property if he or she dies prior to the expiration of the term of years (i. e., the property will return to the grantor's probate estate or be subject to a power held by the grantor).

Example (3). Assume the grantor, age 75, transfers $1,000,000 to a trust in which he retains the income interest for five years. If he dies prior to the end of this term, the remaining income for the five-year term continues to be paid to his probate estate. Compare the value of the remainder interest in this instance (at an assumed interest rate equal to 8.2 percent), which is $674,316, with the value of the remainder interest if the grantor had retained the right to receive income for the first to occur of his death or the expiration of five years and a reversionary interest if he dies prior to the expiration of five years. The value is $512,632. In that situation, the remainder interest, which is the discounted present value of the right to receive $1,000,000 at the first to occur of five years in the future or the grantor's death, is decreased by the risk that the remainder interest will not be received if the grantor dies during those five years.[12]

Appreciation. A third method of tax savings will result if the transferred property appreciates during the retained income term.

Example (4). If the value of $1 transferred to a five-year GRIT increases during the five-year period to $1.50, then the $.50 increase escapes transfer taxation. If the amount transferred were $1,000,000 and appreciated by a total of 50 percent during the five-year period, then this $500,000 escapes transfer taxation. At the end of the five-year retained income interest term, the entire then value of the trust—$1,500,000—passes to the remaindermen without additional gift or estate tax even though the initial gift tax was calculated based on the discounted present value of only $1,000,000.

Is the tax savings on appreciation a glitch in the transfer tax scheme that needs to be corrected? The answer is a qualified no. From a transfer tax perspective, the transferor bears the risk that the property may depreciate (and thus there would be a transfer tax loss pursuant to the above analysis) and should thus be accorded the benefit if the property appreciates.[13]

Payment of Gift Tax. A fourth means by which a transfer tax savings is effectuated occurs if the grantor pays a gift tax. In that event, there will be an additional estate tax savings (which could be quite substantial) based on the fact that the gift tax system is tax exclusive (i. e., there is no additional gift tax on the amount used to pay the gift tax), whereas the estate tax system is tax inclusive (i. e., there is, in essence, an additional estate tax on the amount used to pay the estate tax).

Example (5). If a testator dies with a gross estate in excess of $8,000,000, the testator pays an estate tax of $1,100,000 on the last $2,000,000 transferred ($2,000,000 × .55). As a result, of the top $2,000,000 in the

[12] See Appendix A for a further explanation regarding these calculations.

[13] However, appreciation is experienced by the total amount of the property transferred, not just the remainderman's fractional, gift tax value, interest. Therefore, in a sense the remainder interest is obtaining the benefit of the appreciation from property that does not technically belong to the remainder interest. For example, if $X is transferred to a GRIT, assume the income interest makes up three-fourths of the value of this $X and the remainder interest makes up one-fourth. Theoretically, the remainder interest should only be entitled to the appreciation attributable to its one-fourth interest in $X, but in a GRIT the remainder interest receives the benefit of the appreciation attributable to the full value of the $X (its one-fourth plus the income interest's three-fourths).

testator's gross estate, only $900,000 passes to the beneficiaries. If the testator isolated this same $2,000,000 and transferred it to the same beneficiaries three years before his death, how much could be transferred and what would the lost opportunity costs be (for consistency, assume a gift tax rate of 55 percent and prior use of the full unified credit)?

The testator could transfer approximately $1,290,322 during life.[14] The gift tax at the 55 percent rate would be $709,677. The transfer tax savings based on the gift tax exclusivity is $390,322. The real tax savings must take into account, however, that interest and appreciation as to the $709,677—the gift tax paid—will be lost. Assume that the $709,677 would grow at a 7 percent rate.

The amount "lost" to the beneficiaries at the end of year three is: $159,708 × .55 (the eventual estate tax that must be paid on this amount), which equals $87,839. This is merely 22 percent of the tax savings attributable to making the gift transfer inter vivos versus testamentary. Further, this tax cost ignores the additional tax savings attributable to the fact that appreciation experienced by the transferred property will not be subject to estate tax. Moreover, it is unlikely that the gift tax rate will equal the assumed marginal rate in this example of 55 percent; therefore, the actual opportunity cost to the beneficiaries of paying the gift tax should be less than the amount illustrated in this example.

In order for the gift tax paid not to be included in the gross estate (and hence to obtain the benefit of gift tax exclusivity), the grantor must survive longer than three years after the transfer of property to the GRIT.[15]

Client Discussion

The practitioner can work through the above calculations and be convinced of the effectiveness of a GRIT. As importantly, the practitioner must be able to describe the GRIT, from a tax savings perspective, in a sensible, understandable fashion to the client. One method is to describe the GRIT by numerical example, leaving out (1) numerical permutations based on potential appreciation, as well as (2) an explicit discussion of discounted persent value calculations.

Example (6). (The following analysis provides a potential framework to discuss the GRIT issue with a client. The footnotes are intended to explain certain points in the example and are not intended to be disseminated to the client.) Without a GRIT, how much is needed to gift $1,000,000 to each of two beneficiaries at a decedent's passing? Assume the decedent's taxable estate for estate tax purposes is $8,000,000. Of this amount, $4,444,444 is needed to pass $2,000,000 total to two beneficiaries because $2,444,444 of the $4,444,444 must be paid as federal estate tax ($4,444,444 × .55, currently the top estate tax rate). Stated another way, the top $4,444,444 in the decedent's estate yields only $2,000,000, after tax, to the beneficaires.[16]

Assume the same individual is 75 years of age. If the same $4,444,444 amount is used to fund a six-year GRIT (i. e., the grantor retains an income interest for six years), what would be the amount passing to the two beneficiaries? In other words, how does it compare with the $2,000,0000?[17]

Conclusion: The grantor could transfer $3,415,269.59 to a GRIT in which the grantor retains (1) an income interest for the first to occur of the grantor's death or six years and (2) a reversion if the grantor dies during the first two years of the trust's existence. The gift tax cost would be $1,029,174.41.[18] At the

[14] To derive that amount, the following formula may be used: $X + X(.55) = \$2,000,000$, where X equals the maximum amount of the gift that may be made at an assumed gift tax rate of 55 percent.

