

QUALIFIED PERSONAL RESIDENCE TRUST A GREAT OPPORTUNITY

By: Douglas A. Fendrick, Esquire

*Law Offices of Douglas A. Fendrick, LLC * 1307 White Horse Road, Building B
Voorhees, NJ 08043 * Phone: 856/489-8388 * Fax: 856/489-8424*

With the warm summer upon us, many of you are spending time at your summer homes. These so called "second homes" are often the single largest asset that a person possesses. Often clients want to keep these properties in their family from one generation to another. An untimely death could present a major obstacle to achieving this goal. Upon an individual's death an estate is created. The Internal Revenue Service imposes an estate tax for estates exceeding \$3,500,000. The State of New Jersey also imposes a New Jersey Estate tax on estates exceeding \$675,000. It is not uncommon for the combined taxes to exceed fifty percent of the value of an estate. *A qualified personal residence in trust* (hereinafter "QPRT") can be a valuable tool to reduce or eliminate this tax.

A QPRT can be established for a primary or secondary residence, or both. To establish a QPRT a homeowner must transfer title of their residence to a trust, the terms of which provide that a homeowner retains the use of the residence for a specified period of years. Thereafter, the residence will pass to the designated beneficiaries (usually the children). For a QPRT to work, the homeowner must outlive the term of the trust, or the house will be included in the estate.

During the trust term, the trust can be structured so that the homeowner is entitled to the same income tax deductions as if the property was owned individually. For example, the income tax deduction for real estate taxes, mortgage interest and homestead rebate. Furthermore, if during the trust term the house is sold, the homeowner can decide whether or when to reinvest the sale proceeds into another residence. If a new house is purchased then it will be placed into the trust. If the sale proceeds are not reinvested in a residence within a certain period of time, the trust converts to an annuity trust for the benefit of the homeowner for the remainder of the term. The homeowner would then be entitled to a portion of the income retained in the QPRT for the duration of the term of the trust.

At the end of the trust term the original homeowner can enter into a lease to pay rent to the beneficiary of the QPRT. The rent normally would be set at the market rate. The payment of rent will further reduce your estate.

The QPRT is a means of leveraging a person's estate tax exemption. Since the beneficiary of the trust does not receive the property immediately, the value of the gift is discounted. The amount of the discount depends on the homeowner's life expectancy, the term of the trust, and the applicable federal

interest rate during the month of the transfer. If the value of the property increases subsequent to the establishment of the trust then the future appreciation can be removed from the estate.

For example, if a 60 year old client owns a vacation property with an appraised value of \$300,000 (assume no mortgage), and title to the home is transferred to a 15 year QPRT. The homeowner will have to report the gift. The amount of the gift would be discounted by the homeowner's retained interest in the property for a 15 year period. The amount of the gift would be approximately \$100,000. This amount would be deducted from the homeowner's \$3,500,000 estate exemption. Assuming the property appreciated at a rate of four percent (4%) then the fair market value of the property at the end of the 15 year term would be approximately \$540,000. The homeowner would declare a gift of \$100,000, but would remove an asset valued at \$540,000 from his estate. If the homeowner was in a fifty percent (50%) estate tax bracket then the savings would be approximately \$219,000.

The QPRT is an extremely valuable estate planning tool. It can result in substantial estate tax savings, while the homeowner retains the use and control of the residence for a stated period. All income tax benefits associated with the residence are retained by the homeowner. The potential detriment to the homeowner is the loss of control after the trust period expires. This detriment can be reduced by entering into a lease arrangement when the trust terminates. Furthermore, if the homeowner should die before the term of the trust expires, then the gift associated with the QPRT is disregarded. Consequently, the heirs would be left in the same position as if no planning had been accomplished.