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# QUALIFIED PERSONAL RESIDENCE TRUSTS (QPRT)

The Qualified Personal Residence Trust ("QPRT") can be an effective estate planning tool to reduce the size of an individual's taxable estate for federal estate tax purposes, by allowing the owner of a residence to continue to enjoy its use and occupancy for a stated term while providing for ultimate ownership by the individual's children or other persons.

A QPRT is an irrevocable trust established by the owner of a residence by transferring title to his or her residence (which may be a vacation home) to the trust. The trust instrument provides that the previous owner of the residence (the "Grantor") will continue to have the right to use and occupy the residence for a term of years. Once the stated term has passed, the trust provides that ownership of the personal residence will pass to remainder beneficiaries, often the children of the Grantor. If the Grantor wishes to continue residency after expiration of the term stated in the trust agreement, a fair market rent must be paid by the Grantor to the new owners of the property, the remainder beneficiaries. Of course, the QPRT can continue as an irrevocable trust for the benefit of the remainder beneficiaries at the expiration of the term of years, rather than being distributed outright to the remainder beneficiaries, such as the children of the Grantor, at that time.

The primary advantage in establishing a QPRT is that a residence, which for many persons is the person's most valuable asset, may be given to that person's children, but valued, for federal gift tax purposes, at a significant discount. Therefore, the value of the gift of a personal residence to the owner's children (via a QPRT) is determined by subtracting from the property's true fair market value, the actuarial value of the owner's right to use and occupy the transferred property for a term of years.

For example, using current Internal Revenue Service tables and assuming an applicable federal midterm rate of 5.0%, if a residence that is currently worth $250,000 is transferred to a QPRT, and the trust agreement provides that the Grantor (age 55) may use and occupy the residence for ten years, but at the end of the ten year term, it will belong to the Grantor's children, the result will be that the Grantor's gift of the personal residence will be valued at $136,122, instead of $250,000. Accordingly, a $250,000 asset will be removed from the Grantor's gross estate for federal estate tax purposes, but the Grantor will only be charged with making a $136,122 gift. If the term of the QPRT was for 20 years, the value of the gift would only be $63,527.

For federal income tax purposes, a QPRT is treated as a "grantor-type" trust. In other words, during the term that the QPRT provides a benefit to the Grantor, the trust is considered to be the Grantor's alter ego for federal income tax purposes. This is beneficial because the Grantor can use the $250,000 exclusion ($500,000 for married persons filing jointly) provided upon the sale of principal residence that would otherwise be available to the Grantor if the Grantor owned the house outside of the QPRT pursuant to Section 121 of the Internal Revenue Code of 1986, as amended. Recently, however, the Internal Revenue Service has indicated that it would seek to disqualify a

QPRT that sells the personal residence to the Grantor, the Grantor's spouse or an entity controlled by the Grantor.

The disadvantages of a QPRT are few. First, if the Grantor should die before completion of the term of years set forth in the trust agreement, current estate tax law causes the full value of the residence to be included in the Grantor's gross estate for federal estate tax purposes. However, the estate tax consequences are no worse than if the QPRT had not been created.

Second, the QPRT is irrevocable, i.e., it cannot be changed. The trust instrument can provide for limited flexibility, but any time a trust is created that cannot be changed, there is always the risk that a change in individual circumstances may make the trust undesirable in the future, not for tax reasons, but for personal reasons. A home may be sold even if it is owned by a QPRT; however, a new home must be purchased with the proceeds, or the proceeds must be converted into an annuity for the benefit of the Grantor, thereby converting the QPRT to a grantor retained annuity trust. That annuity would terminate at the end of the term of years set forth in the trust instrument, and the remaining proceeds would be transferred to the remainder beneficiaries of the trust.

Third, the Office of the Florida Attorney General has opined that a residence transferred to a QPRT is not eligible for the homestead exemption for ad valorem tax purposes. But two Florida appellate court decisions have held contrariwise and supported the homeowner's entitlement to the homestead exemption throughout the homeowner's term interest in the QPRT. This is not an issue if the residence conveyed to the QPRT is a second (vacation) residence.

In conclusion, a QPRT is a an extremely viable tool to reduce the size of a potentially taxable estate by allowing for a substantial reduction in gift tax valuation. This allows persons to leverage their unified credit. As with all estate planning tools, the QPRT has some disadvantages, but those disadvantages are minimal when compared to the potential estate tax savings.

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