[15] IRC Sec. 2035(c).

[16] If the decedent's taxable estate is in excess of $10,000,000, the result is that even less property passes to the beneficiaries because of the 5 percent additional estate tax on that amount of the taxable estate in excess of $10,000,000. IRC Sec. 2001(c)(3).

[17] In order to allow for a proper comparison of the two scenarios—the establishment of a GRIT versus no use of a GRIT—the assumed gift tax rate should be equivalent to the assumed estate tax rate, 55 percent.

[18] To reiterate, the gift tax is calculated on the value of the total interest transferred to the trust minus the value of the grantor's retained interests. The value of the grantor's retained interests in this example equals (1) the value of the right to receive income for the first to occur of six years or death and (2) the value of the reversion if the grantor dies during the first two years of the trust's existence. See infra for an explanation as to why the reversion may not be for the full six-year income interest term. The example assumes that 120 percent of the federal midterm rate in effect for the month of the transfer is 9.60 percent. See IRC Sec. 7520. The value of the income interest in this example is .3685 of the total interest transferred; the value of the reversion is .0836 of the total interest transferred.

(Continued on following page.)

time the grantor's income interest lapses, the full $3,415,269.59 (plus any appreciation) passes to the other beneficiaries of the trust free of both gift tax and estate tax. In other words, using the same $4,444,444 which at death results in $2,000,000 passing to the beneficiaries, the grantor is able to give away during the grantor's lifetime $3,415,269.59. By using this strategy, the grantor/decedent saves estate and gift taxes (on this $4,444,444 amount) of $1,415,269.59 (i. e., $3,415,269.59 versus $2,000,000). The estate tax savings would be increased if the property in the GRIT appreciates.

Alternatively, the practitioner could provide to the client a numerical analysis in which the client pays no gift tax (and therefore eliminates the fourth means by which a transfer tax savings may be effectuated) but assumes modest appreciation.

Example (7). Assume a client, age 60, requests advice as to how to reduce her estate tax exposure without having to make any actual payment of gift tax. The client has current assets which would render her gross estate equal to $5,000,000 and has not previously made any lifetime taxable gifts. In order to reduce her estate tax exposure without having to make any gift tax payment, a GRIT could be established and funded with sufficient assets so that the discounted present value of the remainder for gift tax purposes does not exceed $600,000. Assume the grantor is willing to risk a 10-year GRIT and that 120 percent of the federal midterm rate then in effect for the month of the proposed transfer is 10.8 percent. The practitioner could demonstrate to the client that instead of only $600,000 passing free of estate tax at her death, a total of $3,038,477 would pass free of estate tax, for an actual tax savings of $1,341,162.

The value of the income interest for the first to occur of (i) her death or (ii) 10 years is .5976; the value of a reversion to her estate if she should die prior to the expiration of 10 years is .1101. Thus, the value of the remainder interest for each $1 transferred to this GRIT is $.2923. If she were to transfer $2,052,686 to the GRIT, the value of the remainder would be $600,000 and her taxable gift would equal the unified credit amount and she would therefore pay no actual gift tax. Assume modest (cumulative) appreciation at 4 percent per year. At the end of the retained income term, $3,038,477 passes to the beneficiaries without any additional gift tax.

In order to calculate the estate tax savings, the estate or gift tax amount shielded by the unified credit—the first $600,000 in taxable transfers—should be removed from the equation. The amount passing free of gift or estate tax because of the GRIT is thus $2,438,477 ($3,038,477 − $600,000). Had this amount been in her estate, it would have been taxed at the highest marginal 55 percent rate, and only $1,097,315 would remain from this amount after the payment of estate tax. The tax savings is thus $2,438,477 minus $1,097,315, or $1,341,162.[18a]

The potential downsides should also be discussed with the client. First, if the grantor passes away during the term of his (or her) income interest, there are no tax savings—the full amount is back in the grantor's gross estate for estate tax purposes.[19] However, the grantor should be no worse off than if nothing were done—that is, the overall gift and estate taxes will be the same as if no plan had been undertaken.[20]

(Footnote 18 continued.)
Therefore, the value of the gift is $3,415,269.59 × (1 − .3685 − .0836), or $1,871,226.21, which, taxed at the 55 percent rate (in order to be consistent with the assumed estate tax rate in this example) yields a gift tax owed of $1,029,174.41. See Appendix B.

[18a] See Appendix C for a breakdown of the actual calculations.

[19] See IRC Sec. 2036(a).

[20] Arguably, the grantor may be slightly worse if the grantor has made an actual payment of gift tax. In that event, the grantor will have lost the income on the gift tax paid (which the grantor otherwise would have earned on the money used to pay the gift tax if no gift had been made). Using Example (6), assume (1) that the grantor has already fully used his or her unified credit (2) that income could have been earned, after tax, of 7 percent, and (3) that the grantor lives for five years, 364 days (i. e., one day before the income interest is due to expire). The lost interest which could have been earned on the $1,029,174.41 is approximately $515,338.85, which, after the payment of estate tax (at the 55 percent rate), would have resulted in $231,902.48 passing to the beneficiaries. Under that analysis, the potential tax savings of $1,415,269.59 is offset by the potential risk, in the worse-case scenario, of an opportunity loss of $231,902.48. (This opportunity loss would likely be less than $231,902.48 since in reality the gift tax incurred in setting up a GRIT will not be taxed at an average rate of 55 percent. The 55 percent rate was assumed in Example (6) in order to properly analyze the transfer tax savings resulting from use of a GRIT.) Even that downside can be eliminated if we limit the amount of property gifted to the trust so that the remainder interest is less than or equal to $600,000 (the tax on which would be less than or equal to $192,800, the unified credit amount). See Example (7). Unified credit used at the time the gift is made is in essence restored if the gift is brought back into the gross estate. See IRC Sec. 2001(b)(2).

