Qualified Personal Residence Trusts

With interest rates rising and the federal estate tax exemption about to be cut in half in 2026, qualified personal residence trusts are becoming increasingly attractive to clients whose net worths are likely to be more than the post-2026 exemption amount. The Qualified Personal Residence Trust (QPRT) can be an effective estate planning technique for an individual to stretch the value of his or her lifetime exemption from estate and gift tax.

The concept is simple: the owner of a personal residence transfers it to a trust, but retains the right to live in the residence for a specified period of years. At the end of that period of years, a trust, the individual's children, or other designated beneficiaries (any of whom can be called a "remainder beneficiary") become the owners of the residence. Thereafter, the residence will no longer be a part of the former owner's taxable estate.

A Brief Description of the Strategy

The tax advantage of the technique comes primarily from the way in which the value of the gift to the trust is calculated. The value of the gift is not the value of the residence on the date of the gift; instead, the gift is only the value of the remainder beneficiary's right to take possession of the residence at the end of the specified period of years, which can be far less than the current value of the property. For example, a $1,000,000 home can be gifted to a QPRT, removing $1,000,000 from the trustmaker's taxable estate, but the taxable gift may be as little as 50 percent or less of the value of the residence.

By keeping the gift tax value of the QPRT transfer below the applicable exemption from federal gift tax, the trustmaker can avoid paying federal gift tax on the gift. If the value of the residence is so large that even the reduced value of the transfer to the children would trigger a gift tax, the use of the QPRT will still be valuable and the payment of the gift tax may actually prove to be advantageous. Any gift tax paid now will reduce the estate tax due at death, provided the trustmaker lives at least three years after the tax is paid.

Although the concept of a QPRT is simple, the decision to create one should not be made without a fairly complex tax calculation to determine the value of the taxable gift which will be made. This value is a function of (i) the age of the trustmaker; (ii) the number of years during which the trustmaker will retain the right to occupy the property; (iii) the current appraised value of the property; and (iv) the current IRS actuarial tables and interest rates used to calculate future values.

The QPRT trust document may contain further provisions such as these:

A. The Trustmaker could be the sole Trustee of the QPRT during the initial rent-free occupancy period ("the QPRT term") and make all management decisions.

B. The QPRT would continue for a specified number of years, after which the property could be transferred either outright to the remainder beneficiaries or in a further trust for their benefit. The number of years that the QPRT is designed to continue requires careful thought since the tax benefits are lost if the trustmaker dies before the QPRT term ends. A longer trust term increases the tax advantages, but also increases the risk that premature death will erase those advantages.

C. During the QPRT term, the trustmaker would be entitled to all rights of occupancy and would be responsible for all costs of maintenance.

D. If the residence is sold during the term of the QPRT, another home can be purchased. If a replacement home of equal value is not purchased, the unused cash proceeds must either be distributed back to the trustmaker (thus forfeiting the tax benefit), or the cash must be invested and the trustmaker will be paid an annuity for the balance of the QPRT term (thus reducing, though not necessarily entirely eliminating, the tax benefit). After the QPRT term, the remaining trust assets will be distributed to the remainder beneficiaries.

Tax Implications of the QPRT

The objective of the QPRT is to reduce estate taxes by removing the property from the trustmaker's estate. If the trustmaker's death occurs after the QPRT term has ended, the trustmaker's taxable estate for federal estate tax purposes will include only the value of the children's future interest in the residence when the trust was created. All appreciation in value after the date of the gift will have been removed from the trustmaker's estate.

On the down side, if the trustmaker has survived the QPRT term, the residence will not receive a "step up" in its income tax cost basis to estate tax value because the residence will not have been taxed in the trustmaker's estate. For this reason, the QPRT is best suited for a home likely to stay in the family until the remainder beneficiaries' deaths, when the residence will get the desired step-up in basis. However, even if the property is later sold by the remainder beneficiaries, the capital gains tax (at least under current tax law) will be far less than the estate tax that otherwise would have been due had the QPRT not been created.

