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How to Use Grantor Retained Income Trusts To Reduce the Gross Estate

by
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HOW TO USE GRANTOR RETAINED INCOME TRUSTS ("GRITs") TO REDUCE THE GROSS ESTATE

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An individual who is already in a taxable estate situation and who owns property which may appreciate in value (and that will eventually be transferred to some member of his or her family) may be contemplating the future tax consequences with some trepidation. That individual may not be ready to make a present gift of the property because he or she is still not ready to give up the income from or use of the asset. Moreover, even if he or she did make a present outright gift, it would be a taxable transfer to the extent of the whole value of the property. If the individual does not act before dying, thereby allowing the property to become part of his or her gross estate for estate tax purposes, the value of the property will likely have substantially increased, thereby exacerbating the estate tax problem.

A GRIT may be the solution. One way of both giving property away and, in effect, not quite giving it away is to create a grantor retained income trust (GRIT). This requires an individual to transfer property to an irrevocable trust under which he or she retains the income for a fixed number of years, at the end of which time the trust terminates and the property is vested in the trust remainderman. Such a transfer is considered a completed gift and is subject to a gift tax at its funding. But, all that the individual is giving away is the remainder interest, so it is only that remainder interest that is subject to a gift tax—*not* the value of the whole property. Further, the anticipated appreciation is no longer part of the individual's gross estate and, therefore, no longer taxable. Apart from this tax advantage, the individual has retained the use of (e.g., residing in a home) or income from the property for a period of years. To crystallize one's understanding of GRITs, this analysis is divided into the following:

The grantor retained income trust—explained and illustrated .. ¶2015.1
The grantor retained income trust and section 2036(c) .... ¶2015.2
The grantor retained income trust as a viable option .... ¶2015.3

[¶2015.1]

THE GRANTOR RETAINED INCOME TRUST—EXPLAINED AND ILLUSTRATED

A grantor retained income trust ("GRIT") is an irrevocable trust established by the grantor (i.e., the "contributor" of funds to the trust) in which the grantor retains the right to income for a term of years (or for a period ending on the first to occur of (1) a term of years or (2) the grantor's death). At the expiration of this term (or period), 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 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.[1] The only estate or gift tax cost is a gift tax at the time the trust is established equal to the discounted present value of the "remainder" (i.e., the right of the beneficiaries to receive the property after the lapse of the grantor's income interest for a term of years).

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Footnote references start at the end of this analysis.

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To consider the effectiveness of a GRIT, consider the following example:

(a) Without a GRIT, how much is needed to give $1 million to each of two beneficiaries at a decedent's passing? Assume the decedent's taxable estate for estate tax purposes is slightly in excess of $8 million. $4,444,444 is needed to pass $2 million 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 million, after tax, to the beneficiaries. If the decedent's taxable estate is in excess of $10 million, the result is that even less property passes to the beneficiaries because of the 5% additional estate tax on that amount of the taxable estate in excess of $10 million.

(b) Assume the same individual is seventy-five years of age. If the same $4,444,444 amount is used to fund a six year GRIT (what is meant by a "six year GRIT" is that 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 million?

Conclusion: The grantor could transfer $3,415,269.59 to a GRIT in which the grantor retains

- an income interest for the first to occur of the grantor's death or six years and
- 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.[2] At the time the grantor's income interest lapses, the full $3,415,269.59 (plus 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 million 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 million). The transfer tax savings would be increased if the property in the GRIT appreciates.

What are the potential downsides? 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. *See* Section 2036(a). 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.[3]

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. One 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—Form 1041S—each year.

[¶2015.2] THE GRANTOR RETAINED INCOME TRUST AND SECTION 2036(c)

(1) Section 2036(c): The Anti-Estate Freeze Provision of The Code

Section 2036(c), enacted by the Revenue Act of 1987 (OBRA'87), 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.[4] Unfortunately, Section 2036(c) was drafted broadly enough to include within its reach transactions which were not stock recapitalizations or partnerships structured to effectuate estate freezes. Practitioners and commentators began ruminating on whether the statute would apply to such traditional estate planning transactions as

- gift transfers of a minority stock interest in a family-owned corporation which has only one class of stock,
- gift transfers of non-voting common stock in a corporation which has only voting and non-voting common stock,
- gift transfers of limited partnership interests when the transferor is also one of the general partners,
- buy/sell agreements,
- GRITs,
- purchased life estate/remainder interests,
- redemption of a transferor's interest in a closely held corporation in exchange for notes or other debt,
- irrevocable life insurance trusts, and so on.

