

# “What keeps you up at night?”

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## GReAT estate planning opportunity will soon be gone

By Jeffrey S. Glaser

Time is running out to take advantage of a limited estate planning opportunity. The Obama Administration would like to change the rules that currently govern the use of the Grantor Retained Annuity Trust (“GRAT”). Acknowledging that the current rules are too effective as wealth shifting tools, the Administration states that GRATs “have proven to be a popular and efficient technique for transferring wealth while minimizing the gift tax cost of transfers....Taxpayers have become more adept at maximizing the benefit of this technique....” By changing existing rules, the Administration hopes to tax more assets.

### WHAT IS A GRAT?

A GRAT is a trust used to transfer assets that are expected to appreciate. An individual who establishes a GRAT is the grantor. After assets are transferred to the GRAT, the grantor receives back a series of payments that typically last for a period of years. When the trust term ends, assets remaining in the GRAT pass to a beneficiary, known as the remainderman. Typically the remainderman is the grantor’s child or a trust for that child. When a GRAT is created, two interests arise: the Grantor’s interest and the remainderman’s interest. The values of these interests are measured actuarially based on variables in existence when the GRAT is created. The actuarial value of the remainder interest is treated as a gift, and thus is subject to gift tax.

### WHY IS A GRAT DESIRABLE?

Current law allows a Grantor to establish a GRAT in which the remainder interest, measured actuarially, is zero. As a result, no gift is deemed to be made when the GRAT is established, so that there is no gift tax (or estate tax) risk.

One of the factors used to value the gift is the interest rate set by the government. Currently, this interest rate is extremely low by historical standards, which is very advantageous for folks who don’t like taxes. Euphemistically known as the “hurdle rate” (the objective is for the total return on trust assets to be higher than the hurdle), this interest rate plays a key part in a GRAT’s success. Essentially, if the GRAT assets outperform the hurdle rate, when the trust term

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ends assets will pass without any gift or estate tax. The hurdle rate for June is 2.8%. So, if a GRAT is established in June and the total return on the GRAT assets exceeds 2.8% each and every year, when the trust term ends, the remainder beneficiary — such as a child or a trust for the child's benefit — will receive property free of gift tax or estate tax.

For a GRAT to be successful, the Grantor must outlive the trust term. Otherwise, the assets that remain in the GRAT at death are subject to estate tax. If death occurs before the trust ends, however, the entire transaction is treated as never occurring.

The Obama Administration does not propose to do away with the ability to create a GRAT with a remainder interest valued at zero, so that opportunity continues to be available. However, the possibility that a GRAT cannot be less than ten years and the expectation that the hurdle rate will continue to rise in future months make the use of a GRAT extremely appealing now. Feel free to contact one of the attorneys in Saul Ewing's Personal Wealth, Estates and Trusts department to learn how you can take advantage of the two-year GRAT technique before it has been relegated to the dustbin of history.

**PROPOSED CHANGES TO  
GRAT LAWS**

To minimize the risk that the Grantor dies before the trust term ends, clients seek to use the shortest term possible, which is currently two years. It is this two-year trust term that the Obama Administration dislikes. According to their suggested proposal, the minimum term for a GRAT should be extended to ten years. The Administration says, “this proposal would require, in effect, some downside risk in the use of this technique.” The Administration understands that Taxpayers have minimized and even avoided gift tax and estate tax quite successfully — but apparently too successfully. If this proposal becomes law, it will become effective upon adoption. There will be no grace period.

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