A second downside is that the trust must be irrevocable and therefore once established, the trust terms cannot change (absent the exercise of a properly designed power of appointment). Because the property will ultimately pass to beneficiaries at the termination of the grantor's income interest, the grantor must be certain that he or she will not need the funds to live on. Importantly, the property can continue to be held in trust after the grantor's income interest expires, but the grantor cannot then have any interest as a beneficiary.

A third downside is that the trust property may depreciate, not appreciate, and then the tax savings would be correspondingly decreased. Presumably, this could be avoided by proper investment of the trust property.

A fourth downside relates to the administrative inconvenience of having a trust. Someone other than the grantor or the grantor's spouse must be the trustee. The trust terms must be carefully considered and properly drafted. The trust must file income tax returns, 1041s, each year.

The IRS's Treatment of GRITs

Of the four previously discussed categories by which transfer tax savings are achieved by use of a GRIT, three are currently beyond effective challenge by the IRS: appreciation, the risk component relating to the valuation of the remainder, and gift tax exclusivity. Only the discounted present value calculations are subject to IRS attack. The IRS has done so indirectly by imposing a "reasonable rate of return" requirement on GRITs. If the remainder interest was initially valued assuming an income interest at X percent and the grantor does not receive a "reasonable rate of income" (which is not defined but is probably something approximating X percent), then in each year in which the grantor does not receive a reasonable rate of return, the IRS may deem the grantor to have made a taxable gift.

This was the result in Private Letter Ruling 8806082,[21] in which the GRIT was invested in a closely held company the stock of which was producing dividends of less than 1 percent. The IRS did not question the amount of the gift of the remainder, valued pursuant to the tables, because the grantor had the power to direct that unproductive or underproductive be sold. It did, however, rule that in each year that the grantor did not receive a "reasonable rate of income," the grantor would be deemed to have made a taxable gift.[22]

The rulings to date have involved GRITs funded with closely held stock yielding substantially less than the assumed interest rate used in initially valuing the gift. The IRS has not yet imposed a requirement that the income received by the grantor during the term of the grantor's retained income interest equal or exceed the assumed rate of return used in initially valuing the gift. In fact the IRS has not ruled whether its theory espoused in Private Letter Ruling 8806082 and related rulings will be applied to a GRIT consisting of marketable securities as opposed to closely held stock.[23]

GRITs and Section 2036(c)

Section 2036(c): The Anti-Estate Freeze Provision of the Code. Section 2036(c), enacted by the Revenue Act of 1987, was intended to treat family transfers which followed certain stock recapitalizations (and similar techniques) as transfers with a retained interest which would result in inclusion of all transferred property in the transferor's gross estate.[24]

[21] CCH IRS Letter Rulings Reports No. 573, Feb. 22, 1988.

[22] The amount of the gift would be (1) the interest rate used for gift tax purposes to initially value the remainder, (2) times the value of the trust during the year in which the grantor did not receive a reasonable rate of return, (3) reduced by the income paid to the grantor for that year, and (4) minus the value of the grantor's interest for the remaining term based upon the same interest assumptions.

[23] See also CCH IRS Letter Rulings Reports No. 568, Jan. 19, 1988, PLR 8801008 (in a trust funded with subchapter S stock whose dividend rate was substantially lower than the average rate for publicly traded corporations, the grantor made a gift each year equal to the lost income which would have been recognized had the trust property been more productive); CCH IRS Letter Rulings Reports No. 504, Oct. 27, 1986, PLR 8642028 (the valuation tables may not be used where property which produced a low rate of return, averaging less than 1 percent for the immediately preceding five years, was transferred to the GRIT and the grantor had no right to compel the trustee to make the property more productive); CCH IRS Letter Rulings Reports No. 624, Feb. 14, 1989, PLR 8905045 (failure of the grantor each year to exercise power to make the trust "normally productive under the standards usually applicable to simple trusts" will result in an additional gift); CCH IRS Letter Rulings Reports No. 686, Apr. 23, 1990, PLR 9015024.

[24] Generally, Section 2036(a)(1) includes in the value of a decedent's gross estate for estate tax purposes the value of all property which the decedent has transferred (for less than adequate and full consideration) under which he or she has retained the right to the enjoyment of income from or control over the property for his or her life. This is often referred to as a "transfer with a retained interest." Stock recapitalizations done to effectuate estate freezes were not generally within

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Unfortunately, Section 2036(c) was drafted broadly enough to include within its reach transactions which were not stock recapitalizations or partnerships done to effectuate estate freezes. Practitioners and commentators began ruminating on whether the statute would apply to such traditional estate planning transactions as (1) gift transfers of a minority stock interest in a family-owned corporation which has only one class of stock, (2) gift transfers of nonvoting common stock in a corporation which has only voting and nonvoting common stock; (3) gift transfers of limited partnership interests when the transferor is also one of the general partners, (4) buy/sell agreements, (5) GRITs, (6) purchased life estate/remainder interests, (7) redemption of a transferor's interest in a closely held corporation in exchange for notes or other debt, (8) irrevocable life insurance trusts, and so on.

The potential reach of Section 2036(c) caught the attention of the IRS and Treasury, which decided that the section could be used effectively to reach (and, in effect, preclude) transactions that clearly were not the intended targets of Section 2036(c), but which the IRS perceived as abuses. Congress, in an attempt to clarify the breadth of Section 2036(c), made numerous amendments to the section via the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). The overall effect of these amendments was to extend the reach of the statute and to otherwise confuse an already uncertain topic.

