Warner Norcross + Judd LLP

QUALIFIED PERSONAL RESIDENCE TRUST ("QPRT")

Description

A qualified personal residence trust ("QPRT") is an irrevocable trust that satisfies certain requirements under the Internal Revenue Code.

The person who creates the trust (the "Settlor") transfers the Settlor's interest in a residence to the trust, and the trust grants the Settlor the right to occupy the residence for a fixed term of years. At the end of the term of years, the residence passes to the beneficiaries the Settlor has named in the trust. After the expiration of the term of years, any use or occupancy of the residence by the Settlor must be based upon a lease in which the Settlor pays fair market rental value.

A QPRT may hold a principal residence or a second residence. A Settlor may have no more than two QPRTs.

Tax Attributes

- **Gift, Estate, and Generation-Skipping Taxes**

  When a Settlor funds a QPRT, the Settlor makes a gift of the residence to the beneficiaries of the trust.

  The amount of the gift is the fair market value of the residence, less a discount based on the delay in the beneficiaries' receipt of the residence and the Settlor's age. The gift will use some of the Settlor's $12,060,000[1] tax-free amount ("unified credit") or, if that amount is exhausted from prior gifts, require the payment of gift tax.

  If the Settlor survives the term of years, the residence is not taxed in the Settlor's estate. If the Settlor fails to survive the term of years, the trust terminates, and the residence remains in the Settlor's estate at its current fair market value. Any unified credit is restored, so failing to survive the term is the same as if the QPRT had not been created, if no gift tax was paid.

  Except in rare occasions, grandchildren should not be beneficiaries of a QPRT due to the generation-skipping transfer ("GST") tax. Surviving children should be the only beneficiaries of a QPRT, unless at the time of the creation of the QPRT is established a child has died, then that child's children may be QPRT beneficiaries. The Settlor may desire to modify estate planning documents to equalize for a beneficiary who fails to survive the QPRT term.

[1] 2022 amount. This figure is annually indexed for inflation.

- **Income Taxes**

During the term of years, the QPRT is a "grantor trust" for income tax purposes. This means that the trust is not a separate taxpayer, and all of the income or capital gain during the term is taxed to the Settlor and reported on the Settlor's personal income tax return.

- **Real Property Taxes**

In Michigan, if the QPRT terminated before December 31, 2014, and the residence is distributed to the beneficiaries, the residence will be reassessed.

If the QPRT terminates on or after December 31, 2014, and the residence is distributed to beneficiaries who are the spouse, the Settlor's or Settlor's spouse's mother, father, brother, sister, son, daughter, adopted son, adopted daughter, grandson, or granddaughter and the residential real property is not used for any commercial purpose following the conveyance, the residence is not reassessed.

However, the real property homestead exemption, which permits lower taxes on primary residences, will be lost when the QPRT term expires unless a beneficiary is able to qualify for the homestead exemption by using the residence as his or her primary residence.

For property located in another state, the effects of that state's real property laws on the QPRT must be examined.

Planning

The longer the term of the QPRT, the greater the discount and, thus, the greater the tax savings. However, there are estate tax savings even with QPRTs with very short terms. The Settlor's retained interest reduces the gift, but no value is added to the Settlor's estate due to the Settlor's occupancy. The following are examples of how the length of the term can affect the amount of the gift the Settlor is deemed to make to the beneficiaries upon creation of the QPRT (shown as a percentage of the fair market value of the residence)[2]:

Term of QPRT (in years)	**Age of Settlor**	60	70	80
2		85%	82%	75%
5		66%	59%	46%
10		41%	32%	17%
15		25%	15%	4%

[2]The gift calculations are for purposes of illustration only with IRS rates of 7.6%. Actual calculations are dependent upon IRS published tables, which change monthly.

Normally, QPRTs are better suited for second residences rather than for primary residences. Unlike a secondary residence, a primary residence qualifies for the real property tax homestead exemption in Michigan.

Advantages of a QPRT

A QPRT removes the residence from the Settlor's estate at a reduced gift value. A QPRT also shifts all appreciation on the residence to the beneficiaries without gift or estate taxation.

Disadvantages of a QPRT

If the Settlor does not survive the term of years, the trust terminates and the residence remains in the Settlor's estate, resulting in no estate tax savings. The beneficiaries will have less basis than the Settlor, thus increasing their capital gains taxes to be paid upon a sale of the residence.

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