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Grantor Retained Trusts: Closing the Loopholes With the Elimination of Zero-ed Out GRTs Does Not Require a Minimum Ten-year Term

Grantor retained trusts are trusts in which the grantor retains some sort of interest in the corpus assets while transferring the remainder interest to a beneficiary. Recently, the Obama Administration proposed requiring grantor retained trusts to have a minimum ten-year term where currently there is no minimum. A ten-year term serves no practical purpose, but another aspect of the proposal eliminating usage of the zero-ed out grantor retained trust will help curb gift tax avoidance.

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I. Introduction

For many, the estate tax represents something that is levied on assets which may have already been taxed. If the taxpayer accumulated wealth from a large salary as a CEO, he paid tax on the wealth as ordinary income.[1] If the taxpayer accumulated wealth through investments or strategic business moves, he paid tax on the gains at capital rates and possibly an additional 3.8% on net investment income. For some, the tax serves as a punishment on taxpayers for being industrious and hardworking.

The estate tax serves as a disincentive to save money and many argue that it creates an unmatched burden upon estates comprised of wealth from a small business.[2] The government levies estate tax only on assets *remaining* in the estate, so, "the simplest possible way to stiff the IRS is just to lavish money on cars, clothing, fine wines, travel, and restaurant meals. The estate tax holds no terror for the spendthrift rich. It's only wealthy people who live far below their means, thoughtfully accumulating assets for the benefit of their loved ones, who have to worry."[3]

For others, the estate tax makes complete sense. It is only levied on the wealthiest of society–a taxpayer who dies with over $5.43 million in assets or a couple with over $10.86 million now with the addition of portability rules.[4] The taxpayer has died anyway, it is not as if he can take the wealth into the afterlife. Even if the decedent planned on passing wealth to younger generations for what are generally considered noble purposes, such as to pay for college for grandchildren, the government already gave the decedent a "free pass" of sorts to give over $5 million tax-free. Anything above that amount is not forfeited, but heirs still receive 60% of the balance as the highest estate tax rate is currently 40% in 2015.[5]

Although estate planning is an important activity for all people who wish to devise their assets, two of the main goals of estate planning are to minimize federal estate taxes and to strategically give "inter-vivos" gifts. These main goals are the central focus of this essay as it deals with one technique specifically used to avoid transfer taxes: grantor retained trusts (GRTs).

A grantor retained trust is as it sounds, a trust in which the grantor retains some sort of right in the trust. GRTs have received much attention lately because the Obama Administration proposed requiring a minimum time period of ten years for GRTs, where currently there is no minimum requirement.[6] Liberals see the usage of GRTs as a tax avoidance tool and what many would call a tax loophole for the wealthy. Estate planners often structure GRTs to save taxpayers a large amount of transfer taxes. While perfectly legal, GRTs often have an "upside only potential" in that the grantor either saves money, or simply receives his money back.[7]

The Obama Administration's proposal in its current state is unfair and fails to achieve its unstated goal of eliminating loopholes for wealthy Americans. While instituting a minimum period of ten years, the proposal also aims to eliminate "zero-ed out" GRTs, perhaps the most common way to avoid gift tax. This aspect of the proposal should help to close the loophole associated with GRTs, but instituting a minimum ten-year term adversely affects older taxpayers.

GRTs are used by taxpayers generally to freeze the value of assets in their estates and pass assets to younger generations at a lower value for gift taxes, particularly by zero-ing out the GRT. The property transferred usually is one which taxpayers expect to appreciate in value. This serves the purpose so that the subsequent appreciation is transferred to the beneficiary(ies) of the trust free of transfer taxes. Congress enacted Internal Revenue Code Sections 2036 and 2702 in an attempt to tax similar assets in taxpayers' estates at death or at the time of gifting, but GRTs generally avoid these taxes or at least minimize them. Requiring a minimum ten-year term will raise minimal additional revenues but does so by targeting the elderly, discouraging diligent estate planning, and actually causing the IRS more work.

Requiring a remainder value of a certain non-zero minimum amount will help to stop wealthy taxpayers from using sophisticated schemes to pay less transfer taxes to the government than they should. While this will also require more compliance checks by the IRS, it is a step in the right direction toward closing loopholes in the tax system. Although, the Obama Administration's proposal currently suggests that remainder values must be the *greater of* 25% of the trust assets or $500,000.[8] This aspect of the proposal is unfair to taxpayers, but the general idea of eliminating zero-ed out GRTs can enact positive reform.

Regardless of one's feelings about transfer taxes and paying additional taxes at death, this essay proceeds from the standpoint simply that laws are laws and taxpayers should do their best to abide by the laws that are in place. The federal government should not enact laws that discriminate against one class of citizens as opposed to others, such as the GRT proposal does to elderly taxpayers by requiring a minimum ten-year term. But, taxpayers also have a duty to not to side-step the law and avoid paying their share of transfer taxes by zero-ing out GRTs.

This essay takes the reader through an analysis of the new Obama Administration proposal in Sections VI and VII, but first, some background information about GRTs is necessary. The first Section explains the basic structure of the estate and gift tax laws, Section III explains GRTs and their valuation, and Sections IV and V deal with specific Internal Revenue Code ("IRC") sections used to value and tax GRTs.

II. The Gross Estate

When a taxpayer transfers assets either by death or by gift to someone else, it is possible that the government will levy transfer taxes in the form of an estate or gift tax.

a. Estate Valuation

When someone dies, the value of his assets combined form his "gross estate." This is the value of everything that a person owns, with a few exceptions. Per IRC § 2031, "The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated."[9] Everything from a decedent's bank accounts to his house to the clothes in his closet have a value that could be subject to tax.

The value of each piece of property is generally its fair market value at date of death,[10] per Regulation 20.2031-1(b). Fair market value is defined as, "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[11] Revenue Ruling 59-60 adds that buyers and sellers must be able and willing to enter into the transaction, and must have adequate knowledge about the market for the property.[12]

b. Gift Tax Valuation

The gift tax works from similar ideals, but is a bit different in its structure. Like the estate tax, a gift is valued at its fair market value.[13] Instead of the date of death, the valuation date is the date of gift.[14] But, unlike the estate tax which is paid only once at death, gift tax can be assessed multiple times and in fact is assessed each time a gift is made, though the gift tax return is filed on an annual calendar-year basis. The gift tax is codified beginning with IRC § 2501, which "imposes a tax on the 'transfer of property by gift' during the calendar year by any individual. Section 2511 goes further in providing that the tax imposed by § 2501 shall apply 'whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.'"[15]

However, not every gift is taxable. The IRS gives taxpayers an "annual exclusion" codified in IRC § 2503, which is adjusted for inflation.[16] In 2015, this amount is $14,000 and it represents the amount a taxpayer can give to a donee before gift tax is assessed.[17] This allows for somewhat regular gifts such as for birthdays, weddings, holidays, and the like to be tax-free, as long as they are cumulatively under the annual exclusion amount. Parents can also help their kids to buy a car or pay rent gift-tax free, as long as the amount of the gift(s) does not exceed $14,000 per donee, per year, per taxpayer. Married taxpayers are counted individually for both purposes of giving gifts, and receiving gifts.[18] That is, a husband and wife can individually give $14,000 to each of their married daughter and son-in-law for a total of $28,000 per recipient, and $56,000 in total for the daughter and her husband as a couple.

