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*A Professional Association*

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Dear Clients, Friends and Colleagues:

As you know, the Federal Reserve's monetary and fiscal policy has reduced interest rates in order to stoke the economy and stave off recessionary pressures. The interest rates prescribed by the IRS for certain types of transactions are reflective of the low interest rate environment, and thus a strategic opportunity presents itself.

The *strategy* entails your making a contribution of assets to a special type of trust, called a Short Term Grantor Retained Annuity Trust (or a "Short Term GRAT"). Pursuant to the Short Term GRAT arrangement, you retain the right to receive a payout (the annuity payment) from the trust each year for a specified term, generally two years. IRS methodology (which reflects the low interest rate) prescribes certain calculational details for the Short Term GRAT, making it particularly advantageous given today's low interest rate. Here are the basic elements of the Short Term GRAT arrangement:

- You create and implement a Short Term GRAT. (You can serve as the initial sole trustee).
- The Short Term GRAT agrees to pay you two installments, each of which is approximately 51.5 percent of the value of the asset(s) contributed to the Short Term GRAT, such installments to be paid on the first and second anniversaries of the GRAT's creation.
- The amount paid back to you is based on the IRS assumption that the GRAT's assets will earn an approximate 1.5 percent rate of return, which we call the "hurdle rate" (called the hurdle rate because the Short Term GRAT's investments need to "hurdle" over this rate). From the IRS standpoint, the value of the annuity paid back to you is equal to the value of the property contributed to the Short Term GRAT. Hence, creation of the Short Term GRAT does not result in a taxable gift.

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- The earnings of the Short Term GRAT which exceed the 1.5 percent hurdle rate will inure to your children (or other beneficiaries), estate and gift tax free.

In a nutshell, so long as the assets you contribute to the Short Term GRAT appreciate at a rate greater than the IRS prescribed hurdle rate, the excess earnings inure to your beneficiaries free of estate and gift tax at the conclusion of the GRAT's term.

*What has happened:* The prevailing low interest rate environment has driven down the hurdle rate making the Short Term GRAT very attractive for a number of taxpayers.

*Key Benefit:* Transfer of assets to the next generation, estate and gift tax free.

*Detriment:* The only detriment is the cost of the transaction. If the values go down, no benefit is derived nor, in such a case, is any detriment realized by the taxpayer.

*Income Tax Attributes:* All income realized by a Short Term GRAT is taxed to the Grantor/creator. This means that capital gains, if any, realized by the Short Term GRAT will be taxed to the Grantor and not the ultimate beneficiaries. This enhances the use of the GRAT for a gifting program because it enables you to pay tax on behalf of your beneficiaries.

#### Special Situations:

The Short Term GRAT is particularly advantageous if one contemplates any of the following transactions:

- The sale of a closely held business.
- The sale of a block of stock in a public company with a significant increase in value, (for example, reflecting a control premium).
- The sale of real estate that will appreciate substantially over a one or two year horizon.
- Significant appreciation in an investment that has been beaten down by market forces.

**Conclusion:** The Short Term GRAT opportunity is available because of the low interest rates presently in effect. The situation gives you an opportunity to take advantage of the impact of the current short term rates on your estate and gift tax planning.