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Funding Lifetime Transfers to Grantor Trusts: *A Practical Framework for Selecting the Right Assets for Families Considering SLATs and Other Grantor Trust Strategies*

Lifetime gifting strategies—such as transfers to Spousal Lifetime Access Trusts (SLATs) or other grantor trusts—are among the most powerful tools available for reducing future estate tax exposure. By transferring assets during life, families can shift future appreciation outside of the taxable estate while maintaining significant planning flexibility.

However, not all assets are equally well suited for lifetime transfer. In many cases, the choice of which assets to transfer can have a greater impact on long-term tax efficiency than the structure of the trust itself.

In our experience, evaluating a client's balance sheet for gifting opportunities benefits from a structured but practical approach. The framework below outlines several key considerations we use when assessing which assets may be appropriate for transfer to a grantor trust.

This approach is not rigid or formulaic—every family's situation is unique—but these principles often help guide an analysis and lead to a thoughtful outcome.

Key Factors When Evaluating Assets for Lifetime Transfers

When considering whether a particular asset should be transferred to a grantor trust, we typically evaluate four broad categories:

- **Administrative Complexity**: Certain assets introduce legal or operational complications when transferred. Examples include assets subject to debt, lender approvals, or restrictive agreements.
- **Income Tax Characteristics**: Because grantor trusts are generally ignored for income tax purposes during the grantor's lifetime, the grantor remains responsible for paying the income tax on trust earnings. This feature can create significant planning advantages in the right circumstances.
- **Valuation Opportunities**: Some assets may qualify for valuation discounts when transferred in minority or illiquid form through family entities. These discounts can increase the efficiency of lifetime transfers.

- Access to Cash Flow or Personal Use: Assets that provide essential income for a family's lifestyle—or assets that are primarily used personally—may not be appropriate candidates for transfer unless structured carefully.

Together, these considerations help determine which assets may provide the greatest planning benefit when transferred during life.

Assets That Are Often Less Attractive for Lifetime Transfers

While every situation is unique, certain types of assets frequently prove less suitable for lifetime gifting strategies.

- Encumbered Assets: Assets subject to significant debt often create unnecessary complexity. Transfers may require lender approval or modifications to loan documents, and personal guarantees can raise questions about additional gifts or retained interests. In addition, if the asset's cash flow does not comfortably service its debt obligations, the structure may require ongoing contributions to support those liabilities.
- Cash and Cash Equivalents: Cash generally offers little transfer tax efficiency because it does not benefit from valuation discounts and has limited appreciation potential. Cash can still be useful in supporting certain strategies—for example, providing liquidity to a trust to fund insurance premiums or annuity payments—but it is rarely the most efficient primary asset for a wealth transfer.
- Highly Appreciated “Legacy” Assets Intended to Be Held Long-Term: If an asset is expected to be held until the owner's death, transferring it during life may sacrifice an important tax benefit: the step-up in basis that typically occurs at death. In many cases, retaining highly appreciated legacy assets in the taxable estate can allow heirs to inherit them with a higher cost basis, reducing future capital gains taxes.
- Personal Use Assets: Assets such as primary residences, vacation homes, artwork, or collectibles often create valuation and administrative complications when transferred to trusts. Unless a specialized structure is used (such as a Qualified Personal Residence Trust, or QPRT), these assets are generally not ideal candidates for lifetime transfers.

Assets That Often Work Well for Lifetime Transfers

Other types of assets can be particularly effective when transferred to grantor trusts.

- High-Basis Assets with Significant Appreciation Potential: Assets that are expected to grow substantially in value can be excellent candidates for lifetime transfer. By transferring the asset today, future appreciation occurs outside of the grantor's taxable estate. This concept—often referred to informally as “freezing” value for estate tax purposes—allows long-term growth to benefit future generations.

- Low-Basis Assets Expected to Be Sold During the Grantor's Lifetime: Assets with significant unrealized gain can also work well in grantor trust planning if a sale is expected during the grantor's lifetime. These situations may produce several advantages simultaneously:
 - Potential valuation discounts when the asset is transferred in minority form
 - Removal of future appreciation from the taxable estate
 - The grantor's continued payment of income tax on trust earnings, which effectively allows additional wealth to shift to the trust without additional gift tax
 - This feature—sometimes referred to as the “grantor tax burn”—can meaningfully enhance the long-term effectiveness of the strategy.
- Assets That Support Valuation Discounts: Certain assets may justify valuation discounts when transferred through family entities or minority interests. Discounts for lack of control or lack of marketability, when supported by a qualified appraisal, can allow families to transfer greater economic value while reporting a lower taxable gift. Common examples include minority interests in closely held businesses, family investment partnerships, or other illiquid investment structures.
- Assets Producing Excess Cash Flow: Assets that generate income beyond what the grantor needs for personal lifestyle can also be good candidates for transfer. This is particularly true when the trust itself will have ongoing expenses, such as life insurance premiums. Transferring assets that produce surplus income can allow the trust to sustain its own obligations without requiring additional gifts.

A Simple Framework for Thinking About Asset Selection

In practice, one of the most helpful ways to evaluate assets is to consider two primary drivers of transfer efficiency:

1. Future appreciation potential
2. Ability to justify valuation discounts

Assets that combine both characteristics tend to offer the greatest planning leverage. For example:

	Low Discount Opportunity	High Discount Opportunity
Low Appreciation Potential	Cash, bonds, stable income assets	Minority interests in stable real estate or investment entities
High Appreciation Potential	Concentrated growth equities	Closely held businesses, private company interests

Assets in the upper left quadrant (low/low) typically provide limited planning benefits. By contrast, the bottom right (high/high) are examples of assets with both strong growth potential and discount opportunities often provide the greatest opportunity for efficient lifetime transfers.

Execution Considerations

When transferring assets that qualify for meaningful valuation discounts, we often prefer an approach that combines a modest initial gift with a subsequent sale to the trust.

In this structure:

1. The trust is first “seeded” with a gift of liquidity.
2. The trust then purchases the discounted asset from the grantor in exchange for a promissory note.

This approach can offer several advantages, including:

- Preserving the client’s lifetime exemption
- Leveraging valuation discounts more effectively
- Retaining flexibility through the note structure

When a client has sufficient liquidity to implement this structure, it can be an especially efficient operational framework.

Conclusion

Lifetime transfers to grantor trusts can be a powerful component of a long-term estate planning strategy. But the effectiveness of these strategies often depends less on the structure itself and more on which assets are selected for transfer.

Assets with strong growth potential, valuation discount opportunities, and manageable administrative complexity tend to provide the greatest benefit. Conversely, assets that rely on future basis step-ups, generate essential lifestyle income, or introduce unnecessary complexity may be better retained in the taxable estate.

Thoughtful asset selection—combined with careful trust design—can allow families to move significant future wealth to the next generation while maintaining flexibility and tax efficiency along the way.

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