In Notice 89-99, the Treasury recently produced guidelines which clarify the breadth and operation of Section 2036(c), especially in relation to GRITs. Although tax practitioners expect Section 2036(c) to be repealed and replaced with a valuation-type statute,[25] until that time practitioners should understand and carefully consider the Section 2036(c) safe harbor exception for GRITs.

A Trust as an "Enterprise." The threshold inquiry in determining whether Section 2036(c) applies to a particular situation is whether an arrangement (such as a GRIT) constitutes an enterprise." One conclusion which is clear from Notice 89-99: Without an express exception to the statute, a GRIT funded with assets other than life insurance or other "personal use property" (discussed below) would be treated as an enterprice and thus subject to the application of Section 2036(c) in general and Section 2036(c)(4) in particular.[26] At the time of the termination of the grantor's retained income interest, the grantor would be treated as having made a gift of the then value of the trust reduced by the value of the taxable gift deemed made at the time the GRIT was established.[27] The TAMRA amendments to Section 2036(c) did, however, create an exception from Section 2036(c) for certain GRITs.

The GRIT Exception—Section 2036(c)(6)—Explored. The retention of a "qualified trust income interest" will prevent, in effect, the application of Section 2036(c). A "qualified trust income interest" is defined as "any right to receive amounts determined solely by reference to the income from property held in trust" if:

(1) The right to receive the income does not exceed 10 years;

(2) The grantor of the funds to the trust is also the individual entitled to receive the income for the term of years; and

(3) The grantor is not the trustee of the trust.

(Footnote 24 continued.)
the reach of Section 2036(a). But see CCH IRS Letter Rulings Reports No. 358, Jan. 11, 1984, PLR 8401006 and CCH IRS Letter Rulings Reports No. 420, Mar. 20, 1985, PLR 8510002. Section 2036(c) was enacted to change that result.

The operation of Section 2036(c) can be illustrated by the following simplified example:

> Father *X* owns two interests, asset *A* and asset *B*, in enterprise *E*. *A* and *B* constitute more than 10 percent of the total outstanding interests in *E*. On January 23, 1989, *X* transfers asset *B* to his son, *S*, for no consideration. A gift tax is paid on the then fair market value of asset *B*. *X* retains asset *A*. At the time of the transfer, the appreciation potential of asset *B* is greater than the appreciation potential of asset *A*. At *X*'s death 35 years later, asset *A* is still owned by *X*. Asset *B* has appreciated 10 times its value as of the date of transfer. At *X*'s death, the then value of asset *B*, even though it was transferred 35 years previous and even though a gift tax was paid at the time of the transfer, will be included in *X*'s gross estate for estate tax purposes.

[25] See, e. g., the Joint Committee on Taxation's discussion draft released on April 20 which would repeal Section 2036(c) retroactively. CCH Federal Estate and Gift Tax Reports ¶ 11,860.

[26] Notice 89-99 sets forth the following definition of enterprise:

> [A]ny arrangement that has significant business or investment aspects. . . . [A] trust, because it is an arrangement to hold and manage property, would generally be considered an enterprise.

[27] The application of Section 2036(c) to a GRIT is, in essence, only important with regard to the lapse of the income interest. If the grantor dies prior to the expiration of his or her income interest then, although Section 2036(c) could apply to include the property in the grantor's gross estate, Section 2036(a) also applies to include the property in the grantor's gross estate, thereby eliminating the need to have Section 2036(c) apply in that situation.

To apply the terms of the statute, one would create an irrevocable trust in which the grantor retains an income interest for a number of years, less than or equal to 10, depending on how long the grantor is expected to survive. In order to increase the value of the grantor's retained interest, the grantor's income interest could be limited to the first to occur of (1) a set term of years (not to exceed 10) or (2) the grantor's death, but the grantor's income interest should then be coupled with a reversionary interest (discussed below) which would return the property to the grantor if the grantor did not survive the set term of years.

As previously discussed, the value of the income and reversionary interests, and therefore the value of the remainder interest, may be determined by using Table H in IRS Publication 1457 (8-89), and assumes an interest rate equal to 120 percent of the federal midterm rate in effect in the month in which the assets are transferred to the trust.[28] Upon establishment and funding of the trust, the grantor is treated as having made a gift equal to the discounted present value of the remainder interest. Because that gift is a future interest, it does not qualify for the annual exclusion and will therefore be treated as a "taxable gift."

Reversions and General Powers of Appointment. An important issue that was not discussed by the TAMRA amendments to Section 2036(c) is what type of contingent principal interest the grantor may retain. From a transfer tax perspective, it is desirable for the grantor to have a reversion (or power of appointment) if the grantor dies prior to the expiration of the retained income right (note that the trust property would, in that situation, be in the grantor's gross estate under Section 2036(a) anyway). The retention of a reversion in this situation will reduce further the value of the contingent remainder interest for gift tax purposes.

> *Example (8).* Assume the grantor transfers $100,000 to a GRIT in which she retains the right to the income for 10 years. If she dies prior to the expiration of 10 years, the remaining income interest passes to her estate. The value of the right to receive the income for 10 years, at 9.8 percent, is .607376 of the interest transferred, or $60,737.60. She would therefore be treated as having made a gift of the remainder equal to $39,267.40. Now assume that the grantor, who is 65 years of age, transfers $100,000 to a trust in which she retains the income interest for the first to occur of her death or 10 years and retains a reversion if her death occurs prior to 10 years (but limited to only 25 percent of the amount of the income interest). The value of her retained interests—the income interest and the reversion interest—equals .5461 plus .1365, or .6826.[29] Therefore, the value of the gift has been decreased to $31,740.[30]

A retention of a reversion or power of appointment will also allow the grantor to control how the trust assets are distributed if the grantor dies prior to the expiration of the grantor's retained income interest.