However, the annual exclusion only applies to gifts of present interests and not future interests of property.[19] "Present interest" denotes that the donee has the right to use the property immediately, as opposed to a future interest where the donee has some right in the future to use or enjoy the gift. Take the example of a trust where the grantor sets the terms to be that taxpayer A receives the rights of income from the trust assets for the remainder of A's life, and at the conclusion of A's life, the entire trust corpus goes to taxpayer B. In this example, A received a present interest since he has the rights to the income immediately, but taxpayer B has a future interest since he does not receive a gift until the death of A. Therefore, A's gift is eligible to be reduced by the $14,000 annual exclusion, but the entire value of the remainder interest to B is taxable and not reduced by the annual exclusion.

In a GRT, the grantor retains some present interest right and gives a future interest in the form of a remainder interest to another beneficiary(ies). Therefore, in the case of a GRT, the grantor has to pay gift taxes on the full value of the remainder interest left to another person or trust since it is not eligible to be reduced by the annual exclusion, even if its value is under the $14,000 allowable exclusion per donee.

c. Gift Tax and Estate Tax Unified Credit

With a general background of the estate and gift tax, it is important now to understand how the two interact to fully know how they apply to GRTs. While technically the estate and the gift tax are two separate taxes that are assessed on different transfers and at different times, the two are very much related. The interrelation and existence of the two taxes is almost necessary to ensure some revenue is collected on the transfer of assets. If there were no gift tax, taxpayers would simply gift all their assets at various points in their lives, likely closer to death. Likewise, if there were no estate tax, taxpayers would likely hold on to their assets until death and wait for disbursement via will.

Not only in structure and valuation are the gift and estate taxes similar, but they also share a unified credit. The unified credit is $5.43 million in 2015, meaning that each U.S. taxpayer can gift, or die with, a combined total of $5.43 million before he will be assessed any estate or gift tax.[20] This unified exemption is codified in IRC §§ 2010 and 2505 and is indexed for inflation.

The way all these sections interplay can be a complex system for taxpayers and estate planners to figure out the best way to lower one's tax due. A taxpayer can therefore gift up to $14,000 per year (in 2015, assuming the gift qualifies for the annual exclusion) to another person without incurring gift tax. If the taxpayer instead gives $15,000 to another person, he still will not *pay* gift tax because his unified credit of $5.43 million will instead be lessened by $1,000, the excess over the annual exclusion. In the next year, if the same taxpayer gives $1,000,000 of a present interest gift to another person, he still will not *pay* any gift tax. Instead, the taxpayer will receive his $14,000 annual exclusion, bringing the taxable gift amount down to $986,000, and then his lifetime unified credit will be reduced by that amount, originally starting at $5,430,000, then reduced by the extra $1,000 gifted in year 1 to $5,429,000, further reduced to now $4,443,000 remaining. The taxpayer still can gift up to $4.443 million before paying gift tax, or he can save that amount to use against the estate tax which is levied at death. If a taxpayer never made any inter-vivos gifts, he will have the full $5.43 million to use against estate tax as a credit upon death. If a taxpayer gifted $5.43 million of taxable gifts or more during life, his full estate will be taxable at death because he has no more unified credit available. Therefore, although the gift and estate tax are two separately assessed and codified taxes on wealth transfers, they share the same "unified" credit. This is an important concept to keep in mind in the context of GRTs.

III. Grantor Retained Trusts, Generally

With a brief background of the estate and gift tax and interplay between the two taxes, it is time to move on to a description of GRTs and how they are structured and used more commonly in practice.

a. <u>What Are Grantor Retained Trusts</u>

A grantor retained trust is as it sounds, one in which the grantor retains some right in the trust. If the grantor retains a right to income from the trust, it is deemed a grantor retained income trust (GRIT),[21] such as if there are investments in the trust, the interest and dividends from the investments are the income. If the trust holds rental real estate, the rental payments are the income of the trust. If the grantor kept a right to annuity payments, then it is deemed a grantor retained annuity trust (GRAT),[22] such as if the grantor receives a $5,000 payment every year coming from the assets of the trust. Or, if the grantor keeps a unitrust interest then it is a grantor retained unitrust (GRUT),[23] which is an interest comprised of a payment received at pre-determined periods and is calculated as certain percentage of the value of trust assets.

The way these trusts generally work is the grantor puts some property that he expects to appreciate into a trust, and name someone else the beneficiary. The grantor keeps some right in the trust for a set period of time and pays gift tax on the value of the beneficiary's remainder interest, which presumably is lower now than it will be at the end of that period of appreciation. This is a helpful technique if a taxpayer holds stock where he expects the company will soon be publicly traded, or perhaps some sort of real property that he expects to increase substantially by the end of that period. By placing the asset in trust, the grantor pays a small amount of gift tax on the lower value and also removes the asset from his or her gross estate at death.[24]

By way of example, assume the grantor holds stock of a start-up company that he paid only pennies for because the company's future was uncertain and it had little assets. Now, a few years later, the company is contemplating an IPO and soon is expected to be publicly traded. The grantor may create a GRAT and place the stock into the trust for the benefit of his granddaughter. Since a gift is valued on the date of donation, the value of the gift is the remainder interest, but is based upon the stock's small value since the company is not yet publicly traded. Then, perhaps a year later when the stock is still in the trust and the IPO is finalized, the value of the stock rises to tens of thousands of dollars. There is no increase in gift tax since the grantor already paid tax on its value at the date of the gift, and the grantor has also removed the assets from his estate by transferring ownership to his granddaughter. The rise in value of the assets is not captured for transfer tax purposes since at the end of the term of the GRAT, the stock will be transferred to his granddaughter tax-free.[25] The grantor of course would have to receive some value of the trust to suffice the annuity value that he retained, say perhaps $5,000 each year. So, the whole value of the gift does not escape tax because those $5,000 payments would be paid back to the grantor and included in his estate; but, the rest of the tens of thousands of dollars will be passed to the granddaughter largely tax-free.

Taxpayers implement GRT techniques for several reasons, particularly for intra-family gifts. Namely, GRTs enable gifts at current values so future appreciation passes to subsequent generations fairly easily and the grantor does not have to continue to make subsequent gifts of the future appreciation.[26] But, these trusts can be a gamble as well because, if the asset used to fund the trust does not "generate enough income to pay the grantor the designated annuity, some of the value of the asset (and its appreciation) will have to be sold to realize enough cash to make up the annuity deficiencies."[27] In the example above, if instead of the penny stock's value skyrocketing, it flops, the trust terms still require a $5,000 annual payment to the grantor. The stock may have to be sold sooner than expected to cover the annuity payments.

