

PUBLICATION

Estate and Gift Tax Planning: Obama Administration's Proposals

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Through the release of the Treasury Department's "Greenbook," the Obama administration has outlined several sweeping proposed changes to the estate and gift tax laws. If enacted, these proposals would reduce or eliminate valuation discounts available to family-owned entities and would require lengthened terms for grantor-retained annuity trusts (GRAT). The Administration also proposed a new consistency requirement for income tax reporting upon the disposition of inherited assets. Finally, the Greenbook reiterates the Administration's plan to "freeze" the estate tax at its current exemption level and tax rate.

Valuation Discounts

When an individual transfers an interest in a closely-held entity by gift or at death under current law, such interest is valued at its fair market value on the date of transfer. Since closely-held entities are not publicly traded, and since the interests transferred in such entities often do not represent a controlling interest, valuation appraisers will often apply both a lack of marketability discount and a lack of control or minority interest discount in valuing the interest being transferred.

A current House Bill pending in Congress would disallow all valuation discounts for nonbusiness family entities and disallow minority discounts in family-owned business entities. That House Bill is called the "Certain Estate Tax Relief Act of 2009" (HR 436).

The proposed change in the Administration's Greenbook would be to amend provisions of the Internal Revenue Code (IRC) to provide that certain restrictions that are typically placed on interests in family-owned entities be ignored in valuing that interest for gift and estate tax purposes. The effect of such a proposal would be similar to the current House bill (HR 436) - that is, the denial or reduction of valuation discounts in appraising family entities.

GRATs

The use of GRATs is a popular estate-planning technique which allows grantors to transfer appreciation in assets with minimal transfer tax consequences in certain circumstances. A GRAT is formed when a grantor transfers assets which are expected to appreciate to a trust. The trust pays back an annuity to the grantor. Provided that the income paid back to the grantor satisfies the rate requirement calculated by the IRS pursuant to IRC Section 7520, any appreciation in the assets above and beyond the Section 7520 rate will be passed transfer-tax free to the beneficiaries of the trust. If the grantor dies during the term of the GRAT, however, all remaining assets in the trust will be included in his or her gross estate.

The Obama Administration perceives that GRATs are being abused because such trusts can be established for very short periods of time, typically two years, which minimizes the chance that the Grantor will die during the term of the trust. In addition, a shorter-term GRAT can be easily "zeroed-out" so that there are no gift tax consequences to the Grantor upon termination of the trust. In order to resolve the perceived abuse, the Administration's Greenbook has proposed a minimum 10-year term for GRATs.