

Chapter 26. Intentionally “Defective” Grantor Trust

If your present Net Worth exceeds the Lifetime Estate Tax Exemption (\$5,430,000 each, \$10,860,000 if married), and you wish to implement an Estate Tax savings tool to complement an Annual Exemption Gifting program, the Intentionally Defective Grantor Trust (“IDGT”) offers a valuable option.

The IDGT works like this. You establish the IDGT by executing a specific type of trust agreement. Next, you transfer “seed” capital to the IDGT, generally in an amount equal to at least 10% of the overall transaction (this is a gift which needs to be covered by use of a gift tax exemption).

Next you transfer the property you intend to gift to the IDGT in exchange for a Promissory Note equal to the value of the property. This results in a net gift of zero (so no use of a gift tax exemption is needed).

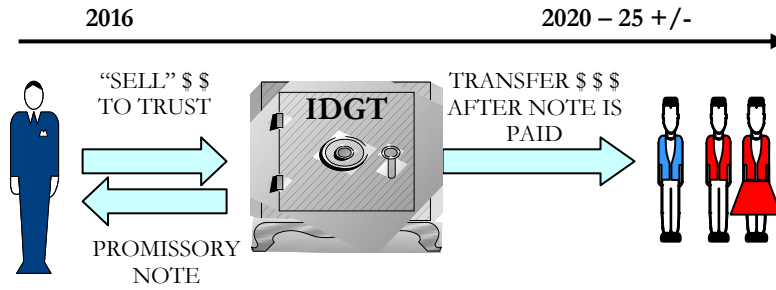
This technique works when the property you gifted to the IDGT grows in value at a rate higher than the interest rate on the Promissory Note. The IRS has rules which establish from time to time the minimum interest rate you must charge (generally about 1% lower than the rate required for GRATs). The growth in the value in excess of the interest you receive on the Note is removed from your Estate and goes to the benefit of your heirs.

This can be illustrated as follows (using a 6% annual growth rate):

	<u>Value Today</u>	<u>Value In 10 Years</u>
Property Transferred	\$3,000,000	\$ 5,370,000
Promissory Note	<u>- 3,000,000</u>	<u>3,660,000</u>
Net Gift	-0-	
Net Value Passed To Heirs (Tax Free)		\$ 1,710,000

This trust is called “defective” because, while it is considered effective at removing the investments from your estate for estate tax purposes, you still own them for income tax purposes. This “defect” actually works to your benefit, because your payment of the income tax on the trust income is an allowable tax-free gift to your beneficiaries.

Intentionally “Defective” Grantor Trust



**Benefit: Move Most of
5 – 10 Year Growth Out
of Owner’s Estate**