During the QPRT term, the trustmaker will be treated for income tax purposes as if he or she were still the owner of the property; i.e., the trustmaker can deduct real estate taxes, take advantage of tax elections on the sale of the property, etc. If the property is sold by the QPRT, a capital gains tax will be due in the same amount as if the trustmaker still owned the property. Additionally, the trustmaker must pay the capital gains tax out of his or her own funds, which often produces a good estate tax result because payment of the tax reduces the trustmaker's taxable estate.

If the trustmaker dies before the completion of the term of years specified in the QPRT, the trust will end and the property will be distributed to the trustmaker's estate and be disposed of by the trustmaker's Will. The tax advantages will be lost, but there will be no tax detriments—taxes will be calculated as though the QPRT had never been created.

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Commonly Asked Questions

Q: How Long Should the QPRT Term Last?

A: Generally, the QPRT should be planned to last as long as possible so as to make the value of the taxable gift to the children as small as possible—but not so long that the trustmaker dies before the QPRT term ends, which would lose the tax benefit because the property would then be included in the trustmaker's taxable estate.

Q: Can I Still Use My Residence After the QPRT Term Ends and the Remainder Beneficiaries Become the Legal Owners?

A: Yes, but you will be required to rent your residence from a trust for its then fair rental value. Actually, paying rent for your residence is an additional estate planning benefit. The rent paid is an additional payment using estate taxable assets to beneficiaries who receive that payment free from estate and gift taxes.

Q: Can I Use a Vacation Home Or Condominum For My QPRT?

A: Yes. A QPRT can hold either your primary residence or one other residence that you occupy.

Q: If My Home Has a Mortgage On It, Can I Transfer My Home to a QPRT?

A: You can, but it is a much preferable to remove the lien of the mortgage before transferring your home to the QPRT. If the mortgage remains on the property and you continue to pay it, the IRS will take the position that each payment is a separate taxable gift to the trust. Each month's payment will require a separate gift tax calculation, and you will be required to file additional gift tax returns each year the mortgage remains outstanding. A better idea would be to use other assets to pay off or collateralize the loan in question.

Q: May I Use My Spouse's Unified Credit (Lifetime Estate and Gift Tax Exemption) To Shelter My QPRT Gift If the Value Of My Gift Exceeds My Own Unified Credit?

A: Yes. However, it is risky (and probably unwise) to do so, because if you die before the QPRT term ends, your spouse's exemption will have been wasted. This unfavorable result can be avoided by giving your spouse a one-half interest in the residence first, and then creating two QPRTs, one for each of you.

Q: What Happens If I Wish To Stop Using The Property In The QPRT As A Personal Residence?

A: There are two choices. The trust agreement can provide that the trust will end and the property is to be given back to you. This may be unattractive, for if the cash proceeds are distributed to you, the tax shelter ends. Alternatively, the trust agreement can provide that the property is to be sold and either (a) a new residence purchased for you, or (b) the cash can be invested and you will receive a cash annuity - for example, if the net proceeds are $1,000,000, you might receive $100,000 per year until the termination of the trust. This will continue the tax shelter.

Q: What Are The Costs Of Managing a QPRT?

A: Little or none. If the trustmaker or a family member or friend is the sole trustee, which commonly is the case, there are no Trustee's fees. Usually no court costs or court supervision is involved. If the trustmaker is also the Trustee, the trust does not file tax returns. There are costs involved in establishing the trust, however, such as attorneys' fees for preparing the trust agreement and deeds of transfer and accountants' fees for preparing the initial gift tax return.

Q: Can My Spouse Have The Right To Live In Our Home After My Term Expires?

A: Yes. Taxes are not affected. Your spouse can be given the right to live in your home either rent-free or upon the payment of fair market rent (to further reduce his or her estate).

Conclusion

Creating a QPRT may be an ideal estate planning strategy to stretch one's lifetime exemption from estate and gift tax. If we can help you with specific questions or problems in this area, please feel free to contact us.