AKIN GUMP
STRAUSS HAUER & FELD LLP

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TAX ALERT

PROPOSED GREEN BOOK REVISIONS COULD AFFECT GRAT AND VALUATION RULES

The Obama administration recently released the Treasury Green Book, which describes in detail the revenue proposals contained in the president's budget for fiscal year 2010. Of particular note, the Green Book proposes revisions to the rules governing grantor retained annuity trusts (GRATs) and to certain estate and gift tax valuation rules. The projected revenues from the proposals are intended to finance the president's health care reform initiative.

One proposal targets short-term GRATs. A GRAT (previously discussed in our December 16, 2008, client alert, "A Surprisingly Opportune Time for Estate Planning") is an estate planning device by which an individual transfers to his/her children or other beneficiaries, at a near-zero gift tax cost, potential future appreciation earned on property over a specified term. A GRAT is successful if the grantor survives the specified term and the appreciation in the value of the transferred property over the term exceeds the IRS' imputed interest rate. A very short-term GRAT—two to three years—is potentially advantageous, not only because it increases the likelihood the grantor will survive the term, but also because good investment performance during the short term may be isolated from poor performance that could dilute the GRAT's performance over a longer term. The Green Book proposal would require a GRAT to have a minimum term of 10 years. Although it would have no effect on the low gift tax cost of creating a GRAT, this proposal could significantly reduce the GRAT's potential transfer tax benefits by increasing the risk of the grantor's death during the term, as well as the likelihood that good performance in some years may be diluted by poor performance in others.

Another proposal targets valuation discounts commonly used in valuing interests in family-controlled entities. Certain restrictions on such interests that ordinarily would justify valuation discounts would be disregarded for valuation purposes where an individual transferred the interests to other family members and, after the transfer, the restrictions lapsed or could be removed by the transferor and/or family members. Disregarded restrictions would include limitations on the transferee's right to liquidate his/her interest that are more restrictive than a specified standard, as well as limitations on the transferee's ability to be admitted as a full partner or holder of an equity interest in the entity. This proposal could result in higher valuations of interests in family-controlled entities and increased transfer tax costs of intra-family transfers of such interests.

Both proposals would apply to transfers made after the date of enactment of corresponding legislation.

We caution that no legislation implementing the president's proposals has yet been introduced, and there is no guarantee that Congress will ultimately agree with the president's specific recommendations. Nevertheless, our legislation trackers in Washington, D.C. believe it is safe to assume that the Obama administration's official endorsement of these proposals will cause legislators to consider them seriously. If you have contemplated engaging in an estate planning transaction that may be affected by the proposals, you may wish to take action now, before any legislation is enacted that makes either technique far less attractive.

Akin Gump Strauss Hauer & Feld LLP will continue to monitor and keep you informed of developments in this area on a real-time basis.

CONTACT INFORMATION

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