REDUCING ESTATE TAXES THROUGH
USE OF QUALIFIED PERSONAL RESIDENCE TRUST
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Estate Freeze:

In the 1980's, many estate planners were utilizing estate freeze techniques to reduce estate taxes for their clients. An estate freeze is a device in which the taxpayer would retain the income from an asset while transferring the growth of the asset to his or her heirs. Generally, the value of the asset in the taxpayer's estate would be frozen as of the date of such transfer to his or her heirs, eliminating all the growth of the assets from his or her taxable estate. Estate freeze techniques were maligned by the Internal Revenue Service and were essentially eliminated through legislative changes to the tax code in 1990. The personal residence was granted special treatment in such legislation. By creating a qualified personal residence trust ("Q-PRT"), taxpayers may freeze the value of their home for estate and gift tax purposes. Taxpayers who create a Q-PRT transfer a future interest in their residence to their heirs in order to have the residence removed from their taxable estate upon death. Following is an example of the operation of a typical Q-PRT:

Typical Q-PRT:

Example: Father (F), age 67, transfers his residence valued at $200,000 to a Q-PRT. The terms of the trust provide that F will retain the beneficial interest in the trust (i.e., will have the right to live in the residence) for a period of ten (10) years. Upon the expiration of the ten years, the beneficial interest of the trust will pass equally to his two children, S & D. The residence will continue to be held in trust after the ten-year period for the benefit of S & D. Consequently, S & D will be entitled to the income produced by the residence after the ten-year period. At such time, F will be required to pay rent to S & D while he continues to live in the residence. Paying rent to S & D allows F to make additional transfers of cash to S & D without incurring gift tax consequences.

On the date the residence is transferred to the trust, F makes a taxable gift to S & D of the remainder interest in the value of their residence. For gift tax purposes, the value is discounted to reflect F's retained beneficial interest in the residence for ten years. An additional discount is allowed for the possibility that if F dies within the ten year term, the residence will revert to his estate. In the example above, F must file a gift tax return reporting a gift to S & D in the year the Q-PRT is created. The gift, after calculating the discounts, equals $82,641 (nearly $120,000 less than the value of the residence). If F survives for the ten-year period, the residence will be completely removed from his taxable estate. All of the appreciation in the value of the residence is also removed from F's estate. Assuming the residence increases to $300,000 in value by the time of F's death and assuming that F is in the 50% estate tax bracket, the resulting estate tax savings is $108,680 [$300,000 less $82,641 (gift) x 50%]. At the time of making the gift, F will utilize a portion of his unified gift and estate tax credit so that no gift taxes will be paid upon the transfer of the residence to the Q-PRT.

As demonstrated in the example, the value of the residence is frozen in F's estate as of the date the residence is transferred to the Q-PRT.

<u>Miscellaneous</u>:

Taxpayers may create multiple Q-PRTs for their primary residence and vacation homes. The Q-PRT provides that the taxpayer may sell the personal residence. If a sale occurs, the taxpayer has two years to rollover the proceeds to a new personal residence. If the proceeds are not rolled over within the two-year period, the proceeds will be returned to the taxpayer.

While the terms of the Q-PRT can be complicated, a Q-PRT has the potential of saving enormous taxes. In addition, there is virtually no risk for creating the trust.

A Q-PRT should be utilized by taxpayers who own their residence and will have a taxable estate upon their death.

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