

# *The Estate Planning Advisor*

## **Qualified Personal Residence Trusts**

By Richard J. Shapiro, J.D.

Most estate planning is not predicated on saving estate taxes. As I have discussed in previous articles, people are generally most concerned about personal planning issues: disability protection, remarriage protection, divorce protection for the children, and creditor protection. But for the increasing ranks of affluent residents of our Region, the reduction of estate taxes remains a planning challenge.

It is no secret that the value of real estate in the Mid-Hudson Valley has skyrocketed the past five years. As home values have increased, so has the potential estate tax liability on those assets. A Qualified Personal Residence Trust (or “QPRT”) is one powerful planning tool for reducing estate and gift tax liability for a primary residence and/or a vacation home.

The QPRT is a form of irrevocable trust sanctioned by the Internal Revenue Code. QPRT’s may be funded only with a personal residence and up to one vacation home. With a QPRT, the homeowner (either an individual or married couple) funds the trust with their interest in the personal residence, retaining the right to reside in the residence for a fixed number of years. During the QPRT term the donor will continue to pay property taxes and maintenance expenses for the premises, and will continue to receive the benefit of real estate tax deductions. So long as the donor(s) survives the stated term of years, at the end of the term the donor’s interest in the trust terminates and the residence will not be included in the donor’s taxable estate for estate tax purposes. The QPRT will typically provide that ownership of the residence is transferred to donor’s children, or one or more trusts for the benefit of the donor’s children. The donor’s and remainder beneficiaries will often agree that the donor will continue to reside in the residence, with the donor to pay a fair market value rental.

The transfer of the residence to the QPRT constitutes a gift, but a significantly tax-favored one. Because the gift is a “deferred” gift – that is, the gift is not completed until the end of the term – the value of the gift is far below the fair market value of the property at the time the property is transferred to the QPRT. This result is based on the “time value of money”: the longer you have to wait to receive a gift, the less it is worth to the recipient. In addition, *all* the appreciation in the property value between the date of funding the QPRT and the end of the QPRT term is transferred to the beneficiaries *without* being added to the value of the gift.

As an example, assume that a 65-year-old woman transfers a home worth 800,000 to a QPRT with a ten-year term. If the home appreciates at 4% annually, under current calculations the value at the end of ten years is \$1,184,195. Because the children have to “wait” ten years for the gift, the value of the gift for gift tax purposes is only \$380,536. So long as the parent survives the ten-year term, she will have effectively transferred a

home with a fair market value of \$1,184,194 at a gift tax value of only \$380,536. If she had previously used none of her \$1 million gift tax exemption prior to creating the QPRT, she will have almost \$620,000 of gift tax exemption remaining after the QPRT term expires. If, however, she were to make the transfer outright at age 75, she will not only fully utilize her \$1 million lifetime gift tax exemption, but also owe gift tax on the extra \$184,194 of the gift!

What if mom did not survive the ten-year term? Then the gift is a nullity and the full value of the property is included in her taxable estate; there is no other “penalty” for failing to outlive the term. While we can never know how long someone will live, choosing a realistic term based on the client’s age and health is critical. The longer the term, the lower the amount of the gift and the more “leverage” that is created by the planning.

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