February 5, 2010

ESTATE AND GIFT TAX ALERT

REVENUE PROPOSALS IN 2011 BUDGET TARGET GRAT AND VALUATION RULES

On Monday, February 1, 2010, the Obama administration released its fiscal year 2011 budget proposal, which, among other revenue-raising bids, proposes revisions both to the rules governing grantor retained annuity trusts (GRATs), as well as to certain estate and gift tax valuation rules. (Notably, the budget proposal contemplates that the federal estate and generation-skipping transfer tax law as it existed on December 31, 2009 remains in effect.) These revisions are similar to those included in the administration's 2010 budget proposal, demonstrating that the Obama administration appears to be focused on limiting the estate planning benefits of GRATs and valuation discounts.

One proposal targets short-term GRATs. A GRAT 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 administration's proposal would require (i) a GRAT to have a minimum term of 10 years and (ii) a GRAT's remainder interest to have a value greater than zero (with no guidance provided as to how much greater than zero). In addition to possibly adversely affecting the extremely low gift tax cost of creating a GRAT under current law, 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. This proposal could result in higher valuations of interests in family-controlled entities and increased transfer tax costs of intrafamily transfers of such interests.

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

We caution that no legislation implementing the administration's proposals has yet been introduced, and there is no guarantee that Congress will ultimately agree with the president's specific recommendations. Nevertheless, because very similar measures were included in the administration's 2010 budget proposal, we believe it is possible that GRATs and valuation discounts may be limited along the lines proposed. 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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