

June 18, 2009

## Congressional Climate: Estate Tax Rates, Short-Term GRATs, and FLP Discounts

While we still have not seen a serious proposal to make major changes to the federal estate tax exemption and rates, pending proposals would prohibit short-term grantor retained annuity trusts ("GRATs") and reduce or eliminate certain valuation discounts on transfers of minority interests in closely-held entities, such as family limited partnerships ("FLPs").

### Making Permanent the Estate Tax Exemption and Rates

Although Congress has yet to address the federal estate tax exemption and tax rates this year, Senate Finance Committee Chairman Max Baucus (D-Mont.) has stated that he will "not let the [tax rate] be zero next year." Senator Baucus has introduced a Senate bill (S. 722) that would index the exemption levels going forward and make permanent the 2009 tax rates: (i) estate tax and generation skipping transfer ("GST") tax exemptions would remain at \$3,500,000 per person (\$7,000,000 per married couple), (ii) \$1,000,000 lifetime gift tax exemption, and (iii) 45% top rate for gift, estate, and GST taxes. As currently proposed, Baucus' bill would be effective for gifts made after December 31, 2009 and estates of decedents dying after December 31, 2009.

### Minimum Ten-Year Term for GRATs

Many taxpayers have utilized a short-term GRAT (usually 2-3 years) or a series of "rolling" short-term GRATs to transfer appreciation in investments to children at a low gift tax cost. Short-term GRATs (i) avoid offsetting gains in early years against losses in later years, and capture the gains in the "good years," and (ii) minimize the risk of the grantor's death during the term which would cause most or all of the remaining assets in the GRAT to be included in the grantor's estate. The Obama Administration has proposed a minimum ten-year term to reduce the estate tax benefits of these trusts, and to help pay for its health care reform objectives. Anyone considering establishing a GRAT today should consider using a mid-term GRAT (e.g., three to five years), rather than facing the possibility of creating a two-year GRAT and then rolling it into a ten-year GRAT at the end of its term. If the proposal is enacted, the minimum ten-year term requirement would likely apply to GRATs created after the date of enactment (though the requirement could be retroactive to the date the proposal is introduced).

### Valuation Discounts for Family Entities

Appraisers often apply discounts to the value of a closely-held business when an individual transfers a minority interest in the entity (including corporations, LLCs, and partnerships), but a recent estate tax bill (HR 436, Pomeroy (D-ND)) would restrict the estate and gift tax benefits associated with such entities.<sup>1</sup> The bill would prohibit valuation discounts with respect to an entity's non-business assets, such as marketable securities and real estate that is not used in the active conduct of a real estate trade or business; in addition, no "lack of control" discount could be applied even to an active business where the recipient's family controls the business. As currently proposed, these provisions would apply to transfers made after the date of enactment.

<sup>1</sup> Please refer to our [Alert dated February 18, 2009](#) for additional details.

The House Ways and Means Committee is considering these proposals and plans to unveil a health care reform plan sometime this month, followed by hearings and a markup after the July 4 recess. Thus, it is possible that Congress could act quickly and make these changes effective in June or July before adjourning for the August recess. Low interest rates and low asset valuations make some of these transactions very attractive, and anyone considering establishing a GRAT or making transfers of interests in a family entity should consider accelerating their planning before any legislation impairing these techniques takes effect.

If you have any questions, please feel free to contact one of the attorneys listed below:

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