



Qualified Personal Residence Trust

“Transfer your residence at a low gift tax value while retaining possession, and shift future appreciation out of your estate.”

We offer you this concept piece to help you understand how a qualified personal residence trust (QPRT) can be used as an estate planning technique. This material contains references to concepts that have legal, accounting and tax implications. It is not intended as legal, accounting or tax advice. Consult your own attorney and/or tax advisor for advice regarding your particular situation. Accordingly, any information in this document cannot be used by any taxpayer for purposes of avoiding penalties under the Internal Revenue Code.

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0166901-00001-00 Ed. 11/09 (Old IFS-A053251)



Do you identify with the following?

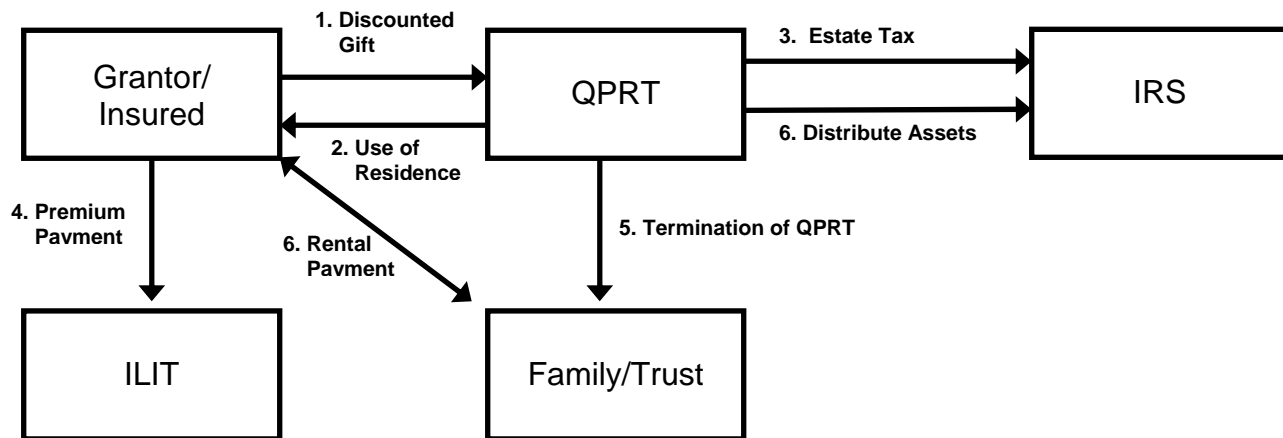
- ◆ You would like to reduce the transfer tax cost of passing your estate to your family; and
- ◆ You have a personal residence or vacation home¹ that is expected to appreciate in value over the next several years; and
- ◆ You are reluctant to give up rights to the home while you are alive.

If so, you may want to consider establishing a qualified personal residence trust (QPRT).

- ◆ A QPRT is an irrevocable trust to which you can transfer your personal residence or vacation home at a reduced gift tax cost;
- ◆ A QPRT allows you the right to use and occupy the residence for the period you've specified in the trust document.
- ◆ At the termination of the QPRT the residence will either pass to your family or continue to be held in trust for the benefit of your family.

¹ A vacation home will qualify if the grantor uses the home for personal purposes for at least the greater of 14 days or 10% of the days each year the home is rented at fair market value.

Structure of the Qualified Personal Residence Trust



1. The grantor establishes a QPRT for the term of years that he/she selects and designates which family member(s)/trust beneficiary(ies) will receive the residence at the end of the term. The grantor transfers the personal residence or vacation home to the QPRT. The transfer of the personal residence or vacation home to the trust is a gift that does not qualify for the annual gift tax exclusion. However, since the grantor retains use of the home, the value of the gift is discounted for gift tax purposes.
2. During the term of the QPRT, the grantor retains the exclusive right to use or occupy the residence.
3. If the grantor dies during the term of the QPRT, the value of the QPRT will be included in the grantor's estate and will be 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 QPRT, 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 residence in the grantor's estate.
5. At the end of the QPRT's term, the residence will pass to, or continue to be held in trust for, the grantor's family. If the grantor survives the term of the trust, the residence and its appreciation will be excluded from the grantor's taxable estate.
6. The grantor can rent the residence from the family/remainder beneficiary.

Benefits to the Family:

- ◆ The QPRT enables the grantor to leverage his/her applicable exclusion amount to transfer his/her residence or vacation home to family members at a fraction of its full value.
- ◆ The QPRT enables the grantor to make a current gift of his/her residence at a reduced gift tax cost, while allowing the grantor the right to live in the home during the term of the QPRT.
- ◆ At the expiration of the QPRT, the grantor may rent the residence from the family member who is the remainder beneficiary, thereby allowing the grantor the ability to continue to live in the residence.
- ◆ Rental payments by the grantor further reduce the value of the grantor's estate while enabling him/her to transfer funds to family member(s) on a gift tax-free basis.

Tax Considerations:

- ◆ The transfer of the residence by the grantor to the QPRT will be subject to gift taxation but, since the grantor retains use of the residence, the value of the gift is reduced by the grantor's interest for gift tax purposes. The transfer will not be eligible for the annual gift tax exclusion.
- ◆ The value of the gift will depend on the length of the QPRT term chosen by the grantor, the applicable federal mid-term rate for the month the residence is transferred to the QPRT, and the value of any reversionary interest retained by the grantor. The longer the QPRT term and the higher the applicable federal mid-term rates, the lower the taxable gift to the family member. The value of the gift is further reduced if the grantor includes a provision in the trust that causes the residence to revert to the grantor if he dies during the QPRT term.
- ◆ A grantor may establish QPRTs for no more than two residences. A QPRT may hold only one residence and a limited amount of cash.
- ◆ If the QPRT is structured to qualify as a grantor trust, deductions and all items of income, gain, and loss will be reported on the grantor's personal income tax return. This will allow the grantor to deduct mortgage interest.

- ◆ The grantor's death during the term of the QPRT will cause the QPRT to be included in the grantor's estate.
- ◆ If the grantor survives the term of the QPRT, the residence and its appreciation will be excluded from the grantor's estate. However, if the residence is not included in the grantor's estate, the family members will not receive a stepped-up basis in the residence.
- ◆ If, after the term of the QPRT, the grantor rents the residence from the remainder beneficiary/family member for its fair rental value, the rental payments may further reduce the value of the grantor's estate while transferring funds to family members on a gift tax-free basis.
- ◆ If, after the term of the QPRT, the remainder interest passes to a trust that qualifies as a grantor trust, the rental payments will not be subject to income tax because the grantor would be paying rent to himself or herself.