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AALU Bulletin No: 10-60

June 16, 2010

Subject: **House Passes Small Business/Jobs Act That Includes Minimum 10-Year GRAT Term Requirement as Revenue Raiser**

Major References: [\*\*Section 531 of H.R. 5486: The "Small Business Jobs Tax Relief Act of 2010"\*\*](#)

Prior AALU Washington Reports: 10-35; 10-15; 09-50

MDRT Information Retrieval Index Nos.: 7400.023

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*As noted in our Bulletins Nos. 10-35, 10-15 and 09-50, both of President Obama's budget proposals for FYs 2010 and 2011 and a recent version of the "Jobs" bill (H.R. 4849) that was passed by the House and is currently under consideration in the Senate, contained a proposal to require a minimum 10-year term for "grantor retained annuity trusts" ("GRATs"). The 10-year GRAT proposal is now also contained as the primary revenue offset (\$5.3 billion over 10 years) in section 531 of H.R. 5486, the "Small Business Jobs Tax Relief Act of 2010," which was passed by the House by a vote of 247-170 on June 15, 2010. The bill was introduced by House Ways and Means Chairman Sander Levin (D- Mich.) on June 9, 2010.*

The principal purpose of H.R. 5486 is not, of course, the GRAT provision. It is instead aimed at providing small business tax relief and infrastructure incentives. In particular, the bill (like H.R. 4849, the earlier Jobs Bill) would provide for a temporary exclusion of 100 percent of gains on qualified small-business stock acquired before January 1, 2012. The infrastructure incentives that were a feature of H.R. 4849 are not included in this version.

With respect to the GRAT provision, Section 2702 of the Internal Revenue Code provides that, if an interest in a trust is transferred to a family member, the value of any interest retained by the grantor is valued at zero for purposes of determining the transfer tax value of the gift to the family member(s). This rule does not apply if the retained interest is a “qualified interest” - *i.e.*, a fixed annuity or unitrust interest, as defined in applicable Treasury regulations. A grantor retained annuity trust - or GRAT - is one such qualified interest, and current law prescribes no particular minimum or maximum length of term for a GRAT.

GRATs have proven to be a popular and efficient technique for transferring wealth while minimizing the gift tax cost of transfers, providing that the grantor survives the GRAT term and the trust assets do not depreciate in value. Taxpayers have become adept at maximizing the benefit of this technique, often by minimizing the term of the GRAT (thus reducing the risk of the grantor’s death during the term), in many cases to 2 years, and by retaining annuity interests significant enough to reduce the gift tax value of the remainder interest to zero or to a number small enough to generate only a minimal gift tax liability.

The bill’s GRAT provision, which is identical to the provision in H.R. 4849, requires, in effect, that there be some downside risk in the use of this technique by imposing the requirement that a GRAT have a minimum term of 10 years (a number that appears to have been chosen because it is the same as the 10-year minimum term of so-called “*Clifford*” trusts that were created on or before March 1, 1986). The provision also requires that the annuity (determined on an annual basis) not decline during the first 10 years of the annuity term; and that the remainder interest must have a value greater than zero at the time of the transfer (although no minimum value is prescribed). At a minimum, the bill would increase the risk of the grantor’s death during the GRAT term and thus the resulting loss of any anticipated transfer tax benefit. This loss would presumably be the Treasury’s gain to the tune of approximately \$5.3 billion over the next 10 years. (We note that this revenue estimate is higher than the \$4.45 billion revenue estimate in H.R. 4849.) As with previous versions of this provision, it would be effective on “date of enactment.” Absent a change in the effective date in any final version of the legislation that may be adopted, the new GRAT restrictions would apply to GRATs executed on or after the date of enactment.

We will continue to monitor the progress of this GRAT proposal, which, because it is currently a popular “revenue offset” to numerous pieces of desirable legislation, appears increasingly likely to be enacted.

H.R. 5486 is being moved simultaneously with a broader bill aimed at providing financing for small businesses, the “Small Business Lending Fund Act of 2010” (H.R. 5297). The House is expected to vote on H.R. 5297 today (June 16, 2010). H.R. 5486 would then be merged into H.R. 5297.

Any AALU member who wishes to obtain a copy of section 531 of H.R. 5486 may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at [www.aalu.org](http://www.aalu.org), enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at [raglani@aalu.org](mailto:raglani@aalu.org) and include a reference to this *Washington Report*.

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