



QUALIFIED PERSONAL RESIDENCE TRUST (QPRT)

What is a QPRT?

It's an irrevocable grantor trust that is formed to own your principal residence or vacation home (the "Residence") and transfer its ownership to the ultimate beneficiaries when the trust term ends. This is commonly used as an effective method of transferring wealth to the next generation at a discounted value in a manner that is approved by the IRS and does not require the outlay of cash when the gift is made. Today's low interest rate and diminished property value environment makes this an ideal time to undertake QPRT planning.

The Benefits –

1. Removing the value of the Residence and any related appreciation from your taxable estate reduces the estate tax due upon death.
2. Allows you, the owner of the Residence and the creator of the QPRT, to continue occupying the Residence and utilizing all related current income tax benefits.
3. Gifting the Residence to the ultimate beneficiaries at a reduced present value (or "discount"). In addition, the possible decrease in the lifetime gift and estate tax exemptions in year 2013 will have no impact on your gift made through a QPRT before 2013.

How it works –

- Step 1 – Form a QPRT – The creator of the trust (the Grantor) decides how long he or she wants to retain the effective ownership rights in the Residence (the Term) and who the ultimate beneficiaries would be when the QPRT terminates. The term selected should be a function of the Grantor's age, life expectancy, and the discount sought. A longer term provides a larger discount, but the Grantor must survive the term for the planning to succeed. Married couples would each make a gift and form their own QPRT for their undivided ownership interests in the Residence.
- Step 2 – Fund the QPRT – Transfer the ownership of the Residence into the trust. Upon the transfer, the ownership is divided into 2 interests: the right to live in it during the Term and the right to own it at the end of the Term. The Grantor would retain the first interest with the right to live in the Residence, while the beneficiaries would receive the 2nd interest with the right to own the Residence at the end of the Term.
- Step 3 – Report the gift to the IRS – The 2nd interest pertaining to the Residence as discussed above is deemed to be a gift made to the ultimate trust beneficiaries at the time of the QPRT formation for gift tax purposes. The present value of this 2nd interest, the gift of the ultimate ownership of the Residence, would be determined by using actuarial tables and is calculated based on the term of the trust.
- Step 4 – Transfer the ownership of the Residence to the ultimate beneficiaries when the Term ends.

**Important considerations –**

1. The value of the Residence must be supported by a professional appraisal and will be reported on a federal gift tax return that may be audited by the IRS.
2. The Residence ideally should carry no debt as any payments made to reduce the principal balance of the debt are considered to be additional gift to the beneficiaries. Additionally, lenders might be reluctant to consent to transferring the Residence to a QPRT or to refinancing a QPRT residence.
3. If it becomes desirable to sell the Residence during the Term – a) the Residence may only be sold to an unrelated third party, and b) the sale of the Residence would force the QPRT to terminate if the sales proceeds were not invested in a replacement residence within two years of the sale. After a sale, the QPRT would convert to an annuity trust which would make periodic payments of the proceeds to you for the remainder of the Term. The Grantor cannot obtain the sales proceeds directly. So essentially the QPRT really lends itself to a situation where you expect to remain in your residence for the rest of your life.
4. If the beneficiaries decide to sell the Residence after the ownership transfers, their income tax basis in the Residence is the Grantor's carryover basis as of the date the Residence is contributed into the QPRT. The beneficiaries would owe capital gains tax if the sales proceeds of the Residence exceed the carryover basis. However, the federal tax rate on capital gains is typically lower than the estate tax rates and thus this method of Residence transfer may be preferable. The current income tax rate on capital gains is 15%, and the estate tax rate is 35%.
5. The Grantor must have exclusive occupancy of the Residence or have the immediate exclusive right to occupy it at all times during the Term. If the Residence becomes a rental property before the Term ends, it would cause the QPRT to terminate. The solution in this case is to convert the QPRT to a certain annuity trust that makes annuity payments of the rental income to you while preserves the gift and estate tax benefits of the QPRT.
6. The Grantor will become a tenant and will owe rent to the beneficiaries if at the end of the Term the Grantor is still living in the Residence. The Grantor may not deduct rental payments for income tax purposes, however, the rental payments further reduce the assets in your taxable estate.

If you would like further information on this topic, please do not hesitate to contact me.

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