But, in the very least, the grantor receives his assets back and less value passes to the beneficiaries. He may be out the legal fees to set up and account for the trust, but since these trusts usually deal with assets of high worth, the fees comparatively should be low. But, the upside can be huge that "the grantor retains for a term most or all of the income generated by the property given away. If the property generates a return exceeding the annuity percentage, the additional income will be accumulated for the remainder beneficiary without added gift taxes."[28]

b. <u>Estate Freezes</u>

Grantor retained trusts are a way of enabling taxpayers to "freeze" their estates. This term generally refers to planners attempting to transfer assets which are likely to appreciate earlier in time in order to avoid including the appreciation in the decedent's estate. By making a transfer of the asset at a certain point in time, estate planners "freeze" its value before potential appreciation. That is, generally, "the older generation retains income from, or control over, the property" but then the asset ultimately passes to a younger generation at its new, higher value.[29] But, "[b]ecause the value of the transferred interest increases while the value of the retained interest remains relatively constant, the older generation now has 'frozen' the value of the property in its estate."[30]

IV. Grantor Retained Trusts, Valuation

With an understanding of GRTs and how they work, now it is important to understand how they are valued.

a. Section 7520

A common estate planning technique is to create life estates and remainders, particularly when drafting a trust agreement. A life estate is when a person or entity is given the rights to a certain asset, such as the income from a trust or use of property, for the remainder of his life. Anyone who takes control of the asset after the life estate beneficiary is termed a remainder beneficiary or "remainderman" such that he enjoys the remainder of the asset. An asset that is given for a term of years is just as it sounds: a grantor or donor gives someone the right to enjoy an asset for a certain number of years before passing possession or enjoyment to another person. GRTs usually are for a term of years.

Although a trust set up for a term of years may seem like the easiest of these to value, the beneficiary may die in the middle of the term of years when his estate still holds the right to the enjoyment for the remaining time allotted. To further complicate matters, trusts can be drafted such that the assets flow to one person if they are alive when another person dies, and if they are not alive, the assets may flow to yet another third person. Since gifts are valued on the date of donation, it is not hard to imagine that situations like this can make valuation efforts very difficult.

Such uncertainties based on the taxpayer's life expectancy can create widely differing valuations. Luckily, the IRS has anticipated such uncertainties and has come up with a solution using tables to value the life expectancy of a person.[31] Sometimes people may live longer than their life expectancy calculated per the tables, and sometimes a person may live for a shorter time. Either way, the IRS has put forward a way of valuing such assets for the purpose of estate and gift taxes. The tables are found in Regulation 20.2031-7, and "if the limitations and conditions affecting possession or enjoyment of the underlying property can be estimated reasonably, the gift tax value of a term interest or remainder is determined by discounting the future payments to present value under Treasury tables based on prescribed discount rates and mortality presumptions."[32]

The tables are adjusted by the IRS on a regular basis to ensure that they are in line with actual averages and current events. More specifically:

> Somewhat more complex rules are necessary to determine the valuation of annuities, life estates, term of years, remainders and reversions. In general, the fair market value of such an interest is its present value, determined under the regulations in accordance with actuarial principles. The interest rate to be used in calculating present value for this purpose is prescribed by statute and adjusted each month. In addition, in valuing an annuity or a life estate, remainder or reversionary interest, it is often necessary to estimate the longevity of a particular living individual. Usually such interests will be valued on the assumption that the particular measuring life will turn out to be equal to the average life expectancy for a person of the same age, based on current national mortality experience.[33]

Below is a screenshot of the chart that is featured in Regulation 20.2031-7, which would be used, for instance, to value a GRAT. Depending on the 7520 rate applicable for the month of transfer, a taxpayer looks for that value at the top of the table, and finds the applicable number of years for the GRAT's term on the y-axis of the table, and then finds the percentage value at the intersection of those two inputs. The taxpayer then multiples the percentage at the intersection by the full value of the trust, and the result represents the value of the remainder interest. To find the value of the retained annuity interest, simply take the full value of the trust and subtract the value of the remainder interest. The remainder interest and the retained interest should always sum to the full value of the trust.

Table B—Term Certain Remainder Factors Applicable After April 30, 1989

Years	Interest rate									
	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
1	.959693	.957854	.956023	.954198	.952381	.950570	.948767	.946970	.945180	.943396
2	.921010	.917485	.913980	.910495	.907029	.903584	.900158	.896752	.893364	.889996
3	.883887	.878817	.873786	.868793	.863838	.858920	.854040	.849197	.844390	.839619
4	.848260	.841779	.835359	.829001	.822702	.816464	.810285	.804163	.798100	.792094
5	.814069	.806302	.798623	.791031	.783526	.776106	.768771	.761518	.754348	.747258
6	.781257	.772320	.763501	.754801	.746215	.737744	.729384	.721135	.712994	.704961
7	.749766	.739770	.729925	.720230	.710681	.701277	.692015	.682893	.673908	.665057
8	.719545	.708592	.697825	.687242	.676839	.666613	.656561	.646679	.636964	.627412
9	.690543	.678728	.667137	.655765	.644609	.633663	.622923	.612385	.602045	.591898
10	.662709	.650122	.637798	.625730	.613913	.602341	.591009	.579910	.569041	.558395
11	.635997	.622722	.609750	.597071	.584679	.572568	.560729	.549157	.537846	.526788
12	.610362	.596477	.582935	.569724	.556837	.544266	.532001	.520035	.508361	.496969
13	.585760	.571339	.557299	.543630	.530321	.517363	.504745	.492458	.480492	.468839
14	.562150	.547259	.532790	.518731	.505068	.491790	.478885	.466343	.454151	.442301
15	.539491	.524195	.509360	.494972	.481017	.467481	.454350	.441612	.429255	.417265
16	.517746	.502102	.486960	.472302	.458112	.444374	.431072	.418194	.405723	.393646
17	.496877	.480941	.465545	.450670	.436297	.422408	.408987	.396017	.383481	.371364
18	.476849	.460671	.445071	.430028	.415521	.401529	.388033	.375016	.362458	.350344
19	.457629	.441256	.425498	.410332	.395734	.381681	.368153	.355129	.342588	.330513

https://www.law.cornell.edu/cfr/text/26/20.2031-7

Because a taxpayer retains a right and cannot gift to oneself, only the remainder interest in a GRT is subject to gift tax.[34] Further, since remainder interests are not completed gifts, no annual exclusion is available, and they are fully taxable. Because the split interests always add to the full value of the trust corpus, "the values of the respective interests are interdependent, and any uncertainty or inaccuracy in the valuation of one interest indirectly affects the valuation of the other."[35]

b. <u>Zero-ed Out</u>

A very popular usage of the GRAT is one which is "zero-ed out." Since money paid to oneself is not a gift, a grantor merely tries to make the annuity payments going back to himself as large as possible such that the value of the remainder interest is essentially zero for gift tax purposes. Because the value of the retained interest plus the remainder interest must always equal the entire value of the trust corpus at funding, if the grantor's share is large, then the remainder interest will be proportionately small. In some cases, for example, taxpayers can earn greater appreciation than the 7520 rate provided in the tables and that appreciation generally passes tax-free to the remainderman.[36] This could result in a large transfer of assets out of an estate to younger generations with very little gift tax paid.

For example, assume that grantor places $100,000 into a ten-year GRAT when the 7520 rate is 4.2%, paying him an annual $5,000 annuity payment.[37] The 7520 rate is based upon the federal AFR rate, which is roughly the rate at which the government expects assets to appreciate.[38] Assuming a 4.2% growth rate in line with the 7520 rate, if the grantor receives an annual $5,000 annuity payment, he will pay gift tax on a remainder value of approximately $90,306, per **Table A**. If in fact the investment appreciated at 5% instead of the expected 4.2% rate, the grantor will have transferred $91,307 to the remainderman while only paying gift tax on $90,306, a savings of $1,001.

