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The IRS is calling foul on an heiress who used a GRAT tax strategy.

IRS Targets Popular Way Of Passing Along Wealth

BY ASHLEA EBELING

Wealthy Americans have for years used a popular type of trust to transfer fortunes to their children without paying hefty gift and estate taxes. Now they are on high alert.

The Internal Revenue Service is calling foul on an heiress who used the strategy—and is slapping her and her husband with a $736 million tax bill. Chuck and Trisha Elcan of Nashville, Tenn., are fighting back in U.S. Tax Court, disputing the agency's claim that they made missteps with grantor-retained annuity trusts, or GRATs, which they used to shift money to their three daughters.

The Elcan case offers a look inside the complex strategies the ultrarich deploy to build intergenerational wealth and how those tactics can sometimes test the boundaries of tax rules.

The couple said the tactics that the IRS is calling out are valid. The moves—which are used routinely by others— were tied to GRATs that included shares of HCA Health--care, a major operator of hospitals that Trisha's father and grandfather helped cofound in 1968.

"The position the IRS is taking produces a draconian result," said John Porter, the couple's lawyer, who contends that the operation of the Elcan GRATs was legitimate.

Note

At the heart of the case is a strategy that has become especially popular with corporate executives and investors with sizable stockholdings as markets have roared in recent

years. The aim is to pass wealth to the next generation, while using little or none of the $15 million lifetime gift and estate tax exemption.

People set up GRATs for a set number of years, typically ranging from two to 10, to hold assets they expect to notably appreciate in value. Generally, if the assets appreciate faster than a special federal interest rate in the month the GRAT is formed—5.4% for September—the gains escape transfer taxes.

The grantor sets annuity payments to get back amounts that mirror the original contribution, plus interest at the special federal rate, to avoid gift taxes on the contribution. Payments must be made at least once a year.

If the assets don't clear the hurdle rate, the grantor simply gets their money back through the annuity payments, leaving a balance of zero. Many simply roll over the annuity payments into another GRAT.

"It's largely no-regrets planning," said Mike Kaercher, deputy director of the Tax Law Center at New York University. "If your GRAT doesn't work, you just throw your assets into a new GRAT and try again."

The Biden administration proposed cracking down on trust maneuvers, including GRATs, and estimated it would result in savings of $84 billion over a decade. But legislative efforts to rein in various trusts have languished, and interest in GRATs has surged.

If someone had put $1 million of **Amazon.com** stock in two-year rolling GRATs 10 years ago, for instance, it would have pushed out about $4.5 million to the beneficiaries, free of gift and estate taxes, said Louis Laski, a former privatewealth lawyer and co-founder of GRATtrack. That is despite a big drop in Amazon's stock in 2022.

"If you keep doing it, you're going to have winning years and losing years, and you hope you come out ahead," said Lauren Wagner, a tax partner at Armanino Advisory.

Advisers said people should consider GRATs before their net worth approaches $15 million, the level when the estate tax kicks in per person. "You should start thinking about GRATs when the velocity of your net worth starts to snowball," said Nathan Dingler, cofounder of DiversiFi Capital, a Bay Area financial-planning firm.

One Dingler client in his 40s who works at a Magnificent Seven tech company has put $8.2 million in a series of GRATs since March 2024 and was able to move $3.1 million into trusts for his two children for a tax savings of more than $1 million so far. Dingler said his clients typically set up new GRATs quarterly using the most "aggressive sleeve of their portfolio" to fund them.

There are ways GRATs can go wrong.

If the person who set up the GRAT dies before the end of the trust term, all or a portion of the assets are subject to estate taxes—which is one reason many set the trusts to expire after two years.

But most find success with GRATs, and many use additional methods to ensure their benefits. Some grantors, for instance, will lock in gains by "freezing" them and substituting the appreciated amount with cash or bonds—or even what amounts to an IOU.

That is the move at issue in the Elcan case.

In 2018, Trisha Elcan funded three GRATs with assets valued at about $1.5 billion: the Patricia Frist Elcan 2018 Annuity Trust I, Trust II and Trust III. Assets in the first two GRATs rose and resulted in trusts for the three daughters receiving assets of about $200 million, according to Porter. The third GRAT, set up in August, didn't grow enough to clear the hurdle and failed, he said.

Trisha funded the GRATs with interests in holding companies with HCA Healthcare stock. The disputed move came when she purchased assets from the GRATs in exchange for interest-bearing promissory notes, which she was required to repay.

The trustee for the GRATs paid the annuities due to her by forgiving portions of the notes.

The IRS asserts that the use of the promissory notes in this fashion violated its regulations that govern GRATs. An agency spokesman said the IRS doesn't comment on pending litigation.

The IRS wants to impose gift tax of $614 million and penalties of $122 million, on the theory that all of the transfers to the GRATs—including to the one that failed—were taxable gifts, taxed at 40%.

Trisha's husband, Chuck, also faces liability, because the couple chose to treat any gifts they made as joint gifts.

The Elcans contend that Trisha's use of promissory notes is consistent with both the tax code and regulations. She was a prolific user of GRATs, forming more than one each year from 2010 through at least 2019, according to court records.

While the Elcan case is pending, some advisers are recommending that people refrain from using promissory notes in GRAT transactions.

"Just do the tried and true thing with GRATs," said Diana Zeydel, an estate lawyer and global chair of the private wealth services practice at Greenberg Traurig in Miami.

Zeydel said she disagrees with the IRS position but said she would caution clients against using notes for now.

"Why put yourself in the crosshairs?" she said.

The Elcans filed a summary judgment motion, requesting that the Tax Court reject the IRS's position, and they are awaiting a decision.