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Qualified Personal Residence Trust

Qualified personal residence trusts (QPRTs) are great estate planning tools for individuals and couples whose estates exceed the unified credit by \$1,000,000.00 or more.

A qualified personal residence trust (QPRT) is an estate planning tool utilized to transfer assets out of a wealthy individual or couple's estate in order to reduce or eliminate the amount of estate taxes due upon their death. A QPRT operates by an individual or couple transferring a personal residence into a grantor trust while continuing to enjoy the use of the residence for a specified number of years before the residence transfers to the children as beneficiaries. The QPRT results in the gift tax being calculated at the time of the transfer upon the value of the remainder interest. The value of the remainder interest is less than the present value of the residence because the residence is not transferred to the children until the set number of years expires. Without the QPRT, the transfer of the residence may be subject to estate taxes on the full appreciated value of the home upon death.

QPRTs are great estate planning tools for individuals and couples whose estates exceed the unified credit by \$1,000,000.00 or more. The grantors must intend their children as the beneficiaries of their estate because QPRTs should not be created to benefit other beneficiaries as less restrictive options are generally available. The ideal QPRT grantors are over the age of fifty because the tax valuation discount on the remainder interest increases with the age of the grantor. A vacation home can be classified as a personal residence. The QPRT is a great instrument to transfer the value of the vacation home at a discount out of the grantor's estate to the children. Some individuals hesitate to enter a QPRT for their primary residence because they are afraid of giving up the security of owning their home until their death. Additionally, clients desiring to establish QPRTs

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should be in relatively good health to increase the likelihood that they will live past the term of years for which they will retain the residence.

The Internal Revenue Code definition of "personal residence" must be met before a QPRT can be

CASE SUMMARY

This article examines constructing a qualified personal residence trust to reduce your taxable estate.



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created. The IRS defines the residence as a personal residence if its primary use is as a residence of the grantor when occupied by the grantor. The residence will not be considered a personal residence where rent paying tenants or co-owners reside in the residence. The residence will still qualify for QPRT treatment if it is vacant when the grantor is absent and its primary use is not "other than as a residence." A person may have up to two residences in QPRTs. One may be the principal residence of the grantor which is determined upon all the facts and circumstances in each case. The other residence must be used by the grantor for a minimum of fourteen days during the year or if rented at fair market value for more than 140 days the grantor must use the property for a number of days equal to ten percent of the number of days it is rented.

If the grantor is a suitable candidate to use a QPRT and has a personal residence as defined by the IRS, the next step is to draft the QPRT. The QPRT will create two interests. The grantor will retain an interest for a term of years during which the grantor will continue to own the residence as before the QPRT was created. The children beneficiaries will be given the remainder interest, which will be the ownership of the residence after the term of years passes. The gift to the children is the remainder interest, rather than the entire residence. The value of the remainder interest is determined using Internal Revenue Code Section 7520 and will be far less than the fair

market value of the residence because the children must wait until the expiration of the term of years before receiving the residence. The gift tax is paid on the value of the remainder interest at the time of making the QPRT, rather than the fair market value of the residence. An additional benefit of the QPRT is that all of the appreciation of the residence will also pass to the children tax-free since the gift tax is paid at the time the QPRT is created.

QPRTs can result in substantial estate tax savings but it is important to highlight their possible problems. The number of years for which the grantor retains the residence must not be set too long because if the grantor dies before the residence transfers to the beneficiaries the entire value of the residence at the grantor's date of death is included in the grantor's estate. The basis of the property will not receive a step-up when transferred to the beneficiaries so the beneficiaries may receive the property with a low basis which would result in large capital gains upon its sale. Also, the grantors must give up the beneficial use of the residence upon its transfer to the beneficiaries at the conclusion of the term of years but may pay fair market rent in order to continue residing in the residence. The rent paid to the children will be taxable as income to the children but this operates to transfer additional assets from the grantor's estate at a tax rate less than the estate tax rate.

QPRTs can be excellent estate reduction tools for the appropriate

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clients. They work great to reduce the taxable estate of older clients who desire to pass their estate to their children. Vacation homes are an ideal asset to fund a QPRT because people generally like to keep the vacation home in the family and do not have to lose the security of giving away their primary residence. However, QPRTs are not for every client as they are an irrevocable transfer and the residence will revert to the grantor's estate if they do not survive the term of years for which they are to retain the residence.