Table A

Year	Beginning Balance	Assumed Growth at 4.2%	Annuity Payment	Assumed Ending Balance	Actual Growth at 5%	Actual Ending Balance
1	100,000	4,200	5,000.00	99,200	5,000	100,000
2	99,200	4,166	5,000.00	98,366	4,960	99,160
3	98,366	4,131	5,000.00	97,498	4,918	98,285
4	97,498	4,095	5,000.00	96,593	4,875	97,373
5	96,593	4,057	5,000.00	95,650	4,830	96,422
6	95,650	4,017	5,000.00	94,667	4,782	95,432
7	94,667	3,976	5,000.00	93,643	4,733	94,400
8	93,643	3,933	5,000.00	92,576	4,682	93,325

9	92,576	3,888	5,000.00	91,464	4,629	92,205
10	91,464	3,841	5,000.00	90,306	4,573	91,037

To take the example even further, assume this time that the grantor aims to create a zero-ed out GRAT. To do so, assume the $100,000 investment of the grantor is comprised of speculative grade corporate bonds paying a 5% annual interest. But, as in the previous example, the 7520 rate on the date of funding is 4.2%, which assumes a 4.2% rate of appreciation. In order to zero-out the GRAT, the grantor needs to draft the trust document so that he receives a $12,452.15 annual annuity payment over the ten-year term. If he does that, at the time of the gift, his retained interest equals the future value of the assets so it appears there will be zero remainder value left at termination. Grantor, therefore, pays *zero* gift tax. In reality, if the asset does receive a 5% interest instead of 4.2%, the remainder beneficiary will receive $96 at termination, completely gift tax free, see **Table B.**

Now, saving $96 is probably not worth the hassle for taxpayers to create the GRAT in the first place. But, if instead of $100,000, assume Grantor places assets worth approximately $1,000,000 into the trust and instead of only a moderate 5% growth, assume that grantor places volatile growth stock that instead grows at a 10% rate. In that case, Grantor transfers $6,931 to the remainder beneficiary paying absolutely no tax as long as he structures his annuity payments high enough to zero-out his GRAT, see **Table C**. Again, ~$7,000 may not be an amount really worth the hassle for taxpayers, but if they have a lot more than $1 million to gift, and their asset appreciates at a much higher rate than the 7520 rate, taxpayers can really transfer a lot of wealth free of transfer taxes.

Table B

Year	Beginning Balance	Assumed Growth at 4.2%	Annuity Payment	Assumed Ending Balance	Actual Growth at 5%	Actual Ending Balance
1	100,000	4,200	12,452.15	91,748	5,000	92,548

2	91,748	3,853	12,452.15	83,149	4,587	83,883
3	83,149	3,492	12,452.15	74,189	4,157	74,854
4	74,189	3,116	12,452.15	64,853	3,709	65,447
5	64,853	2,724	12,452.15	55,125	3,243	55,644
6	55,125	2,315	12,452.15	44,988	2,756	45,429
7	44,988	1,889	12,452.15	34,425	2,249	34,785
8	34,425	1,446	12,452.15	23,419	1,721	23,694
9	23,419	984	12,452.15	11,950	1,171	12,138
10	11,950	502	12,452.15	0	598	96

Table C

Year	Beginning Balance	Assumed Growth at 4.2%	Annuity Payment	Assumed Ending Balance	Actual Growth at 10%	Actual Ending Balance
1	1,000,000	42,000	124,521.50	917,479	100,000	975,479
2	917,479	38,534	124,521.50	831,491	91,748	884,705
3	831,491	34,923	124,521.50	741,892	83,149	790,119
4	741,892	31,159	124,521.50	648,530	74,189	691,560
5	648,530	27,238	124,521.50	551,247	64,853	588,862
6	551,247	23,152	124,521.50	449,878	55,125	481,850
7	449,878	18,895	124,521.50	344,251	44,988	370,344
8	344,251	14,459	124,521.50	234,188	34,425	254,155
9	234,188	9,836	124,521.50	119,503	23,419	133,086
10	119,503	5,019	124,521.50	0	11,950	6,931

In a more drastic "real world" example, take the initial holders of Facebook stock (NASDAQ: FB). In 2008, traders valued shares at approximately $3.50 each.[39] Assume that a Facebook insider placed 1,000 shares in a seven-year GRAT in April 2008 when they were valued at $3.50 each, for a total value of trust assets of $3,500. In order to zero-out the GRAT, the insider would have to receive annual annuity payments of $570.30 over the seven years.[40] He would have paid no gift tax on the transfer. Now, seven years later in April 2015, Facebook is publicly traded and each share is worth approximately $80, for a total value of trust assets of around $80,000.[41] That $80,000 now gets distributed to the remainder beneficiary *gift tax free*, see **Table D**. As of February 2013, Facebook founder Mark Zuckerberg owned 632 *million* shares of Facebook stock.[42] This example is by no means an attack on Facebook shareholders or tech companies, but serves rather as a means of putting wealth and the possibility of avoiding transfer taxes in perspective.

Table D

Year	Beginning Balance - 3.50/share	Assumed Growth at 3.4%	Annuity Payment	Assumed Ending Balance	Actual Ending Balance
1 - 08/09	3,500	119	570.30	3,049	
2 - 09/10	3,049	104	570.30	2,582	
3 - 10/11	2,582	88	570.30	2,100	
4 - 11/12	2,100	71	570.30	1,601	
5 - 12/13	1,601	54	570.30	1,085	
6 - 13/14	1,085	37	570.30	551	
7 - 14/15	551	19	570.30	0	80,000

There is little risk associated with a zero-ed out GRAT because in the very least, if appreciation meets the 7520 rate, the grantor simply receives his initial investment back in the form of annuity payments.[43] If instead, in a worst case scenario, his assets actually depreciate at a rate that is less than the 7520 rate, he still receives his initial investment back because the trustee would invade the principal and start distributing his initial investment to satisfy the required annuity payments. The asset would have depreciated whether or not the asset was held in trust. Although these situations may be rare, the grantor simply has "lost only the use of capital during the term of the trust"[44] and possibly some attorney fees.

c. <u>Problems with Valuation</u>

As one can imagine, with so many uncertainties, using a standardized set of tables is an imperfect system. There are assumptions inherent in the tables that make the values less accurate, "First, the tables assume that the trust corpus remains constant in value and that the trust's entire investment return takes the form of current income. Any assumption concerning the allocation of investment return to income or corpus is unreliable because that allocation normally depends on subsequent actions of the trustee in administering the trust."[45] Assume, for example, "that the trustee of A's GRIT property invests the trust corpus of $100,000 in stock that generates $9,000 of capital appreciation and $1,000 of dividends annually. Although A actually receives annual income of only $1,000, the tables value her retained income interest as a stream of $10,000 annual payments and produce a corresponding undervaluation of the remainder transferred to B."[46] Because the grantor-retained interest and the remainder interest are correlated, overinflating the grantor retained interest at $10,000 instead of $1,000 reduces the value of the remainder interest accordingly. This ultimately allows a taxpayer to pay less gift tax on the reduced remainder interest while more appreciation is kept in the trust ultimately passing to the remainder beneficiary, essentially transfer-tax free.