Is the retention of a reversion or power of appointment (hereinafter, merely for brevity, only a "reversion" is referenced in the text) a right to receive any amount that is not "determined solely by reference to income" and therefore in violation of the statutory GRIT? The IRS answered this question in Notice 89-99:

> The grantor's retention of a reversion in, or general power of appointment over, trust corpus should not adversely affect the availability of the exception if the value of such interest is ***insubstantial*** relative to the value of the retained interest in income. [Emphasis added.]

Whether the value is "insubstantial" is determined by the following test: At the time the GRIT is created the value of such reversion may not exceed 25 percent of the value of the retained income interest. For this purpose, the value of the retained income interest must be the value of the income interest for the first to occur of (1) the expiration of the fixed term or (2) the grantor's death. The value of the reversion may not be compared with the value of an income interest for a stated fixed-year term because, if the grantor were to die during this term and the remaining income for the fixed term was paid to his or her estate, the income interest in the grantor's estate would not (according to IRS personnel) be deemed an income interest in the grantor.

There has been substantial discussion by commentators regarding when a full 10-year reversion will exceed 25 percent of the value of the retained 10-year income interest. For example, based on a 10.2 percent interest rate, the 25 percent limitation comes into effect at 64 years for a term of 10 years or the grantor's earlier death.

[28] See Examples 9 through 11 in IRS Publication 1457; see also IRC Sec. 7520.

[29] See Appendix D for a further explanation of these calculations.

[30] See also Example (3).

. The best approach, rather than adhering to arbitrary guidelines, is to make the calculations on a case-by-case basis. If a reversion for the full income interest term (e. g., if the grantor retains an income interest for 10 years, then having the grantor retain a reversion for the 10 years) exceeds 25 percent of the value of the income interest, the possibility of retaining a reversion should not be dismissed. Rather, the reversion should be limited to either the first *X* number of years or the latter *X* number of years (during the existence of the retained income right), or the reversion should be over only a fraction of the property, so that the value of the reversion does not exceed 25 percent of the value of the income interest.

> *Example (9).* A grantor age 64 establishes a GRIT and retains a 10-year income interest. The applicable assumed valuation rate is 10.2 percent. The value of the right to receive the income until the first to occur of death or the expiration of 10 years is .5635 of the value of the interest transferred. The value of a reversionary interest for the full 10-year term is .1510 of the value of the interest transferred.
>
> The reversion therefore exceeds 25 percent of the value of the income interest (.1510/.5635 = .268). However, if the grantor retains a reversion for the first nine years, the value of this reversion is .1389 of the value of the interest transferred, which is less than 25 percent of the value of the income interest (.5635 × .25 = .1409). Further, if the grantor retains a reversion over the property for the nine years at the end of the grantor's 10-year income interest, this value, .1328, also does not exceed 25 percent of the value of the income interest. Moreover, the grantor could retain a fractional reversion over .932 of the trust property during the full 10-year retained income interest term. The value of the fractional reversion would equal .1407 (i. e., .932 × .1510, the value of the reversion for the full 10 years) of the value of the interest transferred, which is less than 25 percent of the value of the income interest.[31]

The IRS has indicated informally that limiting the reversion in these manners will be acceptable.[32] From a practical standpoint, limiting the reversion to the first *X* number of years or latter *X* number of years, rather than a fractional approach, is more conservative, easier to calculate, and easier to administer.

Spousal Unity. A practitioner should be careful with the spousal unity rules under Section 2036(c) when using a GRIT. For example, the IRS has indicated that the grantor's spouse cannot act as a trustee of the GRIT.[33]

Allowing the spouse to have an interest in the trust at the expiration of the grantor's income interest should not invoke application of the statute. However, if a spouse is given a contingent reversionary or remainder interest over the trust which qualifies for the marital deduction (e. g., to allow for the deferral of the estate tax if the grantor does not survive the income interest term), arguably this could invoke application of the statute. Nevertheless, IRS personnel have stated informally that the spousal unity rules will also not apply in that situation.

S Corporation Stock. In certain situations, it will be possible to fund a statutory GRIT with subchapter S stock without jeopardizing the underlying S status of the corporation.[34] The trust cannot be a "qualified subchapter S trust"—persons other than the income beneficiary/grantor will have an interest in the trust during the grantor's life after the termination of the grantor's fixed term income interest.[35] However, if the retained contingent principal interest exceeds 5 percent of the value of the trust at inception, the grantor will then be taxed on all trust income pursuant to Section 673(a) and the trust, as a grantor income trust, will qualify as a permissible shareholder of an S corporation (at least during the income term).[36]

Another possibility is to have the grantor retain the right to substitute other property of equivalent value for the subchapter S stock.[37] A further possibility would be to give to a third party a Section 675(4) power. Other provisions of Section 675 could also be used, but care should be taken to make sure that the grantor will not be alleged to have retained an interest in the

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[31] See Appendix E for the longhand calculation of these numbers.

[32] See CCH IRS LETTER RULINGS REPORTS No. 664, Nov. 20, 1989, PLR 8945006; CCH IRS LETTER RULINGS REPORTS No. 683, Apr. 3, 1990, PLRs 9012034 and 9012057.

[33] PLR 9012034.

[34] But see the discussion on the IRS's position regarding unproductive or underproductive property in a GRIT, infra.

[35] See IRS Sec. 1361(d)(3)(A).

[36] IRC Sec. 1361(c)(2)(A)(i); see also PLR 9015024.

[37] See IRC Sec. 675(4)(C). Consider, however, whether this would violate a statutory GRIT requirement because the right may constitute an impermissible retained interest in principal.

principal or retained an interest as a constructive trustee.

Commutation Powers. A commutation power is the right of the trustee to terminate the grantor's retained income interest by paying to the grantor the present value of the grantor's right to receive, for the remaining term of the grantor's retained income term, income. The power would be useful if the grantor were expected to die prior to the expiration of his or her retained income interest (i. e., if effectively used, the power would eliminate inclusion of the full value of the trust in the grantor's gross estate under Section 2036(a)).

