By Carol Sycip, CPA

The Basics of Qualified Personal Residence Trust

Personal residence is one of our most valuable assets. With rising home prices, transferring a residence to a qualified personal residence trust (QPRT) becomes a popular estate planning technique. When properly structured, a QPRT freezes the value of the residence at the time the trust is created. This results in significant estate tax savings and also helps to keep the value of many estates below the taxable estate threshold.

How does QPRT work?

1) **Transfer of residence to QPRT**
   The homeowner / grantor creates a QPRT and contributes the residence to the trust.

2) **Grantor's use of residence**
   The grantor retains the right to use and enjoy the residence for a term of years specified in the QPRT rent-free. The grantor pays any ordinary and recurring expenses such as real estate taxes and insurance and claims the associated tax deductions. The cost of any capital improvements made by the grantor after the QPRT is set-up will be treated as an additional gift to the trust.

3) **Gift Tax Return**
   Since the residence is contributed to the trust for no consideration, a gift has been made and therefore a gift tax return has to be filed. The value of the gift will be the fair value of the residence less the value of the retained interest (the right the grantor retained to live in the house for a specified period of time).

   The value of the retained interest depends on the length of the trust term and the interest rates published by the IRS. This makes the value of the gift lower than the fair value at the time of the transfer. In general, a longer trust term means a higher retained interest value and thus a smaller taxable gift.

   The annual gift exclusion does not apply since this is a gift of future interest.

4) **The Term**
   Will the grantor outlive the term or pass before the QPRT expiration?

   Assuming the grantor outlives the term of the QPRT, the residence passes to the beneficiary designated in the trust and is now out of the grantor's estate. If the grantor wishes to continue living in the house, he can lease the residence back from the beneficiary of the trust but this must be at fair rental value. The rental payments he makes would further reduce his estate. This also means extra cash inflow for the beneficiary.

   If the grantor dies before the trust term expires, the value of the residence at date of death will be included in the grantor's estate and subject to estate taxes. However, any gift tax paid or lifetime exemption used as a consequence of the initial gift to the QPRT will be credited to the grantor's estate. Therefore, the grantor is now back to square one without any loss.

5) **Planning**
   As mentioned, a longer QPRT term results in lower gift tax. Nevertheless, this benefit must be compared to the real risk of the grantor passing before the expiration of the trust term, ergo defeating the purpose of QPRT.

   Other things to consider are cost of establishing the trust, loss of step-up basis and other alternative strategies. This concept can also be mixed with multiple QPRTs and fractional discounts to hedge the trust term and further reduce the value.

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