Another issue with the tables is that the drafters expect people to live as long as the national average. But, there are multiple factors that can play into longetivity aside from just age.[47] The tables can therefore produce an inaccurate value depending on whether the taxpayer is especially healthy or unhealthy as compared to the average person at his age. Also, taxpayers using the tables for valuation are generally wealthier, which correlates often times with better health care and quality of life, leading to greater longevity.[48] A taxpayer who guesses he will outlive his life expectancy per the tables is able to wait until later in life to make the transfer of assets when the tables expect he will only live for a short time period, thereby valuing his retained interest at a higher value and a correspondingly lower value for the remainderman, allowing for less gift tax to be paid.[49]

Although the system may be flawed, the IRS needs some system to value gifts or estate assets and a case-by-case basis rule would provide greater uncertainty and create bigger administrative hassles. But, despite its inaccuracies, as long as the risks are split fairly between the taxpayers and the government, the system should ultimately produce a zero sum gain.[50]

However, these tables can provide a major opportunity for taxpayers with superior knowledge as to their future that the Service is not yet aware. For instance, stock of a closely held business that will soon be publicly sold may make for an excellent gift because of its low value, and possibly even receive a discounted valuation for lack of marketability. Or, a family history of longevity may provide another opportunity (albeit uncertain) for taxpayers to try to gamble and use the tables to their advantage, creating a problem of adverse selection.[51] In the example discussed earlier regarding Facebook, early stockholders and insiders had superior knowledge to the government about when and if the company stock would be publicly sold. Mark Zuckerberg along with Goldman Sachs CEO Lloyd Blankfein, Ralph Lauren, and Dish Networks chairman Charles Ergen are among those who have used GRATs to transfer billions of dollars.[52] Between 2000 and 2013, GRTs may have cost the government over $100 billion in tax revenue.[53]

V. Internal Revenue Code Sections 2036 and 2702: How Retained Interests Can be Taxed

With an understanding of what GRTs represent and how they work, it is important now to consider how they may be taxed. After all, saving tax tends to be the driving force behind the creation of GRTs and two IRC sections in particular govern taxation of GRTs.

a. Section 2036

The IRS is aware that taxpayers spend lots of time and resources attempting to pay as little estate tax as possible. In an attempt to close loopholes, Congress enacted IRC § 2036, which states in relevant part that, "[i]f a person transfers property and retains a life estate in that property, either by transfer in trust or by retaining a legal life estate, the full value of the transferred property will be included in the gross estate at the transferor's death."[54] GRTs, however, are usually structured to last for a certain period of time rather than for one's life, so GRTs avoid this provision of § 2036. However, §2036(a) serves to include in the taxpayer's estate any property for which he retained an interest and the period of retention is either the taxpayer's life, a period of time that cannot be described without reference to the taxpayer's life (such as "payment every quarter except the last quarter before death"), or a period that does not in fact end before the taxpayer's death.[55] Therefore, this portion of § 2036 may serve to include GRTs in the taxpayer's estate at death, if in fact the taxpayer does not outlive the term of the trust. In this instance, the entirety of the value of the trust would be included in the gross estate, not just the value of the retained interest.[56]

By way of illustration, "Suppose a grantor transfers property in trust and provides that the income shall be received by her for ten years with the remainder to be distributed to a named beneficiary. If the grantor dies before the expiration of the ten-year period, § 2036(a)(1) will cause the property to be included in her gross estate because she retained the right to income for a period which did not in fact end before her death. However, if she lived longer than the ten-year period, there would be no inclusion because the statutory requirement would not be met."[57]

Taxpayers, in an attempt to out-smart the IRS, might respond by gifting such values right before death as their health declines so that they have not retained an interest at death. But Congress implemented a rule for that, too. IRC § 2035 requires inclusion in the taxpayer's estate of property that the taxpayer gave away within three years of death if the property would have otherwise been included in his estate under § 2036."[58]

Therefore, a GRT will accomplish its goal only if the taxpayer who created the GRT outlives the term of the GRT. But, the taxpayer bears the risk that if he dies during the term of the GRT, the full value at the date of death, which is possibly now a far more appreciated value, is included in his estate and possibly subject to a 40% estate tax. So, in an attempt to avoid inclusion in the taxpayer's estate, estate planners generally set up GRTs with short terms of about two to three years with high grantor payments making the remainder interest respectively smaller.[59] The taxpayer then takes a gamble that if the assets appreciate at a fast rate, he has successfully transferred a significant amount of appreciation out of his estate while paying a relatively low amount of gift tax.[60]

Despite the possibility of having the trust assets included in a taxpayer's estate, because of a concept called "adjusted taxable gifts" that is implemented in calculating the estate tax, there still is little risk to a GRT because if in fact the gift is included in the taxpayer's estate (say under § 2035), any unified credit used against that gift is reinstated as if the gift had never been made.[61] Therefore, the positives of creating a GRT seem to outweigh the costs pertaining to § 2036. That is, any gift that the grantor made that happens to also be included in his estate at death is not double taxed and any unified credit used to reduce the gift tax is again added to his lifetime unified credit as if he never created the GRT. The newly reinstated unified credit is available for usage against the estate tax due to the asset's inclusion in his estate.

b. Section 2702

But, Congress was aware of attempts to avoid tax by using trusts and the attempt to make low-valued remainder interests for little gift tax, so it enacted § 2702. That code section requires taxpayers to value the retained interest as zero, thereby making the remainder interest the full value of the assets, if the grantor and remainderman are closely related.[62] Because the retained interest and the remainder interest sum to the total value of the trust, when the government imposes an artificial zero value on the retained interest, the remainder interest automatically is valued as the total trust assets' value at funding of the trust. Also, since the remainder interest is a future interest and not eligible for the annual $14,000 exclusion, § 2702 would serve to essentially force the grantor to be subjected to some gift tax.

More specifically, "[s]ection 2702(a)(2) says that the value of a retained interest in a trust will be treated as zero, if: 1) there is a transfer in trust; 2) the transfer is to or for the benefit of a member of the transferor's family; and 3) there is a retention of an interest in the trust by the transferor or by an 'applicable family member,' including the transferor's spouse, and an ancestor of the transferor or the transferor's spouse."[63]

But, § 2702 does not apply to "qualified interests." That is, "[w]ithin families, there are three important types of qualified interests now in common use. The first is a 'qualified personal residence trust' (a QPRT), under which the grantor transfers title to a personal residence to a trust, retaining a possessory interest in the residence, but assigning the remainder to one or more donees. The second and third types of qualified transactions are simply the GRATs and GRUTs, which require that the trust fix the income interest in terms of mandatory annual payments of either a specific dollar amount (the GRAT) or a specific percentage of the trust corpus, as annually appraised (the GRUT)."[64]

Therefore, § 2702 says that when an interest is transferred in trust to a related party and the grantor keeps an interest, such as in GRTs, the retained interest is valued at zero, essentially making the entire value of the trust be a gift. This serves to bypass the valuation tables using the 7520 rate and forces the grantor to pay gift tax on a much larger value since the taxpayer does not have the benefit of paying tax on just the remainder interest. But, there is still an exception to § 2702 as Congress drafted the IRC so that this zero-value rule does not apply to "qualified interests." Therefore, GRATs and GRUTs essentially bypass this rule and use the valuation tables under 7520 as discussed earlier in this essay.[65]

VI. Proposed Law

With a background on GRTs and how they are impacted by the estate and gift tax, it is now time to analyze the proposal put forth by the Obama Administration.

a. Obama Administration Proposal

President Obama and his administration have proposed changes to legislation monitoring GRTs multiple times, including most recently in the fiscal year 2016 budget proposal. The Greenbook is published by the Department of the Treasury on a fiscal-year basis outlining budget proposals for the presidential administration.[66] The 2015 Greenbook states that the latest proposal requires a GRAT to have a minimum of a ten-year term, among other proposals.[67]

Additionally, in order to avoid zero-ed out GRATs, the value of the remainder interest which passes to a beneficiary would need to be worth the greater of $500,000 or 25% of the value of the total trust assets, essentially forcing the taxpayer to pay gift tax on some value since remainder interests are future interests which do not qualify for the annual exclusion.[68]

The last major provision is to disallow a decrease in annuity payments after the trust has already been created.[69] These provisions apply prospectively and would require any grantor who dies during the term of the trust to include the value of the trust in his estate under § 2036.[70] Although the proposal has been on President Obama's radar for many years, it has never passed, though there were attempts, as discussed more fully in the next two sections.

