Grantor Retained Annuity Trust

"Transfer assets to the next generation at a reduced gift tax cost, and receive a stream of fixed income over the trust term."

We offer you this concept piece to help you understand how you can use a grantor retained annuity trust as an estate technique. This material is designed to provide general information in regard to the subject matter covered. It should be used with the understanding that it does not constitute legal, accounting or tax advice. Such services should be provided by the client's own legal, accounting and tax advisors. Accordingly, information in this document cannot be used for purposes of avoiding penalties under the Internal Revenue Code.

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Prudential

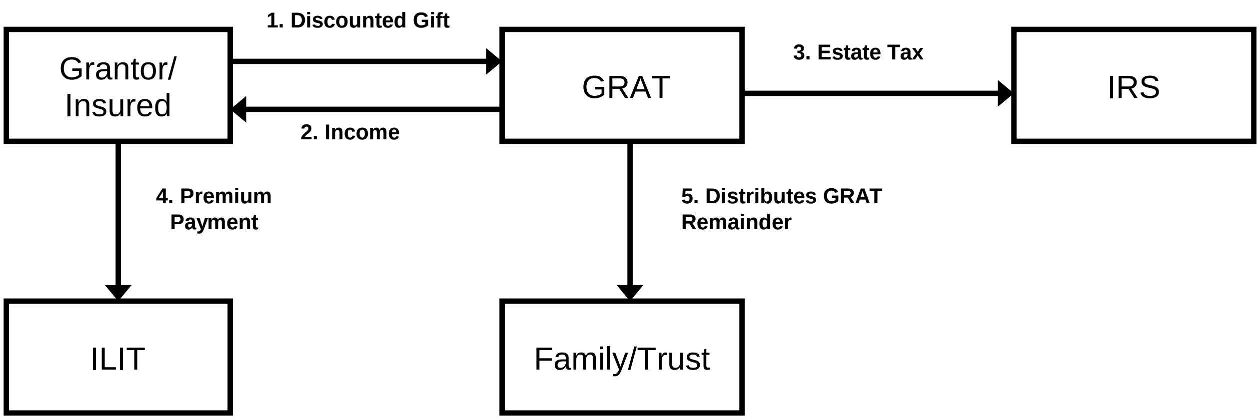
Do you identify with the following?

- You want to reduce the transfer tax cost of passing your estate to your family.
- You have assets that are expected to appreciate in value over the next several years.
- You are reluctant to give up the income from the assets for a limited period of time.

If so, you may want to consider establishing a grantor retained annuity trust (GRAT).

- A GRAT is an irrevocable trust to which you can transfer assets at a reduced gift tax cost.
- It allows you to retain the right to receive a fixed income for the period you have specified in the trust document.
- It provides that, at the termination of the GRAT, the assets remaining will either pass to the beneficiaries you've selected or will continue to be held in trust for the benefit of those beneficiaries.

Structure of the Grantor Retained Annuity Trust (GRAT)



1. The grantor establishes a GRAT for the term of years that he/she selects and designates the family member(s)/trust beneficiaries who will receive the assets at the end of the term. The grantor transfers assets to the GRAT. This is considered a gift from the grantor. The transfer does not qualify for the annual gift tax exclusion, but, since the grantor retains an income interest, the value of the gift is discounted for gift tax purposes. The gift does qualify for the applicable exclusion amount of $5,000,000 (2011 and 2012 as indexed for inflation).

2. The grantor retains a fixed income interest during the term of the GRAT.

3. If the grantor dies during the term of the GRAT, the value of the GRAT will be included in the grantor's estate and subject to estate tax.

4. To protect against the estate tax liability that will be incurred if the grantor dies prior to the end of the GRAT, the trustee of an irrevocable life insurance trust (ILIT) may purchase life insurance on the grantor. The life insurance death proceeds may be used to help pay the additional estate tax caused by including the assets in the grantor's estate.

5. At the end of the GRAT's term, the assets remaining in the trust will pass to, or continue to be held in trust for, the grantor's family or other beneficiaries. If the grantor survives the term of the GRAT, the assets and the appreciation (if any) on those assets will be excluded from the grantor's taxable estate.

Benefits to the Grantor and the Heirs:

- The GRAT enables the grantor to leverage his or her gift tax applicable exclusion amount by transferring his or her assets to family members where the assets are assessed at a fraction of their total value.

- The GRAT enables the grantor to make a current gift of assets at a reduced gift tax cost while allowing the grantor the right to receive a fixed income interest during the term of the GRAT.

Tax Considerations:

- The transfer of the assets by the grantor to the GRAT will be subject to gift taxation; but since the grantor retains an income interest, the value of the gift for gift tax purposes is reduced by the grantor's interest. The transfer will not be eligible for the annual gift tax exclusion.

- The value of the gift will depend upon the length of the GRAT term chosen by the grantor, the income interest retained by the grantor, and the applicable federal mid-term rate for the month the assets are transferred to the GRAT. The longer the GRAT term, the greater the retained income interest, and the lower the applicable federal mid-term rates, the lower the taxable gift to the family member.

- As a grantor trust, all items of GRAT income will be reported on the grantor's personal income tax return. The grantor will not recognize gain if trust principal is distributed for the annuity payout.

- The grantor's death during the term of the GRAT will cause the GRAT to be included in the grantor's estate.

- The generation skipping tax exemption cannot be allocated to a trust until the end of the grantor's retained interest (end of the estate tax inclusion period).

- If the grantor survives the term of the GRAT, the remaining assets and their appreciation will be excluded from the grantor's estate. The family members will not receive a stepped-up basis in the assets unless the assets are included in the grantor's estate.

- Life insurance death proceeds payable to the ILIT will be excluded from the insured's taxable estate provided the grantor insured possesses no incidents of ownership in the life insurance policy.