Overbroad reach. 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 potential breadth of Section 2036(c), made numerous amendments to the section via TAMRA. The overall effect of these amendments was to extend the reach of the statute and to otherwise confuse an already uncertain topic.

The Treasury recently produced guidelines, *Notice 89-99,*[5] which clarify the breadth and operation of Section 2036(c), especially in relation to GRITS.

(2) 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 *infra*) would be treated as an "enterprise" and thus subject to the application of Section 2036(c), in general, and Section 2036(c)(4), in particular. 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 appreciated amount in the trust.[6] The TAMRA amendments to Section 2036(c) did, however, create an exception from Section 2036(c) for certain GRITs.

(3) 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:

- The right to receive the income does not exceed 10 years;
- The grantor of the funds to the trust is also the individual entitled to receive the income for the term of years; and
- The grantor is not the trustee of the trust. The word "income" should mean income as determined under applicable state law.

Statutory GRIT. 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,

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depending on how long the grantor is expected to survive. Depending upon how the GRIT is structured, the value of the income interest may be determined by using Table H in IRS Publication 1457 (8-89), and assumes an interest rate equal to 120% of the federal midterm rate in effect in the month in which the assets are transferred to the trust. See Section 7520, enacted by TAMRA. If the grantor does not survive the term of his or her income interest, all of the trust assets are back in his or her gross estate as a result of Section 2036(a). 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."

(4) 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. For example, 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, 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.

Is the retention of a reversion or power of appointment (for brevity, only "reversion" will be used) a right to receive any amount that is not "determined solely by reference to income?" Rather than discussing the above question, the *Notice* concludes:

> 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, completely arbitrary, test: At the time the GRIT is created the value of such reversion may not exceed 25% of the value of the retained income interest.

There has been much discussion regarding when a full ten-year reversion will exceed 25% of the value of the retained ten year income interest. For example, based on a 10.2% interest rate, the 25% limitation comes into effect at 64 years for a term of 10 years or the grantor's earlier death (at 63 years, the value of the reversion is 24.78% of the value of the income interest).

Calculate case-by-case. 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 10 years) exceeds 25% 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) so that the value of the reversion does not exceed 25% of the value of the income interest. For example, if a grantor age 64 retains a ten year income interest, then the retention of an eight year reversion (assuming a 10.2% rate) should be okay (i.e., less than 25% of the value of the retained income interest).

Fred Grundeman, the drafter of the *Notice,* has indicated that limiting the reversion in this manner will be acceptable. Another strategy is to allow the reversion for the full retained income term, but to limit it to a fractional amount of the trust property so that its value will not exceed 25% of the value of the income interest.[7] The first two approaches are more conservative, easier to establish, and easier to administer.[8]

(5) Making the Calculations

Apparently there is computer software offered for $20 or so which will make the income reversion and remainder calculations for a GRIT. However, doing the calculations by hand is not as inefficient as one may think. As a general rule, it takes about 5 to 10 minutes to do the calculations and to derive a reversion which will not exceed 25% of the retained income interest.[9]

(6) Spousal Unity

A practitioner should be careful of the spousal unity rules under Section 2036(c) when using a GRIT. For example, IRS personnel have stated informally that the grantor's spouse cannot act as a trustee of the GRIT.

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, 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.

(7) S Corporation Stock

It may be permissible to fund a statutory GRIT with subchapter S stock. The trust cannot be a "qualified subchapter S trust"—persons other than the income beneficiary will have an interest in the trust during the grantor's life after the termination of the grantor's fixed term income interest. However, if the retained contingent principal interest exceeds 5% 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 shareholder of an S corporation (at least during the grantor's life). Another possibility is to have the grantor retain the right to substitute other property of equivalent value for the subchapter S stock.[10] (Consider, however, whether this would violate a statutory GRIT requirement because the right may constitute an impermissible retained interest in principal.) A further possibility would be to give a third party a Section 675(4) power. Other provisions of Section 675 could also be used, but again, extreme care should be taken to make sure that the grantor will not be alleged to have retained an interest in the principal or retained an interest as a constructive trustee.

(8) Unproductive Property

The practitioner should keep in mind the IRS position regarding funding a GRIT with unproductive or underproductive property and the potential gift tax consequences to the grantor each year such property is retained.[11]

(9) 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 income for the remaining term of the grantor's retained income interest. The power is useful if the grantor is expected to die before 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 the amount of the income (see ¶2015.2(3)).

