AKIN GUMP
STRAUSS HAUER & FELD LLP

Estate and Gift Tax Alert

Congress Poised to Overhaul GRATs

March 31, 2010

On March 24, 2010, the House of Representatives passed H.R. 4849, the Small Business and Infrastructure Jobs Tax Act of 2010, which includes a revenue offset measure that would significantly affect the rules governing grantor retained annuity trusts (GRATs). The proposed new rules are similar to those included in the Obama administration's 2010 and 2011 budget proposals, suggesting that GRATs have been targeted as a means to raise revenue.

As proposed earlier by the Obama administration, the bill takes aim at short-term GRATs. A GRAT is an estate planning device by which an individual transfers to 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.

If the bill, as passed by the House, becomes law, it would require (i) a GRAT to have a minimum term of 10 years, (ii) a GRAT's remainder interest to have a value greater than zero and (iii) the annuity payments not to decrease during the first 10 years of the GRAT's term. In addition to possibly adversely affecting the extremely low gift tax cost of creating a GRAT under current law, the bill 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.

The proposed new GRAT rules would become effective upon the enactment of the bill, and enactment could occur in the very near future. Congress has so far acted quickly in considering and passing the bill (only eight days after it was introduced in the House); the bill was sent to the Senate on March 25.

We caution that the bill may not ultimately be enacted as passed by the House. Nevertheless, because very similar measures were included in the Obama administration's 2010 and 2011 budget proposals, and because the bill's GRAT provision is the second-largest revenue offset contained in the bill, we believe, at this time, that the GRAT provision will likely be included in the bill if it is passed by the Senate. If you have contemplated creating a GRAT, you may wish to take action now, before the bill or any similar legislation is enacted.

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

If you have any questions concerning 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