A commutation power should not be used with a statutory GRIT. Arguably, the amount to be distributed to the grantor would not be determined "solely" by reference to the amount of the income.[38] As a practical matter, the practioner should distinguish between game-playing and acceptable risk. The IRS would certainly view the commutation power as game-playing and subject to careful scrutiny.[39]

The possibility that the grantor may die prior to the expiration of the grantor's income interest should be leveraged in ways other than by use of a commutation power. For example, an irrevocable insurance trust or the purchase of insurance by third parties on the grantor's life would be one means to leverage the risk that the grantor may die prior to the expiration of the grantor's retained income interest. Further, more than one GRIT could be established; for example, three-year, five-year, seven-year and nine-year GRITs could be established to hedge against the possibility of early death. Another possibility would be to have both the grantor and his or her spouse independently establish GRITs.

Leveraging of the GST Exemption. Prior to TAMRA, there was uncertainty as to whether a GRIT also provided an avenue in which to reduce generation-skipping taxes, for example, by leveraging the GST exemption in the same manner as the unified credit.[40] TAMRA said no. For a transfer which will be includible in a transferor's gross estate if the transferor dies immediately after the transfer (such as with a GRIT, which will be included in the transferor's estate until his or her income interest expires), no allocation may be made of the transferor's GST exemption to the trust until the termination of the "estate tax inclusion period." [41] The estate tax inclusion period will end at the time the property would not be included in the gross estate of the transferor if he or she then died (e. g., the termination of the grantor's retained income interest), but in no event will the period extend beyond the transferor's death or the date on which there is a generation-skipping transfer. As a result, practitioners should consider advising clients to establish GRITs in a manner which will avoid the generation-skipping transfer tax.

Common Law GRITs—Funding with Personal Use Property. The common law GRIT is defined as a GRIT which violates—intentionally or unintentionally—one or more of the statutory GRIT terms. For example, the retained income interest may be for a period longer than 10 years, or the reversion may be greater than 25 percent of the retained income interest. The advantage of a common law GRIT over the statutory GRIT is that the common law GRIT can be set up so that the value of the remainder is further reduced for gift tax purposes. For example, if the grantor retains an income interest for 15 years rather than 10 years, the taxable gift consequences will be less.[42]

As discussed, a common law GRIT will probably be treated as an "enterprise" and Section 2036(c) applied unless the common law GRIT is funded with personal use property. "Personal use property" means any property substantially all of the use of which by the taxpayer is not in connection with a trade or business of the taxpayer or an activity related to the production or collection of income.[43] There is a presumption that arrangements with personal use property lack significant business or investment aspects and therefore are outside the scope of Section 2036(c) (i. e., such arrangements are not "enterprises"). The presumption may be rebutted by the IRS by a demonstration that the arrangement's personal use aspects are subordinate to its business or investment aspects. The pre-

[38] See the discussion, infra.

[39] See CCH IRS LETTER RULINGS REPORTS No. 675, Feb. 5, 1990, PLR 9004002 (presence of a reversionary interest clause precludes the trustee from using a commutation power to distribute any share of corpus to the remainder beneficiary if a terminally ill income beneficiary would not survive the term necessary to negate application of the reversion).

[40] Arguably, GST exemption equal only to the value of the remainder interest for gift tax purposes needed to be allocated to the GRIT in order to obtain an "inclusion ratio" of zero (rendering the trust free of generation-skipping transfer tax). Thereafter, when the grantor's income interest expired, the full value of the property initially transferred to the trust, plus appreciation, would be free of generation-skipping transfer tax.

[41] IRC Sec. 2642(f).

[42] See Example (1), supra.

[43] IRC Sec. 1275(b)(3), as referenced by Notice 89-99.

sumption is irrebuttable if the arrangement involves life insurance or an individual's principal residence. A common law GRIT should therefore be a viable planning opportunity for the principal residence.

If other personal use property is used to fund a common law GRIT, the IRS could still apply Section 2036(c) by arguing that the personal use aspects of the GRIT were subordinate to its investment aspects. Example 6 of Notice 89-99 describes a painting held in trust and states that the trust arrangement with respect to the painting is "presumed to lack significant business or investment aspects." The example recites the factors which would support the showing that the personal use of the painting is subordinate to the investment aspects of the trust, including (1) general recognition among art collectors that the painting or other objects are suitable for investment and (2) a collection that is so numerous that it makes the residential display of all of the items at once impractical. (An interesting tangent to Example 6 is that the arrangement, though it does not constitute an "enterprise" and therefore renders Section 2036(c) inapplicable, would constitute a retained interest under Section 2036(a) and the entire trust would be included in the grantor's gross estate when the grantor died.[44])

Common Law GRITs—Grantor Retained Appreciation Trusts. Another variation of the common law GRIT would be to require that all appreciation in the trust property during the income term return to the grantor at the expiration of this term. By doing so, this should also negate the application of Section 2036(c). A second requirement for that statute to apply is that the transferred property must carry with it a disproportionate right to receive potential appreciation in the enterprise. Since the transferred property—the remainder interest—is entitled to no portion of the appreciation, that requirement is not satisfied. The transfer tax benefits of this type of GRIT are the use of the valuation tables, in particular the valuation of the remainder interest based on the risk that the grantor will not survive the income term.[45]

Conclusion

The GRIT, if carefully drafted and considered, remains a viable approach to reduce estate taxes. There are indications that Congress may try to eliminate the use of GRITs.[46] If this comes to pass, it would indeed be an unfortunate exercise of congressional authority. There are no glitches in the Code out of which the GRIT results. Rather, the effectiveness of the GRIT is based on legitimate risk created by the grantor and is consistent with the current estate and gift structure and policy behind it. ●

[44] See also CCH IRS LETTER RULINGS REPORTS No. 670, Jan. 2, 1990, PLR 8951065.

[45] See Examples (3) and (8), supra.

