FAQs about QPRTs

Have you considered transferring ownership of your home to a trust? By using a qualified personal residence trust (QPRT), you can avoid potential estate tax pitfalls without drastic changes during your lifetime. Essentially, you can continue to live in the home for a stated term of years. When the trust ends, the remainder interest passes to your designated beneficiaries, such as your children.

But this unique estate planning technique is sometimes misunderstood. Accordingly, here are the answers to several FAQs about QPRTs:

Q: Who operates the trust?

A: For starters, you must appoint a trustee to manage the QPRT. Frequently, a grantor will act as the trustee. Alternatively, it can be another family member, friend or professional.

Q: What are the gift and estate tax consequences?

A: The home is removed from your taxable estate. The gift and estate tax currently is an inflation-indexed $11.58 million, but it's scheduled to revert to $5 million in 2026. Also, the transfer of the remainder interest is subject to gift tax, but tax resulting from this future gift is generally low, especially in the current environment. The IRS uses the Section 7520 rate, which is updated monthly, to calculate the tax. For August 2020, the rate was a record-low 0.4%, compared to the high of 11.6% when the rate was first introduced.

Q: What happens if I die before the end of the trust term?

A: The home is included in your taxable estate. Of course, this defeats the intentions of the trust, but other than the costs involved with creating and maintaining the QPRT, financially your family is no worse off than it was before the QPRT was created.

Q: Do I have to transfer my principal residence?

A: Normally, this is the case, but a QPRT may also be used for a second home, like a vacation home. In fact, you can maintain trusts for both residences.

Q: Does the home include adjoining land?

A: Generally, yes. In most cases, the IRS will treat the land adjacent to a house as being part of the principal residence. But it must be reasonable under the circumstances. The location, size and use of the home are determining factors.

Q: How long should the trust term last?

A: There's no definitive time period. Note that the longer the term, the smaller the value of the remainder interest for tax purposes. On the flip side, as mentioned above, the home will be included in your estate should you die before the end of the term.

Q: Can I sell the home during the trust term?

A: Yes. But there are caveats. While a comprehensive review of the nuance is beyond the scope of this article, generally you must then reinvest the proceeds in another home that will be owned by the QPRT and subject to the same trust provisions.

Q: Who pays the monthly bills for residence?

A: As long as you're still living in the home, you must foot the bill. Typically, you'll have to pay property taxes, maintenance and repair costs and insurance. Because the QPRT is a grantor trust, you're entitled to deduct qualified expenses on your tax return, within the usual limits.

Q: If I outlive the trust term, will I be kicked out of the home?

A: Not exactly. When the term ends, the remainder beneficiaries become owners of the home, but you can pay them a fair market rental for living there. This may seem strange but it actually coincides with the objective of shifting more assets to the younger generation.

Q: Can I back out of the deal?

A: Unfortunately, no. This type of trust is irrevocable. However, remember that the worst that can happen is that you pay rent to the beneficiaries if you outlive the trust term, or the home goes back into your estate if you don't. Also, note that the beneficiaries will owe income tax on any rental income.

Q: Are there any other drawbacks?

A: Yes. First, there are costs associated with a QPRT, including attorneys' fees, appraisal fees and title expenses. Second, you can't take out a mortgage on a home that has been transferred to a QPRT. (An existing mortgage is permitted but it complicates matters.)

Q: Is this estate planning technique right for you?

A: It's not for everyone, but it may be part of a comprehensive estate plan. Discuss this option with your estate planning advisor so that you can make an informed decision.

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