

Private Client Services Alert

July 12, 2013

Higher Treasury Yields Expected to Negatively Impact New GRATs

Interest rates applicable to grantor retained annuity trusts (GRATs) and other estate planning techniques are expected to increase significantly in August as a result of the recent headline-grabbing volatility in the bond markets. The interest rate applicable to GRATs (the 7520 Rate) is computed for each month based on the U.S. Department of the Treasury (Treasury) note yields in the preceding month. Accordingly, the August 7520 Rate will reflect surging Treasury yields during the volatile period from June 15 through July 14.

Some forecasters are predicting an increase in excess of 40 percent over the July 7520 Rate, which is at a near historic low of 1.40 percent. A further increase is expected for September. If you have been considering creating a GRAT, you may wish to fund it before the end of this month to take advantage of the low July 7520 Rate in case it increases as predicted.

As you may know, a GRAT is a type of trust designed to transfer future appreciation on assets at a nominal, close to zero, gift tax cost. The GRAT's creator, or "grantor," transfers assets to a trust for a specified term of years. Over the GRAT's term, the GRAT repays the grantor, in the form of fixed annuity payments, property equal in value to the initial value of the transferred assets plus an assumed rate of return. This assumed rate of return is based on the 7520 Rate in effect for the month in which the GRAT is funded and is often referred to as the GRAT's "hurdle rate." The GRAT will be successful if, among other things, the GRAT's assets appreciate in excess of the hurdle rate, in which case that excess appreciation will pass to the GRAT's beneficiaries (such as trusts for the grantor's children) free of additional transfer taxes.

A GRAT is a particularly attractive planning technique because there is no downside other than transaction costs if the GRAT's assets do not perform as well as expected. If the GRAT's assets appreciate at a rate lower than the hurdle rate, the assets simply will be repaid to the grantor through the required annuity payments. Although there is no estate planning benefit under such circumstances, the grantor will be in substantially the same position as if the GRAT had never been created in the first instance.

Contact Information

If you have any questions regarding this alert, please contact—

Irene A. Steiner

isteiner@akingump.com

212.872.8015

New York

Elizabeth E. Harris

eharris@akingump.com

212.872.7407

New York

Victoria F. Bolton

vbolton@akingump.com

212.872.8067

New York

Anta Cisse-Green

acissegreen@akingump.com

212.872.7473

New York

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