CONSIDER THE IMPORTANCE

What is a Grantor Trust?

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As legislation has bounced around Washington, the potential outcome on various estate and tax planning strategies has been center stage. One of the most important questions revolved around Grantor Trusts and their use.

When the House Ways & Means Committee released a sweeping proposal in September, many in the field expressed concern (and rightfully so) over what would effectively have been a stripping of Grantor Trusts and their efficacy in estate and tax planning. At the time of this writing, it seems we may be dodging the proverbial bullet with respect to these proposed changes. Nevertheless, it is beneficial to understand what exactly Grantor Trusts are and how they fit into many estate planning scenarios.

WHAT IS A GRANTOR TRUST?

Traditionally, an Irrevocable Trust existed as its own “entity” apart from the Grantor who created it, as though the Trust was a person unto itself. This had the beneficial effect of removing the Trust assets from the Grantor’s estate, but the Trust would also have to file its own tax return to address – and be taxed on – the income it generated.

Developed over decades of tax regulations and court rulings, Grantor Trusts flipped the script on this arrangement. By including provisions in the Trust document that allowed the Grantor to retain certain aspects of control over Irrevocable Trust assets and income, the resulting Trust still held the assets outside of the Grantor’s estate, but the income tax consequences therein were funneled back to the Grantor. Powers such as the ability to substitute assets in the Trust or the use of income to pay life insurance premiums on the life of the Grantor (or their spouse) are examples of provisions that would “trigger” Grantor Trust status.

IN PRACTICE

By employing this method, the Grantor gains the benefit of excluding the held assets from the estate while essentially allowing the Trust to be their "alter-ego" from an income tax perspective. This is quite beneficial, for example, for Spousal Lifetime Access Trusts (SLATs) and Grantor Retained Annuity Trusts (GRATs). Assets in Grantor Trusts can grow without the hamstrings of the Trust paying the income tax, since it is channeled back to the Grantor, essentially creating a "tax-free" gift to the beneficiaries. It should be noted, however, that once the Grantor dies, such a Trust will lose this special classification and become a non-Grantor Trust.

How do you know if your client currently has a Grantor Trust in place? A thorough reading of the governing Trust document will show if it contains any triggering provisions. But a much simpler (yet still accurate) method is to check the tax ID number of the Trust in question. Generally speaking, since a Grantor Trust is the "alter-ego" of the Grantor for tax purposes, the tax ID will be the Grantor's social security number as opposed to a separate and unique EIN number.

WHERE DO WE GO FROM HERE?

It remains to be seen what, if any, changes to Grantor Trusts will result from proposed legislation now or in the near future. At the time of this article, it may seem that we have already heard a death knell for the sweeping Grantor Trust proposals initially put forth by the Ways & Means Committee. As always, however, it remains important to understand the exact nature of any Trusts in a client's estate plan and whether they coincide with a client's estate goals and legacy objectives. Furthermore, should any changes come to pass regarding Grantor Trusts, it will be vital to consult with a qualified estate planning specialist to assess what actions may need to be taken to address the implications for a given client's estate plan.

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