[46] See the Joint Committee on Taxation's discussion draft released on April 20, 1990 (CCH FEDERAL ESTATE AND GIFT TAX REPORTS, ¶ 11,860).

Appendix A

Value of Remainder Interest for Five-Year $1,000,000 GRIT—Additional Calculations for Example (3)

Set forth below are calculations that compare the value of remainder interest for two situations described in Example (3): (1) if the grantor retains an income interest for entire five-year term versus (2) if the grantor retains an income interest for first to occur of expiration of fixed five-year term or death, and retains reversion if death occurs during retained income term. For both situations, the following facts apply: (1) the amount transferred to the GRIT is $1,000,000; (2) the assumed interest rate is 8.20 percent; (3) the grantor's age is 75 years; and (4) all calculations are pursuant to IRS Publication 1457 (dated 8-89).

I. Value of Remainder If Grantor Retains Income Interest for Entire Five-Year Term. The income and remainder interests are calculated as follows:

Table B, p. 3-16, column (3), 8.20 percent, five-year term income factor	.325684
Table B, p. 3-16, column (4), five-year term remainder factor	.674316
Value of remainder interest ($1,000,000 × .674316)	$674,316

II. Value of Remainder If Grantor Retains Income Interest for First to Occur of Expiration of Fixed Five-Year Term or Death, and Retains Reversion If Death Occurs During Retained Income Term. *A. Value of Income Interest.* The value of the income interest—the right to receive

the income until the first to occur of death or the end of five years—is calculated as follows:

N factor (age 75)	948.7018
Minus N factor (age 80, the latest time the income interest may terminate)	(404.2715)
	544.4303
Divided by D factor (age 75) ..	153.9204
Annuity factor	3.53708995
Required income factor (annuity factor × interest rate (.082)) ..	.2900413

B. Value of Reversionary Interest. The value of the reversionary interest—the right to receive back the principal if the grantor dies during the first five years of the trust—is calculated as follows:

M factor (age 75)	76.12683
Minus M factor (age 80)	(45.75423)
	30.37260
Divided by D factor (age 75) ...	153.92040
Reversion factor	.1973266

C. Gift Tax. The gift tax on the transfer of X dollars to the trust is calculated on the following amount. The gift equals X times the following: 1 minus (i) the grantor's retained interests, the right to receive the income until the first to occur of the grantor's death or five years (.2900413) and (ii) a reversion if death occurs in the first five years (.1973266), which equals .512632. Assuming $X = \$1,000,000$, there will be a gift of $512,632.

Appendix B

Maximum Amount Transferable to a Six-Year GRIT With the Use of $4,444,444—Additional Calculations for Example (6)

Set forth below are calculations of the maximum amount which can be transferred to a six-year GRIT as described in Example (6). In this situation, the following facts apply: (1) the amount available for use is $4,444,444; (2) the assumed interest rate is 9.60 percent; (3) the grantor's age is 75 years; and (4) all calculations are pursuant to Table H (9.60) of IRS Publication 1457 (dated 8-89).

I. Value of Income Interest. The value of the income interest—the right to receive the income until the first to occur of death or the end of six years—is calculated as follows:

N factor (age 75)	336.20690
Minus N factor (age 81, the latest time the income interest may terminate)	(110.90980)
	225.29710
Divided by D factor (age 75) ..	58.68798
Annuity factor	3.83880
Required income factor (annuity factor × interest rate (.096)) ..	.3685

II. Value of Reversionary Interest. The value of the reversionary interest—the right to receive back the principal if the grantor dies during the first two years of the trust—is calculated as follows:

M factor (age 75)	26.41212
Minus M factor (age 77)	(21.50296)
	4.90916
Divided by D factor (age 75) ...	58.68798
Reversion factor	.08360

III. Gift Tax. The gift tax on the transfer of X dollars to the trust is calculated on the following amount. The gift equals X times the following: 1 minus the grantor's retained interests, the right to receive the income until the first to occur of his or her death and six years (.3685) and a reversion if death occurs in the first two years (.0836), which equals .5479.

IV. Maximum Transfer to GRIT. How much of the $4,444,444 can the grantor transfer to the GRIT? He can transfer X plus the gift tax attributable to X, provided these two amounts add up to $4,444,444. Assume gifts from the grantor are in the 55 percent tax bracket. This assumption is necessary in order to compare properly the total transfer tax savings discussed in Example (6), i. e., to be consistent with the 55 percent estate tax rate assumed in that example. The formula for determining X is:

$$X + X(.5479)(.55) = \$4,444,444,$$

where .5479 is the amount of the transfer which will be treated as a gift and .55 is the rate of the gift tax.

Solving the above equation for X yields the following result: $3,415,269.59. Therefore, the grantor can transfer $3,415,269.59 to the GRIT described in Example (6) and still have enough left over from the $4,444,444 to pay the gift tax.

(Proof:
(1) $3,415,269.59 (transfer) × .5479 (percentage of transfer treated as gift) × .55 (gift tax rate) = $1,029,174.41 (gift tax)
(2) $3,415,269.59 (transfer) + $1,029,174.41 (gift tax) = $4,444,444)

Appendix C

Maximum Amount Transferable to 10-Year GRIT with Use of the Unified Credit—Estate Tax Savings—Calculations for Example (7)

Set forth below are calculations of the amount which can be transferred to a 10-year GRIT with the gift value not exceeding $600,000 as described in Example (7), and calculations of the total estate tax savings. In this situation, the following facts apply: (1) the desired gift value of the GRIT is $600,000; (2) the assumed interest rate is 10.80 percent; (3) the grantor's age is 60 years; and (4) all calculations are pursuant to Table H (10.80) of IRS Publication 1457 (dated 8-89).