According to the Greenbooks, the "proposal was estimated to raise revenue over ten years by $3.25 billion in the 2009 Greenbook, $2.959 billion in the 2010 and 2011 Greenbooks, $3.33 billion in the 2012 Greenbook, $3.894 in the 2013 Greenbook, and $5.711 billion in the 2014 Greenbook."[71] The Joint Committee on Taxation, however, in 2009 valued the ten-year revenue stream from the proposal at $2.28 billion.[72] Taking the most liberal of those estimates listed above, $5.711 billion, spread over 10 years, means an average revenue for the government of

$571 million annually. With a proposed 2016 federal budget of $3.525 trillion receipts, this new legislation will represent approximately 0.016% of the federal revenues as proposed for 2016.[73]

b. H.R. 4849 & 5486

Although President Obama has proposed GRAT reform for a number of years now to no avail, Congress twice tried to codify similar proposals. More specifically, "[t]hese limitations on GRATs were included in section 307 of the 'Small Business and Infrastructure Jobs Tax Act of 2010' (H.R. 4849), which the House of Representatives passed by a vote of 246-178 on March 25, 2010. The vote was partisan; only four Republicans voted for the bill and only seven Democrats voted against it."[74] The bill contained similar proposals that GRATs must have at least a ten-year minimum term and the remainder interest must be greater than zero.[75] With this bill, "[i]t would still be possible to 'zero out' a 10-year GRAT with a remainder interest valued at, say, 54 cents, but fewer donors will be interested in creating 10-year GRATs because of the increased risk that they will die before the 10-year term ends, thus destroying any estate tax savings."[76] But, the bill did not pass the Senate.

Similarly, "The same provisions appeared in section 531 of the 'Small Business Jobs Tax Relief Act of 2010' (H.R. 5486), which the House of Representatives passed by a vote of 247-170 (with five Republicans in favor and eight Democrats against) on June 15, 2010."[77] Then, "[t]hese provisions appeared again in section 301 of the 'Trade Adjustment Assistance Extension Act of 2011,'" but the President never had a chance to sign any into law.[78]

VII. Analysis

Regardless of one's feelings about the estate tax in general, a minimum ten-year term for GRTs and the abolishment of zero-ed out GRTs can greatly affect wealthy individuals. While the proposal has some positive reform with the elimination of zero-ed out GRTs, requiring a ten-year term is unfair to older taxpayers, making the entire proposal as a whole a flop.

a. <u>Arguments Against the Proposal</u>

The proposed ten-year minimum term is simply too long of a time period. Taxpayers who use the GRT structure are more likely to be older taxpayers who have had more time to accumulate wealth who, quite frankly, may not outlive the ten-year term. This requires inclusion in the taxpayer's estate under § 2036, a result the taxpayer never intended simply because he did not outlive the minimum requirement imposed by law. The result is a law that is strongly skewed against the elderly and towards younger taxpayers. If in fact the government already taxed the assets put into the GRT, Congress effectively is double-taxing older taxpayers and disallowing them from using a useful estate planning tool.

GRTs can be a sensible way for older taxpayers to ensure a monthly reliable income stream in the form of an annuity or unitrust payment while not having to deal with management of the assets, all the while knowing that they designated beneficiaries to receive their assets in the event of their death. If a taxpayer chooses to relinquish control of his assets and accept a smaller portion of income in the form of an annuity or unitrust payment, he should not be punished for his careful planning because of his age. Because GRTs are irrevocable, grantors effectively relinquish control of their assets when giving them to the trust. The taxpayer no longer has control and enjoyment of the assets, and he should be taxed accordingly instead of having to include the assets in his estate if he does not outlive the term of the trust.

To illustrate how unfair the proposal is, "[t]his difference can be surprisingly dramatic: an average sixty-five-year-old man has a life expectancy of 17.19 years, while an eighty-year-old man has a life expectancy of only 7.90 years. . . . In fact, this proposal would enact a form of legislative discrimination against the elderly that the government itself has been lobbying to eliminate for decades."[79] Therefore, the average eighty year old man will not outlive the minimum term of the GRT he sets up and whatever assets he placed in the trust will be fully included in his estate even though he has no effective control over the assets.

Additionally, the proposal punishes taxpayers for performing diligent estate planning. Estate planning should be something the government tries to encourage to allow for the most efficient distribution of assets after death. Probate courts, though monitored at the state or county level, are major costs to taxpayers to decide issues that could be resolved more easily through the use of careful and thoughtful estate planning. Particularly for wealthier taxpayers where there may be more disputes arising in probate, a GRT eliminates some of this hassle and time by clearly outlining the testator's intentions per the terms of the trust document. Diligent planning and using the government-provided measuring tables should not be punished. Of course, taxpayers naturally should have more information about the value of their assets or events happening in their lives than the government. It is not a crime or even a bad stigma to use such information to their advantage. In fact, America is even dubbed "the land of opportunity."

The money or assets being used to fund the trust may have already been taxed by the government. If the trust corpus is from a taxpayer's salary earned while spending hours working as a company's CEO or as a doctor, or if the trust corpus is comprised of a taxpayer's gains from precise investment decisions, the grantor's wealth could have been taxed before.

Furthermore, changing the rules will not raise much revenue. By the government's own projections, a ten-year minimum will raise at most about $5 billion over *ten years.* All of this hassle and the costs that changing would place upon taxpayers and estate planners is unnecessary. The changes require more gift tax returns prepared, trust documents in law firms across the country to be edited, more consultations with attorneys, more advanced calculations for inclusion in the taxpayer's estate, etc. The time for argument on the floor of either congressional House seems to be a waste of time for 0.016% of the government's annual revenues. The country is amidst an oncoming Social Security crisis, an ever-increasing federal debt in the trillions of dollars, in need of immigration reform, has a child homeless population of approximately one of every fifty children, [80] and many other more poignant and important issues than the finite number of wealthy taxpayers using GRTs to pass wealth to their grandchildren.

