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PENDING LEGISLATION COULD LIMIT POPULAR ESTATE PLANNING TECHNIQUE

Estates & Trusts Alert
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Practices & Industries

Trusts & Estates

On March 26, 2010, the House of Representatives passed a bill that would drastically reduce the effectiveness of a popular and successful estate planning technique known as a short-term grantor retained annuity trust, or GRAT. The bill was passed in the House in a week's time, and it could move just as swiftly through the Senate and become law in the near future. Hodgson Russ urges clients whose estate plans may benefit from a GRAT to consider creating a GRAT immediately, before the bill becomes law. Clients who should consider this kind of planning are those who meet the following descriptions:

- An estate valued at over $3.5 million, or $7 million if married,
- A significant portion of their estate is closely held or nonpublicly traded business or investment interests, or they have a substantial portfolio of publicly traded securities they expect to appreciate over the near term (two years),
- These interests are expected to appreciate, perhaps because of an eventual liquidity event, such as a sale, and
- A desire to maximize value to family members.

Successful short-term GRATs can pass significant assets to the next generation without the imposition of any estate or gift tax. Typically, a grantor will create a two-year GRAT, and he can structure the trust so that no gift tax is due when he funds the trust. If the GRAT's rate of return exceeds the "hurdle rate," all of the return above the hurdle rate passes to the beneficiaries without gift tax. The hurdle rate for both March and April is 3.2%. If the GRAT fails — that is, if its assets do not return more than the hurdle rate — the grantor simply gets the assets back and is no worse off than if the GRAT technique had never been employed.

The legislation, which just passed the House as part of the Small Business and Infrastructure Jobs Tax Act of 2010, imposes a 10-year minimum term on GRATs. If enacted, this rule would reduce the attractiveness of GRATs by raising the mortality risk, requiring assets to be tied up for at least 10 years and eliminating the use of a series of short-term GRATs in which assets that fail to beat the hurdle rate during the GRAT term come back to the grantor, while those that outperform pass to the beneficiaries. In addition, the new legislation would result in the grantor having to pay some gift tax or use some lifetime credit on the creation of the trust.