

Estate Planning Bulletin

GRATs—Going...Going...Gone?

By the end of the year Congress may effectively eliminate one of the most effective estate planning techniques. Plan now, before this opportunity is lost.

While the economy shows signs of recovery (at least compared to a few months ago), Congress now has ample time and motive to focus on estate and gift tax legislation. As a result, one highly effective estate planning technique could be effectively eliminated by the end of this year. The Treasury Department has issued a surprising new proposal that, if enacted, would all but eliminate the usefulness of the **Grantor Retained Annuity Trust (GRAT)**.

GRAT Basics. A GRAT allows individuals to transfer wealth without estate or gift tax. A GRAT is an irrevocable trust funded with assets that are expected to appreciate in the short term. The grantor retains an annuity (the right to fixed payments) for a term of years, to be paid by the GRAT. The net present value of that annuity, calculated based on an interest rate determined by the IRS, is offset against the value of the property contributed by the grantor in determining the amount of the gift. This allows the donor to reduce the taxable gift amount to as low as zero. If the grantor survives the end of the GRAT term, any assets remaining in the GRAT following the last annuity payment (representing any appreciation exceeding the IRS interest rate) will be distributed according to the terms of the trust agreement. The grantor is thus able to transfer that appreciation to family members or other beneficiaries without any gift or estate tax. If the grantor does not survive the term of the GRAT, some or all of the trust assets will be subject to estate tax, but that result will be no worse than if the GRAT had never been established.

A GRAT works well when interest rates are low, when asset values are depressed, and when the GRAT can be structured for a short term. All three of these conditions generally apply now, meaning that ***there may never be a better time for establishing a GRAT.***

The Treasury Proposal. A GRAT is clearly an effective estate planning strategy—perhaps too successful, in the view of a government seeking to increase tax revenue. The Treasury Department's proposal, if enacted, would require that a GRAT have a minimum term of 10 years, substantially eliminating the attractiveness of a GRAT. First, it is difficult (and usually inadvisable) to lock up assets for such a long period of time. A 10-year term also decreases the chance that a GRAT will be able to capture success in a volatile market, as it is more likely to suffer some bad years that will offset good years. Furthermore, waiting 10 years to determine whether or not a GRAT is successful is not practical from a personal or planning perspective. A 10-year term also reduces the chance that the grantor will survive to the end of the GRAT term, thus increasing the chance the GRAT will fail.

Fortunately, if the Treasury proposal is enacted, it is not likely to be retroactive. In that case, a GRAT created before enactment with a term shorter than 10 years would be "grandfathered" in. ***Planning and implementing a GRAT now, before legislation is enacted, allows donors to seize a great opportunity before it disappears.***

A Great Time for a GRAT. A GRAT is most likely to succeed when interest rates are low and assets have good or great potential for appreciation. With interest rates low, values depressed but poised for recovery, and Congress still debating, now is a great time to establish a GRAT—before the opportunity to use a shorter-term

GRAT disappears. Contact any member of the Vedder Price Estate Planning Group to discuss a GRAT or other estate planning opportunities.

For further discussions of GRATs, see our prior Estate Planning Bulletins of **August 2007**, **April 2008**, **November 2008**, and **January 2009**. If you are viewing this Bulletin on-line, click on the indicated links to go to each Bulletin. Otherwise, these can all be found at www.vedderprice.com under "News and Publications," in "Tax & Estate Planning."

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For questions about estate planning opportunities created by the current economic environment, please contact any member of the estate planning group.

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The Estate Planning Group

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