I. Value of Income Interest. The value of the income interest—the right to receive the income until the first to occur of death or the end of 10 years—is calculated as follows:

N factor (age 60)	13039.710
Minus N factor (age 70, the latest time the income interest may terminate)	(3189.434)
	9850.276
Divided by D factor (age 60)	1780.224
Annuity Factor	5.5331
Required income factor (annuity factor × interest rate (.1080))	.5976

II. Value of Reversionary Interest. The value of the reversionary interest—the right to receive back the principal if the grantor dies during the first 10 years of the trust—is calculated as follows:

M factor (age 60)	371.9358
Minus M factor (age 70)	(175.9045)
	196.0313
Divided by D factor (age 60)	1780.2240
Reversion factor	.1101

III. Gift Tax. The gift tax on the transfer of X dollars to the trust is calculated on the following amount. The gift equals X times the following: 1 minus the grantor's retained interests, the right to receive the income until the first to occur of her death or 10 years (.5976) and a reversion if death occurs in the first 10 years (.1101), which equals .2923.

IV. Maximum Amount of Transfer. How much can the grantor transfer and have the remainder equal $600,000? The total value of the gift times .2923 must be less than or equal to $600,000. The formula for determining this is:

$$.2923X = \$600{,}000$$
$$X = \$600{,}000/.2923$$
$$X = \$2{,}052{,}686$$

Therefore, the grantor can transfer $2,052,686 to the GRIT described in Example (7) and use the unified credit to shield fully any gift tax owed. (Proof: $2,052,686 transferred to a 10-year GRIT described above will result in a taxable gift as to .2923 of the amount, or $600,000, the tax on which is fully shielded by the $192,800 unified credit (against gift or estate taxes).)

V. Appreciation. If the amount gifted appreciates at a cumulative rate of 4 percent per year, at the end of 10 years $2,052,686 will equal $3,038,477.

VI. Total Tax Savings. The amount, independent of the amount shielded by the unified credit, passing free of estate tax with use of GRIT is calculated as follows:

$$\$3{,}038{,}477 - \$600{,}000 = \$2{,}438{,}477$$

The amount subject to estate tax, independent of the amount shielded by the unified credit, is:

$$\$3{,}038{,}477 - \$600{,}000 = \$2{,}438{,}477$$

The amount that remains after payment of estate tax (assume that the estate is taxed at the highest marginal rate, 55 percent, and that the 5 percent phaseout rate is not in effect) is:

$$\$2{,}438{,}477 \times .55 = \$1{,}097{,}315$$

Thus, total tax savings are:

$$\$2{,}438{,}477 - \$1{,}097{,}315 = \$1{,}341{,}162$$

Appendix D

Tax Consequences of a 10-Year GRIT—Additional Calculations for Example (8)

Set forth below are additional calculations of the tax consequences of a 10-year GRIT as described in Example (8). For purposes of the calculations below, the following facts apply: (1) the assumed interest rate is 9.80 percent; (2) the grantor's age is 65 years; and (3) all calculations are pursuant to Table H (9.80) of IRS Publication 1457 (dated 8-89).

I. Value of Income Interest. The value of the income interest—the right to receive the income until the first to occur of death or the end of 10 years—is calculated as follows:

N factor (age 65)	1276.5220
Minus N factor (age 75, the latest time the income interest may terminate)	(290.2868)
	986.2352
Divided by D factor (age 65)	176.9871
Annuity factor	5.5723
Required income factor (annuity factor × interest rate (.0980))	.5461

II. Value of Reversionary Interest. The value of the reversionary interest—the right to receive back the principal if the grantor dies during the first 10 years of the trust—is calculated as follows:

M factor (age 65)	51.88800
Minus M factor (age 75)	(22.73954)
	29.14846
Divided by D factor (age 65)	176.98710
Reversion factor	.16469

III. Value of Reversion. The value of the 10-year reversionary interest—the right to receive back the principal if the grantor dies during the first 10 years of the trust—is greater than 25 percent of the value of the income interest. The reversion can be limited to exactly 25 percent by use of a fractional formula. As limited, the value of the reversion would be .5461/4, or .1365.

Appendix E

Tax Consequences of a 10-Year GRIT: Reversion Limited to 25 Percent of Income Interest—Additional Calculations for Example (9)

Set forth below are additional calculations relating to the tax consequences of a 10-year GRIT in which the reversion is limited to 25 percent of the value of the income interest, as described in Example (9). For purposes of these calculations, the following facts apply: (1) the assumed interest rate is 10.20 percent; (2) the grantor's age is 64 years; and (3) all calculations are pursuant to Table H (10.20) of IRS Publication 1457 (dated 8-89).

I. Value of Income Interest. The value of the income interest—the right to receive the income until the first to occur of death or the end of 10 years—is calculated as follows:

N factor (age 64)	11237.0300
Minus N factor (age 74, the latest time the income interest may terminate)	(2564.3870)
	8672.6430
Divided by D factor (age 64)	1569.8210
Annuity factor	5.5246
Required income factor (annuity factor × interest rate (.1020))	.5635

II. Value of Rerversionary Interest. The value of the reversionary interest—the right to receive back the principal if the grantor dies during the first 10 years of the trust—is calculated as follows:

M factor (age 64)	423.6443
Minus M factor (age 74)	(186.6233)
	237.0210
Divided by D factor (age 64)	1569.8210
Reversion factor	.1510

III. Value of Reversion upon Grantor's Death During First Nine Years or Last Nine Years of Trust. The value of the reversionary interest—the right to receive back the principal if the grantor dies during the first nine years of the trust or the last nine years—is calculated as follows:

First Nine Years

M factor (age 64)	423.6443
Minus M factor (age 73)	(205.6467)
	217.9976
Divided by D factor (age 64)	1569.8210
Reversion factor	.1389

Last Nine Years

M factor (age 64)	423.6443
Minus M factor (age 65)	(395.0376)
	28.6067
Divided by D factor (age 64)	1569.8210
Reversion factor for a reversion in the first year	.0182
Full 10 years (.1510) minus first year (.0182) equals reversion factor for last nine years	.1328