(10) Leveraging of the GST Exemption

The GST exemption cannot be leveraged in the same manner as the unified credit may be leveraged. Section 2642(f) provides that no allocation of the exemption may be made before the close of the "estate tax inclusion period" (i.e., at the time the grantor's retained income interest lapses).

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(11) 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 ten years or the reversion may be greater than 25% of the retained interest. One purpose of a common law GRIT is that it can be structured so that the value of the remainder interest is reduced further than if a statutory GRIT were established.

As discussed, a common law GRIT will probably be treated as an "enterprise," thereby triggering Section 2036(c), 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. 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 presumption is not rebuttable 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 the Notice 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 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 Section 2036(c) is 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.[12]

[¶2015.3] THE GRANTOR RETAINED INCOME TRUST AS A VIABLE OPTION

The GRIT, if carefully drafted and considered, remains a viable approach to reduce estate taxes.[13] The reduction in estate tax is due to the discounted present value of the remainder interest for gift tax purposes, and the further discounted value of the remainder to account for the possibility that the reversion (e.g., if the grantor dies within the retained income interest period) will return the property to the grantor and prevent the vesting of the remainder interest, as well as the elimination of the appreciation in the transferred property from the decedent's gross estate. Importantly, if the grantor pays a gift tax, (as in the example in ¶2015.1), 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 whereas the estate tax system is tax inclusive.

Consult Table Under Tab Card "Cross Reference Tables" for Other Articles and New Developments Related to This Subject

TABLE OF CITATIONS

Listed below are references cited in the preceding analysis.

Footnote **References**

(1) *But see* Section 2036(c), discussed ¶ 2015.2.

(2) The gift tax is calculated on the value of the total interest transferred to the trust minus the value of the grantor's retained interest. The grantor's retained interest 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 6 year income interest term. The example assumes that 120% of the federal midterm rate in effect for the month of the transfer is 9.60%. *See* Section 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. Therefore, the value of the gift = $3,415,269.59 × (1 − .3685 − .0836), or $1,871,226.21. $1,871,226.21 taxed at the 55% rate (in order to be consistant with the assurred estate tax rate in this example) yields a gift tax owed of $1,029,174.41. *See* Exhibit A. Each individual is allowed a credit, totaling $192,800, which may be used as an offset against gift tax owed. Any amount of this $192,800 credit not used during life is available at death as a credit against estate tax.

(3) Arguably, the grantor may be slightly worse off since 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). In our example, assume (1) that the grantor has already fully used his or her unified credit (2) that interest could have been earned, after tax, of 7%, and (3) that the grantor lives for 5 years, 364 days (i.e., one day before the income interest is due to expire). The lost interest which could have been earned is approximately $515,339 which, after the payment of estate tax (at the 55% 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 worst case scenario, of an opportunity loss of $231,902.48. (This opportunity loss would likely be less than $231,902.48 since in realty the gift tax incurred in setting up a GRIT will not be taxed at an average rate of 55%. The 55% rate was assumed in our example in order to properly compare the transfer tax savings with the 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). Generally, most clients prefer to limit the amount transferred to a GRIT so that the remainder interest does not exceed $600,000, i.e., does not result in a gift tax having to be paid.

(4) 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 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 the reach of Section 2036(a). *But see* Ltr.Rul. 8401006, PH Private Letter Rulings ¶4893(84) and Ltr.Rul. 8510002, PH Private Letter Rulings ¶4665(85). 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% 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. S 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.

(5) 1989-38 I.R.B. 4. If the discussion draft released by the Joint Committee on Taxation on April 20 of this year is passed by Congress in its current form, Section 2036(c) would be repealed retroactively.

(6) The application of 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 2036(c) could apply to include the property in the grantor's gross estate, 2036(a) also applies to include the property in the grantor's gross estate, thereby eliminating the need to have 2036(c) apply in that situation.

(7) *See also* Ltr.Rul. 9012034, PH Private Letter Rulings ¶800(90), and Ltr.Rul. 9012057, PH Private Letter Rulings ¶801(90).

(8) *See* Exhibit B for an example of how the reversion can be decreased to less than or equal to 25% of the value of the reatained interest.

(9) See Exhibit B for an example of how the reversion can be decreased to less than or equal to 25% of the value of the retained interest.

(10) IRC, Sec. 675(4)(C).

(11) *See, e.g.,* Ltr.Rul. 8801008, PH Private Letter Rulings ¶3428(88). In order to allow a GRIT funded with underproductive or unproductive property to be valued pursuant to the tables, the grantor must retain the right to make underproductive or unproductive property productive. *See* Ltr.Rul. 8642028, PH Private Letter Rulings ¶4090(86).

