

Qualified Personal Residence Trusts

By Mindy Menke, Esq.

Despite the recent decline in real estate values, for most families their home remains the most valuable assets in their estate. For those people who are faced with a possible estate tax liability, a Qualified Personal Residence Trust -- known as a "QPRT" - is an effective tool for reducing the taxable estate and maximizing the individual's unified gift tax credit.

A QPRT is a type of irrevocable trust that is created to hold a personal residence and up to one vacation home. The homeowner creates the QPRT and transfers his or her interest in the residence to the trust, retaining the right to live in the residence for a set term of years. During this term of years, the Trustmaker must pay all of the property taxes, as well as any additional maintenance expenses of the transferred property. Because this is a "grantor" trust, the Trustmaker may continue to deduct real estate expenses, and if the property is sold during the term, Trustmaker will still qualify for his or her \$250,000 capital gains tax exclusion (\$500,000 for married couples). The Trustmaker must live in the personal residence until the end of the QPRT term, or the trust must terminate. However, in the event the Trustmaker needs care in an assisted living facility or nursing home, so long as the property remains available for the Trustmaker's use, it will continue to qualify as a tax-favored QPRT. In the event the residence is sold during the term of years, the proceeds must be reinvested in another personal residence for the remainder of the QPRT term, or the trust will no longer qualify as a QPRT.

At the end of the QPRT term, the Trustmaker no longer has an ownership interest in the trust property, and the trust property is no longer part of the Trustmaker's taxable estate. At this point, the property in the QPRT is transferred to the trust beneficiaries, often times the Trustmaker's children, or trusts for their benefit. The Trustmaker and his or her beneficiaries often agree that after the QPRT term, the Trustmaker can continue to reside in the residence, but he or she must pay a fair market value rent.

The initial transfer of the property to the QPRT is considered a gift by the IRS, and will reduce the Trustmaker's \$1 million unified gift tax credit. But, the value of the property gifted is discounted based on the age of the Trustmaker, the QPRT term, and the applicable federal rate (the "AFR"). As an example, assume that a 55-year-old woman transfers a home worth \$ 1,000,000 to a QPRT with a fifteen-year term. If the AFR is 4% at the time of the transfer, the value of the gift for gift tax purposes is only \$441,920. If at the end of the fifteen-year period the home has increased in value to \$1,500,000 -- and so long as the Trustmaker survives the fifteen-year term -- she will have effectively leveraged her gift tax exemption by transferring a home with a fair market value of \$1,500,000 at a gift tax value of only \$441,920. Assuming the Trustmaker makes no other lifetime above the \$13,000 annual exclusion amount, she will retain \$558,080 of her unified gift tax credit, which she can utilize to further reduce her taxable estate.

In order for the QPRT to successfully remove property from the Trustmaker's estate, the Trustmaker must live through the QPRT term. If the Trustmaker dies during the QPRT term, a significant amount of the value of the transferred property will be included in the Trustmaker's estate.

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