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GRATs – Going, Going, Gone?

Grantor Retained Annuity Trusts, or GRATs, have been a staple of estate planners for a number of years. Successful GRATs have the ability to pass significant amounts of appreciation to beneficiaries with the imposition of little or no gift tax. On March 26, 2010, the House of Representatives approved a bill that could potentially destroy the effectiveness of this planning technique.

Typically, a GRAT is structured as a short-term trust to which the grantor transfers property that is either expected to appreciate in a fairly short period of time or that will generate significant amounts of income. In exchange for transferring the property, the trust agrees to pay the grantor an annuity which is designed to "zero-out" the trust economically so that the grantor essentially gets back everything he put into it, plus interest.

The GRAT is a success if the property appreciates at more than the government's interest rate, or if it is an income-producing property – if income produced can equal or exceed the amounts necessary to pay the annuity and interest to the grantor. These trusts are frequently structured as two- or three-year trusts so that the appreciation can be captured and is not returned to the grantor.

If enacted, the legislation would impose a 10-year minimum term on GRATs and would also require some gift tax to be paid (although this last requirement raises a number of questions as to what is meant by 'some').

Anyone who has been considering estate planning and has considered using a GRAT should act now. Once enacted, the efficacy of a GRAT will be restricted.

For more information, please contact Randi Schuster, Principal in Charge of Trusts and Estates, at (212) 697-6900, RSchuster@hrrllp.com.

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