(12) Ltr.Rul. 8951065, PH Private Letter Rulings ¶4023(89).

(13) The Joint Committee on Taxation released on April 20th a discussion draft that would repeal Section 2036(c) and substitute in its place a set of rules intended to modify the gift tax valuation rules. With the exception of GRITs funded with personal residences, the GRIT as an estate tax reducing device would be substantially (arguably totally) impaired if this proposal were passed in its current form. Hopefully, Congress will modify the proposal as it applies to GRITs so that this non-abusive planning area will remain viable.

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Exhibit A
Maximum Amount Which Can Be Transferred
To a Six-Year GRIT With the Use of $4,444,444

The assumed interest rate = 9.60%. The grantor's age is 75 years. All calculations are pursuant to Table H (9.60) (from IRS Publication 1457 dated 8-89).

(a) The value of the income interest—the right to retain the income until the first to occur of death or the end of six years—is calculated as follows:

N factor (age 75) minus	336.2069
N factor (age 81, at the latest time the income interest may terminate)	(110.9098)
	225.2971
÷ D factor (age 75)	58.68798
= Annuity Factor	3.8388
Annuity Factor x Interest Rate (.096) = Required Income Factor	.3685

(b) 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) minus	26.41212
M factor (age 77)	(21.50296)
	4.90916
÷ D factor (age 75)	58.68798
= Reversion factor	.0836

(c) 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 the reversion if death occurs in the first two years (.0836), which equals .5479.

(d) 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. In order to be consistent with the estate tax rate applicable to the property with which we are comparing, assume gifts from the grantor are in the 55% tax bracket. 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

$$X = 3,415,269.59$$

Conclusion: The grantor can transfer $3,415,269.59 to the GRIT described in the example and still have enough left over from the $4,444,444 to pay the gift tax.

Proof: The gift tax on the transfer of $3,415,269.59 to the GRIT will be: $3,415,269.59 × .5479 × .55 = $1,029,174.41. The gift, $3,415,269.59, plus the gift tax, $1,029,174.41, equals $4,444,444.

EXHIBIT B

Calculating the Reversion so That It Does Not Exceed 25% of the Retained Income Interest

The assumed interest rate = 9.60%. The grantor's age is 75 years. All calculations are pursuant to Table H (9.60) (from IRS Publication 1457 dated 8-89).

(a) The value of the income interest—the right to retain the income until the first to occur of death or the end of six years—is calculated as follows:

N factor (age 75) minus	336.2069
N factor (age 81, at the latest time the income interest may terminate)	(110.9098)
	225.2971
÷ D factor (age 75)	58.68798
= Annuity Factor	3.8388
Annuity Factor × Interest Rate (.096) = Required Income Factor	.3685

(b) The value of the reversionary interest—the right to receive back the principal if the grantor dies during the first six years of the trust—is calculated as follows:

M factor (age 75) minus	26.41212
M factor (age 81)	(13.32208)
	13.09004
÷ D factor (age 75)	58.68798
= Reversion factor	.223

(c) .223/.3685 (value of retained income interest) is substantially in excess of 25% (closer to 60%) and therefore violates the terms of a statutory GRIT. The reversion must be limited to no greater than 25% of the value of retained income interest. That can be done as follows:

i. Retain a fractional reversion over a portion of the trust, determined as follows: value of income interest divided by 4, .3685/4, is .092, which is the maximum permissible value of the reversion. Since we know that a reversion for the full six years equals .223, what fraction of this reversion would yield .092? (.223)x = .092 x = .4125. Hence, the grantor could retain a reversion for the full six year period over .4125 of the value of the trust property. The value of this fractional reversion equals (.4125) (.223), or .092, which equals 25% of the value of the income interest.

ii. Retain a reversion for first two years of trust. The value of the reversionary interest—the right to receive the principal back if the grantor dies during the first two years of the trust—is calculated as follows:

M factor (age 75) minus	26.41212
M factor (age 77)	(21.50296)
	4.90916
÷ D factor (age 75)	58.68798
= Reversion factor	.0836

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.0836/.3685 is less than 25%. If a reversion were retained for the first three years of the trust, this would exceed 25% of the value of the retained income interest.

iii. Retain a reversion for last two years of trust. A reversion for the last two years should equal the value of a reversion for full 6 years minus value of a reversion for first 4 years:

a. Reversion for first 4 years equals .1576

b. Reversion for full 6 years equals .223

c. Reversion for last two years equals .0654 (.223 minus .1576), which is also less than 25% of the value of the retained income interest.

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