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## Are GRATs an Endangered Species?

On March 24, 2010, the U.S. House passed H.R. 4849, [The Small Business and Infrastructure Jobs Tax Act of 2010](#).

Although the legislation focuses primarily on job creation, its revenue provisions include long-anticipated restrictions on the use of short-term, zero-remainder grantor-retained annuity trusts (GRATs) as effective estate tax planning vehicles.

A GRAT is an irrevocable trust that pays a fixed annuity to the grantor for a specified number of years, before distributing the remainder to the grantor's beneficiaries. The GRAT remainder is a taxable gift from the grantor to the beneficiaries. However, because its value is determined for gift tax purposes when the trust is initially funded, any actual value increase in excess of the IRS's assumed rate is effectively transferred to the remainder beneficiaries free of gift tax. On the other hand, if the grantor dies before the GRAT annuity term ends, all of the trust assets, including the remainder, are brought back into the grantor's estate for estate tax purposes.

For years, taxpayers have sought to avoid the risk of estate tax inclusion by using short-term GRATs. To minimize gift taxes, they also have selected an annuity rate that would produce a present value (taking into account certain IRS assumptions) close or equal to the initial trust value, thus creating a remainder with an

assigned tax value near zero. In addition, some planners have combined a declining annuity schedule with short-term GRATs to "lock in" any early appreciation above the assumed IRS rate.

H.R. 4849 would eliminate these valuable GRAT strategies, effective for transfers made after the bill is signed into law:

1. **Short-term GRATs will no longer be allowed;** the grantor's initial annuity term must last at least 10 years. In other words, if the grantor dies within 10 years of creating the GRAT, the tax strategy fails because all of the trust assets will be included in the grantor's estate.
2. **Annuity payments may not decline in amount during the initial 10-year term.**
3. **The remainder value must be greater than zero at the time of funding.**

The Senate must now take up the legislation and is expected to make changes to it. Of course, few can predict when the process will be completed or if those changes will affect the GRAT provisions or answer other outstanding gift, estate and generation-skipping tax issues.

But one thing is certain ... The window to implement short-term, zeroed-out GRATs appears to be closing soon.

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