New Gift Tax Legislation Pending - Immediate Action Required

On June 15, 2010, the House of Representatives passed The Small Business Jobs Tax Relief Act of 2010 (the "Act") which, if passed by the Senate and signed by the President, will significantly limit the utility of grantor retained annuity trusts (GRATs).

New Limitations

The Act would impose the following new limitations on GRATs:

(1) A required minimum 10-year term;
(2) The annual annuity payment cannot decrease relative to any prior year during the first 10 years of the term; and
(3) The remainder interest must have a value greater than zero determined as of the time of the transfer.

The new legislation would apply to all transfers to GRATs made after the date of the enactment of the Act.

Impact of New Legislation

When creating a GRAT, a short annuity payment period is considered advantageous because the grantor's death during the annuity payment period will cause all of the GRAT property to be included in the grantor's estate for tax purposes. In addition, potential significant appreciation within the shorter term will not be cancelled out by virtue of a longer term normalization or reduction in values. The required minimum 10-year term increases the mortality risk and could make GRATs less desirable for those who anticipate significant short term appreciation. Furthermore, by mandating that the annual annuity payments cannot decrease during the first 10 years of the GRAT term, the Act removes the possibility of front-loading the annual annuity payments as a means of converting a 10-year GRAT into a shorter term GRAT.

By requiring a remainder interest with a value greater than zero, the Act would require that the grantor pay gift tax, or at least use some portion of the grantor's $1,000,000 gift tax exemption, when establishing the GRAT. Since the GRAT may or may not actually realize an investment return sufficiently in excess of the §7520 Rate (i.e., the hurdle rate to beat to actually have an effective transfer of property via the GRAT) so as to pass property to the GRAT remainder beneficiaries, this can result in a waste of the grantor's gift tax exemption or the payment of gift tax without any benefit.

Please click here for a more detailed explanation of how GRATs work.

What action do you need to take?

Although it is impossible to say whether the Act will actually become law, the current confluence of (i) low asset values, (ii) a §7520 Rate near its all time low, and (iii) the real possibility that GRATs might not remain as viable an estate tax planning technique for much longer, suggests that now is the time to establish a GRAT. Please call your Moses & Singer contact if you would like to take advantage of the current GRAT rules.

MOSES & SINGER LLP

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Gideon Rothschild
Co-Chair
212.554.7806
grothschild@mosessinger.com

Irving Sitnick
Co-Chair
212.554.7821
isitnick@mosessinger.com

Lori Anne Douglass
212.554.7803
ldouglass@mosessinger.com

Daniel S. Rubin
212.554.7899
drubin@mosessinger.com

Alvin H. Schulman
212.554.7888
aschulman@mosessinger.com

Ira W. Zlotnick
212.554.7870
izlotnick@mosessinger.com

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The Chrysler Building
405 Lexington Avenue
New York, NY 10174-1299
Tel: 212.554.7800 Fax: 212.554.7700

2200 Fletcher Avenue
Fort Lee, NJ 07024
Tel: 201.363.1210 Fax: 201.363.9210
Abraham Y. Skoff, Esq.
Managing Attorney for New Jersey