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Qualified Personal Residence Trust (QPRT)

Because a QPRT is irrevocable, it can also be used as an asset protection device, even if taxes are not a concern.

A qualified personal residence trust (QPRT) offers an excellent opportunity for homeowners with taxable estates to minimize federal gift tax and avoid federal estate tax.

What is a QPRT?

A QPRT (pronounced "Q-Pert," and sometimes referred to as a house GRIT) lets you give away your house, but still keep possession for a while. More specifically, a QPRT is an irrevocable trust into which you transfer your home while retaining the right to live there rent free for a specified number (term) of years. At the end of the term of years, the property passes outright to your children or whomever you've named as the remainder beneficiaries.

What are the potential tax savings?

When you transfer a home into a QPRT, you're considered to have made a gift to the remainder beneficiaries that is subject to gift tax. However, the value of the taxable gift isn't the full fair market value of the home, as it would be with an outright transfer. Rather, the gift can be discounted to reflect the fact that you have retained an interest (the right to live in the home). IRS tables and current interest rates are used to determine the amount of the discount.

Moreover, provided you outlive the term of years, the value of the home, plus any appreciation, will completely avoid estate tax because the home will have been removed from your estate.

Tip: *Each taxpayer has an exemption from the federal gift and estate tax, which, to the extent it has not already been used, can offset any gift tax that is due. The exemption amount for 2011 is $5 million.*

Caution: *The transfer of a home to a QPRT does not qualify for the $13,000 annual gift tax exclusion.*

What happens if I die during the term of years?

If you die before the term of years expires, the home will be included in your estate for estate tax purposes (just as it would have been had you not created the QPRT).

How long should the term be?

Because you must survive the term of years to benefit from the QPRT, you might conclude that a shorter term would be best. However, there's a tradeoff--the shorter the term of years, the larger the gift to the remainder beneficiaries and the smaller the tax savings. You must find the right balance, taking your age and health into consideration.

What are the income tax consequences?

For income tax purposes, a QPRT is typically set up as a grantor trust, which means that income and deductions, such as mortgage interest and real estate taxes, are accounted for on your personal income tax return. You also continue to pay for all expenses related to the home, such as repairs and insurance.

Additionally, this arrangement preserves your ability to take the home sale capital gain exclusion ($250,000; $500,000 if married filing jointly) in case the home is sold before the term of years expires.

There is also a significant drawback. When beneficiaries receive property at someone's death, they generally receive an income tax cost basis that is stepped up to fair market value. However, because your beneficiaries will get the home as a gift, they'll receive a carryover basis (your basis) instead. If your home has appreciated substantially in value, the increased capital gains tax that the remainder beneficiaries will owe upon the sale of the home may offset any gift and estate tax savings you'll enjoy.

How do you create a QPRT?

Although the rules that govern QPRTs are many and complex, creating one is relatively easy:

- *Consult an experienced estate planning attorney*
- *Have the home professionally appraised*
- *Execute a written trust agreement*
- *Transfer the home's title to the QPRT*
- *File a gift tax return; pay gift tax, if any*
- *Reside in the home for the entire term of years*
- *Execute a written lease and pay fair market rent if you continue living in the home beyond the term of years*

Can I transfer more than one home to a QPRT?

No. You can't transfer more than one home to a single QPRT. However, you are allowed to set up two QPRTs and transfer one home into each trust. A husband and wife can actually transfer up to three homes to QPRTs--one home that is jointly owned, another home owned by the husband alone, and a third home owned by the wife alone. The home may be either a principal residence or a vacation house.

Can mortgaged property be placed in a QPRT?

Yes. You can transfer mortgaged property to a QPRT. However, it's generally not recommended because any mortgage payments that you make will be considered gifts to the remainder beneficiaries.

Must I live in the home during the term of years?

You, your spouse, or your dependents must occupy the residence for the entire term of years. The home must be used as a residence at all times, and generally can't be sold unless a replacement home is purchased. Although the primary use must be as a residence, you are allowed to have a home office or some other secondary use of the home.

What if I want to keep living in the home after the term of years expires?

If you wish to continue occupying the home once the term of years expires, you must pay fair market rent to the remainder beneficiaries. You must also enter into a written lease with the remainder beneficiaries, and should do so only at the end of the term of years. The lease should contain all the standard residential lease terms, which should be strictly enforced by the remainder beneficiaries.

Can other property be transferred to a QPRT?

Property that is transferred to a QPRT may include not only the actual home but also other structures that are on the property, such as a separate garage. You may also include a reasonable amount of the surrounding land, but you may not transfer personal property, such as furniture.

A QPRT can also hold cash for the initial purchase of a home, but the purchase must take place within three months of the cash transfer. Additionally, a QPRT can hold cash for up to six months for the payment of certain trust expenses, such as mortgage payments and improvements to the home. And, there are special rules in the event the home is sold or destroyed by fire.

A QPRT example:

Jill, age 50, transfers her vacation home, worth $1 million, to a QPRT. She retains the right to occupy the home for 10 years and a right of reversion, after which the home will pass to her son. Assuming a discount rate of 3.0%, Jill's gift can be discounted by $303,580. The gift is valued at $696,420 but Jill owes no gift tax because it's offset by her available gift and estate tax exemption. If Jill outlives the QPRT's 10-year term and dies several years later when the home is worth $2 million, Jill's estate will owe no estate tax on the $2 million because the home is no longer part of her estate.