

## **Qualified Personal Residence Trust (QPRT)**

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### *What is a Qualified Personal Residence Trust?*

A qualified personal residence trust (QPRT) is an irrevocable trust detailed by the IRS that takes advantage of certain provisions of the law to allow a gift to the trust at a discounted value. A QPRT allows the creator of the trust (Settlor) to transfer his/her residence to the trust, usually for the benefit of their children. As a result, the residence is removed from the Settlor's estate, reducing potential estate taxes on the settlor's death.

### *How Does it Work?*

In a basic QPRT, the Settlor deeds his/her house to the trust, and the trust grants the Settlor the right to occupy the residence for a fixed term of years. At the end of the term, the house (including all post-gift appreciation) passes to the Settlor's children or other named beneficiaries free of any additional federal or state estate or gift taxes. If the Settlor dies before the end of the period, the house is brought back in the Settlor's estate at its value on the date of the Settlor's death.

### *Terms of a Qualified Personal Residence Trust*

Under Treasury Regulations section 25.2702-5(c), which creates the concept of a QPRT, the Settlor transfers title of his/her house to a QPRT trust. The individual retains the right to live in the home for a specific length of time, such as 20 years. Under Revenue Procedure 2003-42 [2003-23 I.R.B. 993, section 4, Art. II(B)(2)], during the 20-year period, the Settlor will not pay rent, but will be responsible for all of the expenses of the home, including real estate taxes, maintenance fees, and the cost of ordinary repairs.

At the end of the 20-year term, assuming the individual is still alive, the home passes to his children, or other named beneficiaries, free of estate tax. The Settlor may remain in the home, if he/she agrees to pay rent to the children at the going rate for such rentals.

### *Tax Advantages of a QPRT*

Assume that an individual creates a QPRT with a \$2 million home. The transfer of the home to the QPRT is a taxable gift; however, the amount of the gift will not be \$2 million. The reason being that the grantor is retaining the right to live in the home for a certain number of years. Instead, the amount of the gift equals the actuarial value of the property that will pass to the children, or other names beneficiaries, at the end of the term. The actuarial value is determined by using tables published by the IRS that take into account the grantor's age, the term of the retained interest, and the monthly interest rate set by the IRS for the month of the actual transfer.

### Disadvantages

The one main disadvantage in created a QPRT is that the Settlor, who creates the trust, has a predetermined limit on his/her right to occupy the residence. After the predetermined time period, the Settlor must give up ownership. The individual's children, or whomever is named as the beneficiary, will then have ownership of the residence, and the Settlor will have to pay rent.

### Example

A 55 year-old parent transfers a house worth \$800,000 to a QPRT for the benefit of his children for a term of 10 years. The approximate value of the current gift would be \$300,000. Assuming the residence appreciates 3% per year, the children will receive a house worth \$1,075,000 at the end of 10 years. If, instead of the QPRT, the house were gifted outright to the children at the end of the 10-year term, the gift tax value would be \$1,075,000, instead of \$300,000. At the lowest marginal estate tax rate, this is a savings of \$270,750.

### Considerations

- ❖ Cash may be put in the trust; however, it is limited to the amount need to pay trust expenses, to make improvements to the residence, and to allow the trust to purchase a replacement residence.
- ❖ The trust must not permit the sale of the residence to the Settlor, the Settlor's spouse, or to an entity controlled by either the Settlor or the spouse, during the period of the Settlor's retained interest and thereafter in certain situations.
- ❖ The residence must be used by the Settlor as his/her primary residence. However, the Settlor may use the residence secondarily for business purposes.
- ❖ A vacation home may quality for a QPRT if certain requirements are met.
- ❖ Under Treasury Regulations section 25.2702-5(c)(2)(iv), a husband and wife may enhance the tax benefits if they own the home jointly. The husband could transfer a one-half interest in the home to a QPRT, and the wife could transfer a one-half interest in the home to a second QPRT. They should be entitled to take an additional discount on the value of their gift because they each made gifts of an undivided interest in real property.