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Client Alert: Leveraging QPRTs in a High Interest Rate Environment

Leveraging QPRTs in a High Interest Rate Environment

A Qualified Personal Residence Trust, or “QPRT” is a planning strategy specifically authorized in the Internal Revenue Code that allows an individual to remove a personal residence from his or her taxable estate at a significantly reduced gift tax cost. QPRTs have become viable again as interest rates have increased, because the higher the interest rate when a QPRT is established, the greater the QPRT savings.

What is a QPRT?

The person who creates the QPRT (the “grantor”) establishes a trust, transfers a personal residence to it, and retains the right to use the personal residence for a specified number of years (the “QPRT term”), after which the residence typically is held in trust for the benefit of the grantor’s spouse and/or children. A QPRT allows a residence to be transferred at a deeply discounted gift tax value, and also freezes the value of the residence as of the date the QPRT is created. If the grantor survives the QPRT term, the residence (including any appreciation after the transfer) is excluded from the taxable estates of both the grantor and the grantor’s spouse.

If the grantor were to die during the QPRT term, the residence would revert to the grantor’s taxable estate. The method of calculating federal estate tax, however, would reflect the gift tax consequences which

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resulted from the creation of the QPRT. Consequently, in the event of the grantor's death during the trust term, the grantor's estate should be in the same federal estate tax position that it would have been had the QPRT not been created. For this reason, many estate planners view QPRTs as a "heads I win, tails I break even" proposition.

Gift Tax Implications.

The discounted gift tax value referred to above begins with the fair market value of the residence transferred to the QPRT as determined by appraisal, but then is reduced by (a) the value of the retained term interest and (b) the value of the retained reversionary interest, both of which are actuarially determined under IRS tables. For example, with respect to a December 2022 transfer, based upon (i) the applicable Federal rate (currently 5.2%), (ii) a 60 year old grantor, (iii) a residence valued at \$1,000,000 and (iv) a twenty-year QPRT term, the gift to the QPRT would be valued at only \$210,490 (a 79% discount). If interest rates have increased further by the date of the gift, the value of the grantor's retained right to use the residence would increase, causing the value of the gift of the future remainder interest to decrease, resulting in an even higher discount and, consequently, a smaller taxable gift.

Use of the Residence During the QPRT Term.

During the QPRT term, the grantor is entitled to unfettered use of the residence. Since the QPRT would be a "grantor trust" for income tax purposes (all trust items of income and deductions reported to the grantor), the grantor would be entitled to claim deductions on his or her individual income tax return for property taxes paid with respect to the residence (to the extent otherwise allowable). In addition, because the QPRT would be a "grantor trust," the grantor could exclude up to \$250,000 (or \$500,000 if married and filing jointly) of



any gain recognized on the sale of a primary residence owned by a QPRT.

If the grantor should decide to sell the residence during the QPRT term, the QPRT could purchase a replacement residence of equal or greater value. If the QPRT does not replace the residence (or replaces it with a residence of lesser value), the excess sale proceeds would be held in an "Annuity Trust" for the grantor's benefit.

What Happens at the Expiration of the QPRT Term?

After the QPRT term expires, the residence, now excluded from the taxable estates of the grantor and the grantor's spouse, would be owned by a "Remainder Trust" for the benefit of the grantor's spouse and/or family – but not the grantor. However, if the grantor's spouse was living, the grantor could continue to occupy the residence based on the grantor's status as the spouse of the beneficiary of the Remainder Trust. Alternatively, the grantor could occupy the residence by paying fair market value rent to the Remainder Trust. Paying rent usually is tax advantageous, since it allows the grantor to transfer additional assets for the benefit of other family members, free of gift tax. In addition, if the Remainder Trust is structured as a "grantor trust" as described above, the grantor's rental payments to the Remainder Trust would be completely disregarded for income tax purposes (because a grantor cannot have a taxable transaction with himself or herself).

Please contact Larry Richman, Eric Mann, Cheryl Schaul, Martin Tish, Kathryn Kaler or your Neal Gerber Eisenberg attorney to discuss whether a QPRT may be appropriate to your situation.



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