Further, the proposal fails to achieve its unstated goal to stop gift tax avoidance via GRTs due to the volatility of the 7520 rates. The use of the valuation tables can be used to the taxpayer's advantage in a short-term GRAT but it also might be to the taxpayer's advantage in a longer-term, such as ten-year, GRAT. No one can fully predict the future and know where the interest and 7520 rates will stand ten years from today. But, by making a gift at a certain point in time, the taxpayer is locking himself into the 7520 rate on that particular date of the gift. However, so is the government. In fact, the Joint Committee on Taxation itself explains, that while the proposal would stop the use of short-term GRATs, some taxpayers would continue to avoid gift tax with long-term GRATs where they feel the 7520 rate will increase in the future.[81]

Additionally, the proposal could backfire and cause the IRS significantly more work. At the beginning of this essay, it was mentioned that overall there is approximately a 0.8% chance of a filed tax return being audited, in general. With the new requirement that remainder interests be much higher, possibly in the range of $500,000, many more gift tax returns will be filed, requiring even more checks on compliance by the IRS. The costs increase as well if the value of the asset transferred is higher and the asset requires a valuation. For instance, the "proposal primarily serves to ensure that a beneficiary must file a gift tax return every time a grantor creates a GRAT, putting the Service on notice of the potential need for an audit."[82]

b. Arguments for the Proposal

Despite the proposal's drawbacks, it does have some positive factors as well. Depending on one's perspective on the estate tax in general, this proposal may seem to unfairly target the wealthy. But, after all, that is the goal of the estate tax: to stop substantial wealth accumulation among families. Arguably on an exaggerated scale, if there were no estate tax, families could continue to pass wealth from generation to generation without penalty where wealth keeps growing and power and influence is centered among a few families akin to the Rockefellers or Carnegies. The ten-year minimum on GRATs affects a finite number of taxpayers, who already can pass $5.43 million onto their heirs tax-free. If someone has that much *extra* money at his death, it should not escape lawful tax by playing tricks and creating a zero-ed out GRAT.

The goal of removing zero-ed out GRTs is a respectable one since those are used almost solely for gift tax avoidance. This paper takes the position that taxpayers should follow enacted laws, despite their feelings towards the law. There is a law levying gift taxes on certain transfers and taxpayers should comply accordingly. The entire value of the transfer to the GRT is not subject to tax, just the value of the remainder interest. By transferring assets to a GRT, the taxpayer is removing the value of those assets from his taxable estate.[83] The taxpayer should not take advantage of that benefit and also try to avoid gift tax taxes by playing games with the 7520 rates. Requiring the remainder interest to have a minimum value of at least 25% of the trust assets is not asking a lot of the taxpayer. This still allows the taxpayer to transfer 75% of the value of assets from his taxable estate without paying transfer taxes. But, the way the proposal is structured currently is that the value of the remainder interest has to be the *greater of* 25% of the trust assets or $500,000 (but not more than the total value of trust assets).[84] Congress could make the proposal even fairer by changing "greater" to "lesser" as requiring taxpayers to pay gift tax on $500,000 when they transferred a remainder interest of less than that amount is unfair.

Locking in a rate for a longer period of time can prove to have a beneficial result for either the taxpayer or the government, depending on the economy ten years from the date of funding. The volatility of rates over time is a wild card factor that can play in favor of either side. But, this is categorically a positive for the government because GRATs historically tend to have better payouts and appreciation in their earlier years, hence why taxpayers usually create a short-term GRAT.[85] Taxing grantors based on a rate at a certain point in time over ten years should prove more beneficial to the government instead of being taken advantage of by taxpayers who quite often create multiple short-term GRATs. The 7520 rates may not prove to have a huge effect on taxpayers' decisions because of their uncertain nature but historically, over a ten-year period, the rates skew in favor of the government.[86]

Furthermore, the minimum required term may not prove to be a huge dilemma for taxpayers. For instance, "[a] ten-year GRAT might also demand greater monitoring and active management. For example, if the asset originally contributed to the GRAT achieves its anticipated upside early in the ten-year term (maybe in the first year or two as is hoped for with a two-year GRAT), the grantor can withdraw that asset and substitute another asset of equivalent value with upside potential. If the grantor holds that withdrawn appreciated asset until death, this will also permit the asset to receive a stepped-up basis."[87]

Lastly, it is important to point out that the government is not banning the use of GRATs. It is only requiring a minimum term. In the event the taxpayer wants to use a GRAT for a certain reason, he still can. The trust technique is available and blessed by the government as a valid planning tool, just with a minimum of ten years. An extra eight or so years should not be a huge hindrance to taxpayers if they are not using the trust as a tax avoidance tool in the first place.

c. Analysis

If someone is so industrious and diligent as to plan for his future, he should be able to take advantage of smart planning and opportunities and placing a required minimum on GRT terms is unfair. It removes yet another possibility to pass along earned wealth. It is not any of the government's business if the taxpayer's company is going public and he wishes to pass that hard-earned success to family members.

On the other hand, the tax laws are enacted for reasons and all taxpayers are expected to abide by them. The government does not deserve to be short-changed by wealthy taxpayers with superior knowledge as to the events of their personal life or near future to essentially cheat the government out of revenues by making a zero-ed out GRAT. If the GRAT really is a structure that interests the taxpayer for reasons other than tax avoidance, then the opportunity is still available, it just must have a ten-year term. If the taxpayer were to simply hold on to the property and not put it into a GRT, the property would already be fully included in the gross estate under § 2033. At least the government is giving taxpayers an opportunity to attempt to remove the asset and appreciation out of the taxpayer's estate should he outlive the ten-year term of the GRT. Usage of a zero-ed out GRT is a tool concocted by estate planners to cheat the government out of its lawful money. Furthermore, as the law stands now, having the taxpayer die before the GRT term ends may even be beneficial as the heirs receive the property at a stepped-up basis instead of a carryover or inherited basis via gift.[88]

Ultimately, the proposal seems wholly unnecessary and does not accomplish much of anything aside from catching a few taxpayers trying to beat the system. If the government or the

Obama Administration really wanted to raise revenues or crack down on tax avoidance techniques, time would be better spent elsewhere. A simple increase in rates would likely raise more revenues than the measly projections from the latest Greenbook. Amongst a world of increasing corporate inversions and lowering percentages of overall revenues from corporate tax, a world with more and more foreign investment in American stocks and real estate, and the success of foreign VAT taxes, it seems the annual ~$500 million could be scraped up elsewhere with more significant tax reform.

Additionally, the minimum term still does not entirely close the loophole as the government intends because in the event rates increase with a more productive economy, the taxpayer still gets a better deal by paying gift tax on a rate ten years prior to when the beneficiary actually receives the trust corpus. The whole proposal, while surely well-intentioned, seems to be a poor usage of Representatives' and Senators' time arguing while Congress is in session.

VIII. Conclusion

Although admittedly there seems to be an abuse of the system by wealthy taxpayers using GRTs to pass wealth at the consequence of little or no transfer tax, the Obama Administration's latest proposal seems to miss the mark. Requiring a ten-year minimum term for a GRAT raises little revenue, does not entirely close the loophole, and unfairly targets the elderly. However, eliminating the possibility of a zero-ed out GRT by requiring a remainder value of the lesser of (instead of *greater of*) 25% of the trust assets or $500,000 will help curb gift tax avoidance related to GRTs.

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[1] This essay consistently uses the masculine form of nouns and adjectives when referring to taxpayers, but applies equally to feminine taxpayers.

[2] *See* Samuel R. Scarcello, Note and Comment: *Transfer Taxes in Flux: A Comparison of Alternative Plans For GRAT Reform*, 107 Nw. U.L. Rev. 321, 341 (2012).

