

# GRAT PLANNING WITH “OPTION COLLARS”

## Creating Wealth Transfer Through Adversity

Investors with appreciated stock positions often attempt to protect the value of their holdings by executing an “options collar”. The “options collar” consists of buying a put option to protect the downside risk to a contractually predetermined level, while simultaneously selling a call option. The call option while limiting the upside potential gain, provides immediate income to reduce or entirely offset the cost of the protective put option.

Many of these same investors also enjoy substantial wealth and are looking for ways to pass on some of their wealth to their children with as little transfer tax consequence as possible. For these investors, we suggest putting on the collar, and *then contributing the put option to a Grantor Retained Annuity Trust (GRAT)*.

While it may normally be unpleasant to see the value of one’s stock holdings decrease, if the Investor transfers the put option to a GRAT *this hedging and asset location strategy can result in potentially significant gift and estate tax savings*.

If the shares do decline considerably, the lower value of the equity would translate into a higher market value for the put option.

If the put option appreciates by more than GRAT’s hurdle rate, the excess appreciation would be transferred to the heirs without any gift tax consequences. Many GRAT’s are structured in a way that results in little to no gift tax liability upon the GRAT’s creation. There would also be no transfer taxes owed at the time the trust terminates and the beneficiaries get any property remaining in the trust.

If the stock retains its value or increases in price by the end of the GRAT term, then the put option contributed to the GRAT simply expires worthless, and *the investor and his family are no worse off from a tax standpoint than if the GRAT had never been created in the first place*.

By executing an options collar and contributing the put option to a GRAT, an investor can hedge his stock holdings while also enjoying the potential for significant transfer tax savings.

Making the options collar do double duty would make sense for any family that is committed to moving money inter-generationally with the least amount of cost or lost alpha. Placing a put into a GRAT seems to accomplish both market protection and tax advantaged transfer.