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The Ins and Outs of a Qualified Personal Residence Trust

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The possibility of facing estate taxes has left many people looking for ways to minimize the tax burden on their heirs.

Trusts…

Annual gifts…

Charitable donations…

These are just a few of the estate planning tools available to design your estate in such a way that you decrease the amount of money Uncle Sam takes from your beneficiaries.

One more option is the formation of a Qualified Personal Residence Trust.

If the value of your estate is high enough to be subject to estate taxes, a Qualified Personal Residence Trust (or QPRT) is an excellent way to minimize federal gift taxes and lessen the estate tax burden.

Here's what you need to know before you opt for a QPRT:

What Exactly Is A QPRT?

Simply put, a QPRT is a type of irrevocable trust you transfer your home into while still retaining the right to live there for a specified period of time. While you still live in the home, you pay no rent and at the end of the specified time period, the property passes directly to the beneficiaries you've chosen to receive it.

A serious consideration in forming a QPRT is the specified length of time you remain in the home. There's an interesting trade here. In order to receive the estate tax benefit, you have to live longer than that specified time period. However, the shorter the time period, the higher the value of the gift to your beneficiaries and the less money they save in estate taxes. Think about your health and age when considering a QPRT.

How Does A QPRT Reduce Your Estate Tax Burden?

Transferring your home into a QPRT is considered a gift to the beneficiaries and is subject to gift tax but the value of the taxable gift is not the full market value of the home. The gift is discounted based upon your retained interest (i.e., the fact that you can still live in the home). The IRS has specific tables used to calculate the discount so talk to an estate planning attorney to determine if the discount is enough to be beneficial to your estate.

Another advantage is that, if you live beyond the specified time period you're allowed to live in the home, the value of the home (including appreciation) is not subject to estate tax because it will no longer be considered a part of your estate. However, this is something of a gamble. If you don't live beyond the time you're allowed to live in the home, the home remains a part of your estate and subject to estate tax just as it would have been had you not created a QPRT. If you're not in good health, it's probably unwise to use a QPRT strictly as a means of reducing your estate tax burden. Talk to an estate planning attorney to weigh the pros and cons.

What If You're Still Making Mortgage Payments On The Property?

You can place mortgaged property into a QPRT; however, the payments you make each month are considered gifts to the beneficiaries receiving the property.

Do You Have To Live In The House?

You, your spouse or your dependents have to live in the home for the full term of the QPRT. It must always be a residence and cannot be sold unless a home is purchased to replace it. You're allowed to use a portion of the home as a home office but it has to be a residence.

How Will A QPRT Affect Your Income Taxes?

A QPRT is considered a grantor trust by the IRS so any income or deductions must be accounted for on your personal income tax return. You have to pay for any repairs or insurance on the home. You also retain your ability to qualify for the capital gain exclusion if the home is sold before the term of the QPRT expires.

However, since your beneficiaries will be receiving the home as a gift, they receive the property differently than they would if they received it upon your death. That means that it will be taxed differently. If your home has appreciated significantly, the capital gains tax your beneficiaries may owe could eat up any estate tax savings gained through the QPRT. Make sure you ask your estate planning attorney about this possibility before you form the QPRT.

The Ins and Outs of a Qualified Personal Residence Trust

As with any estate planning tool, there are pros and cons to forming a QPRT and they are unique to the individual estate. We've addressed only a portion of these issues here.

Call us and we'll talk about all these issues before you proceed.

Schedule your Family Wealth Planning Session today. Our Family Wealth Planning Session is normally $500, but this month I've made space for the next two people who mention this article to have a complete planning session with me at no charge. Call today and mention this article.

About Matthew Crider, J.D.

Matthew Crider formed **Crider Law PC** in 1999 so he could help individuals and business owners by providing creative solutions and be their trusted advisor and legal counselor. He serves his clients by listening closely to their goals, dreams and concerns and working with them to develop superior and comprehensive estate and asset protection plans. His estate planning practice focuses on preserving and growing wealth by providing comprehensive, highly personalized estate planning counsel to couples, families, individuals and businesses.