[3] *See* Steve Chapman, *Fairness Is A Stranger To The Estate Tax: Taking Swipes At – Forgive My Language – The* Rich, CHICAGO TRIBUNE, (Mar. 4, 2001), http://articles.chicagotribune.com/2001-03-04/news/0103040057_1_estate-tax-tax-avoidance-income.
[4] Alesha Ebeling, *IRS Announces 2015 Estate and Gift Tax Limits,* FORBES (Oct. 30, 2014, 2:49 pm), http://www.forbes.com/sites/ashleaebeling/2014/10/30/irs-announces-2015-estate-and-gift-tax-limits/.
[5] *Id.*
[6] *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, DEPARTMENT OF THE TREASURY, 197 (Feb. 2015). Available at: http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf.
[7] Scarcello, *supra* note 2 at 324.
[8] Department of the Treasury, *supra* note 6.
[9] I.R.C. § 2031 (2015).
[10] Taxpayers can also use an "alternate valuation date" per IRC § 2032, which is six months from the date of death.
[11] Treas. Reg. § 20.2031-1(b); A similar definition exists for gift tax purposes in Treas. Reg. § 25.2512-1.
[12] Rev. Rul. 59-60, 1959-1 C.B. 237.
[13] John K. McNulty & Grayson M.P. McCouch, Federal Estate and Gift Taxation 47 (6th ed. 2003).
[14] I.R.C. § 2512 (2015).
[15] McNulty & McCouch *supra* note 13 at 47.
[16] Ebeling, *supra* note 4.
[17] *Id.*
[18] *Id.*
[19] McNulty & McCouch, *supra* note 13 at 92.
[20] Ebeling, *supra* note 4.
[21] Howard M. Zartinsky & Ronald D. Aucutt, Structuring Estate Freezes Under Chapter 14 151 (1991).
[22] *Id.* at 176.
[23] *Id.*
[24] *See id.*; The transfer may still be taxed if the grantor dies during the term of the trust in which case it will be included in his estate under IRC § 2036 or if he makes the gift within 3 years of death in which case some value may be included in his estate per IRC § 2035.
[25] This example works pending the taxpayer outlives the period of the GRAT, or else the value of the assets would be included in his estate under IRC § 2036. The increase in value of the assets will eventually be taxed at the time of sale since the granddaughter takes a carryover inherited basis of the grantor. Upon sale, the amount realized will be decreased by her basis, which is only pennies. Still, at that point, the sale will be subject to preferential capital gains tax rates.
[26] Zartinsky & Aucutt *supra* note 21 at 171.
[27] *Id.*
[28] *Id.*

[29] Joint Comm. On Taxation, 101st Cong., 2d Sess., *Federal Transfer Tax Consequences of Estate Freezes*, *in* FEDERAL WEALTH TRANSFER TAX ANTHOLOGY 288, 288 (Paul Caron et al. eds., 1998).
[30] *Id.*
[31] Other rules apply when the taxpayer is terminally ill at the time of the valuation. See Reg. 1.7520-3.
[32] Grayson M.P. McCouch, *Rethinking Section 2702*, *in* FEDERAL WEALTH TRANSFER TAX ANTHOLOGY, 297, 297 (Paul Caron et al. eds., 1998).
[33] McNulty & McCouch *supra* note 13 at 299-300.
[34] Zartinsky & Aucutt *supra* note 21 at 176.
[35] Grayson M.P. McCouch, *supra* note 32.
[36] *2011 TNT 115-14 JCT Describes Revenue Provisions in Obama Budget: Section 32 -- Earned Income Credit*, TAX NOTES TODAY, (Jun. 2011, Accessed Lexis Nexis Feb. 2015).
[37] In April 2015, the 7520 rate is 2.0 and May 2015 is 1.8. *See* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Section-7520-Interest-Rates and Rev. Rul. 2015-7 and 2015-8.
[38] *Section 7520 Interest Rates*, IRS, available at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Section-7520-Interest-Rates.
[39] Dan Primack, *Facebook's Pre-IPO Pricing History*, FORTUNE, (May 2012), http://fortune.com/2012/05/18/facebooks-pre-ipo-pricing-history/
[40] The April 2008 7520 rate was 3.4%, *see* www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Section-7520-Interest-Rates-for-Prior-Years#2008
[41] Closing share price on April 27, 2015 was $81.91. For purposes of the example, a rounded figure of $80 was used.
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[43] TNT, *supra* note 36.
[44] *Id.*
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[46] *Id.*
[47] *Id.*
[48] Kimberly Palmer, *Do Rich People Live Longer? Wealthier People Do Live Longer But The Reason Isn't As Obvious As It Seems*, US NEWS AND WORLD REPORT (Feb. 2012), http://money.usnews.com/money/personal-finance/articles/2012/02/14/do-rich-people-live-longer.
[49] Grayson M.P. McCouch, *supra* note 32.
[50] *Id.*
[51] Jordan M. Barry & John William Hatfield, *Pills and Partisans: Understanding Takeover Defenses* (February 23, 2011). University of Pennsylvania Law Review, Forthcoming; Stanford Law and Economics Olin Working Paper No. 407; Rock Center for Corporate Governance at Stanford University Working Paper No. 98. Available at SSRN: http://ssrn.com/abstract=1767683
[52] Zachary Mider, *Accidental Tax Break Saves Wealthiest Americans $100 Billion*, BLOOMBERG BUSINESS, (Dec. 2013), http://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion.

[53] *Id.*
[54] McNulty & McCouch *supra* note 13 at 154.
[55] *See* I.R.C. § 2036 (2015).
[56] *Id.*
[57] McNulty & McCouch *supra* note 13 at 157.
[58] *Id.* at 158-159.
[59] Richard Schmalbeck, *Avoiding Federal Wealth Transfer* Taxes, *in* RETHINKING ESTATE AND GIFT TAXATION 113, 137-138 (William G. Gale et al. eds., 2001).
[60] *Id.*
[61] Zartinksy & Aucutt *supra* note 21 at 180.
[62] Schmalbeck *supra* note 59 at 137.
[63] Zartinksy & Aucutt *supra* note 21 at 79.
[64] Schmalbeck *supra* note 59 at 137.
[65] Zartinksy & Aucutt *supra* note 21 at 79.
[66] The Green Book published by the Committee on Ways and Means of the United States House of Representatives provides background material and data on the programs within the jurisdiction of the Committee on Ways and Means. *See* http://greenbook.waysandmeans.house.gov/.
[67] *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, DEPARTMENT OF THE TREASURY, 197, (Feb. 2015) available at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf.
[68] *Id.*
[69] *Id.*
[70] *See General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals*, DEPARTMENT OF THE TREASURY, 162-163, (Mar. 2014) available at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf.
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[72] *Id.*
[73] *The Budget For Fiscal Year 2016: Summary Tables*, THE WHITE HOUSE, 91, available at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/tables.pdf.
[74] Aucutt, *supra* note 84 at 25.
[75] Jeffrey S. Dible, *Feature: Fixing The Estate Tax Mess In 2010:By The Time You Read This…*, RES GESTAE INDIANA BAR JOURNAL, (Jun. 2010), accessed via LexisNexis April 28, 2015.
[76] *Id.*
[77] Aucutt, *supra* note 71 at 26.
[78] Aucutt, *supra* note 71 at 26-27.
[79] Scarcello, *supra* note 2 at 349.
[80] *Facts and Figures: The Homeless*, PBS, Jun. 2009, available at http://www.pbs.org/now/shows/526/homeless-facts.html.
[81] TAX NOTES TODAY, *supra* note 49.

[82] Scarcello, *supra* note 2 at 350.
[83] Unless the taxpayer does not outlive the term, or transfers the assets within three years of death. See *supra* note 30.
[84] Department of the Treasury, *supra* note 80.
[85] Scarcello *supra* note 2 at 336.
[86] *Id.*
[87] Aucutt, *supra* note 71 at 27.
[88] McNulty & McCouch, *supra* note 13 at 425.