# Estate Planning Techniques: The Qualified Personal Residence Trust

January 4, 2011

The qualified personal residence trust ("QPRT") is a unique estate planning tool that provides an opportunity for parents to transfer future ownership of real property to their children at a substantial discount and "freeze" the value for transfer tax purposes. This article briefly explains how the QPRT works.

**What is an "Estate Freeze?"**

An "estate freeze" describes any planning technique where a parent transfers appreciating assets to a child while retaining a right to use the assets for a period of time. Because of the retained rights of usage, the value of the transferred assets for gift tax purposes is less than the assets' fair market value. Moreover, because the potential appreciation in the assets is transferred to the child, the interest retained by the parent is "frozen" for estate tax purposes.

Estate freeze techniques can save taxpayers substantial amounts in gift and estate tax. Because the results are so advantageous to the taxpayer, however, the IRS has banned many estate freeze planning techniques.

**An Exception for Qualified Personal Residence Trusts**

One remaining estate freeze opportunity is the QPRT. With a QPRT, a parent may put a residence in trust for the benefit of a child but retain the right to use the residence for a specific term of years. For gift tax purposes, the value of the remainder interest of the child is determined after subtracting the value of the parent's right to use the residence for the term of years.

**Requirements for a Qualified Personal Residence Trust**

Under appropriate circumstances, a QPRT can be an ideal estate planning technique. To achieve the desired tax result, however, certain regulations must be followed:

- **"Personal Residence."** Only a "personal residence" may be transferred to a QPRT. A residence qualifies if it either is the parent's principal residence or is used primarily for residential purposes (such as a vacation home). The residence may be rented to other parties, so long as the parent uses the residence part of the time.
- **Jointly Owned Property.** Spouses who own a residence together may put that residence into a single QPRT (or separate QPRTs depending on the circumstances). Furthermore, if a parent owns a vacation home with someone other than a spouse, the parent's interest in that vacation home may be placed in a QPRT.
- **Mortgaged Property.** A residence with a mortgage also may be put into a QPRT (and the amount of the mortgage will reduce the value of the remainder interest for gift tax purposes).

- **Surrounding Land.** A QPRT may include an amount of land surrounding the residence that is "reasonably appropriate" for residential purposes. How much is "reasonably appropriate" will be determined by the size of the house and the type of neighborhood in which it is located. In an area of large country estates, 100 acres may be "reasonably appropriate." Typically, however, only a small amount of land may be included. For example, a QPRT holding a farm house likely could not include all of the farm acreage.
- **Length of the Parent's Term Interest.** The length of time that the parent can continue to use the residence is not limited - instead, that period is chosen by the parent and set forth in the QPRT. The longer the parent can use the residence, the lower the value of the gift to the child (and hence the lower the gift tax). As a practical matter, however, the term of use should be kept well short of the parent's life expectancy, because if the parent dies before the end of the term, the full value of the residence will be included in the parent's estate for estate tax purposes (thus defeating the entire purpose of the trust).
- **Sale of Residence; Sales Proceeds.** A QPRT may sell the residence and, so long as the sales proceeds are converted into a "qualified annuity," the QPRT may hold the sales proceeds until the termination of the parent's term of use.
- **Lease of Residence after Term Interest.** The QPRT may give the parent the right to lease the residence after the parent's term of use ends, so long as the rent paid is a "fair market value" rent. In this way, the parent may continue to live in the house as long as desired. By paying rent, the parent also is able to transfer additional wealth to the children free of any gift or estate tax.

The QPRT can provide significant tax savings if designed properly and used in appropriate circumstances. For parents who are willing to pass wealth to their children prior to death, it is one of the most effective estate planning tools currently available.

*For further information regarding the issues described above, please contact a member of the Trusts & Estates practice: Virginia Carter, Eldridge Dodson, Zac Lamb, Gregory Peacock, John Sloan, Matt Thompson, or Peter von Stein.*