WHAT IS A QUALIFIED PERSONAL RESIDENCE TRUST INCALIFORNIA?

"If your estate is going to be exposed to the estate tax, you could potentially reduce the taxable value of your home through the creation of a qualified personal residence trust."

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To learn more about qualified personal residence trusts and other estate tax efficiency tools, schedule a consultation with a licensed estate planning attorney.

A qualified personal residence trust can be a useful addition to your estate plan if you are exposed to the federal estate tax. Before we look at the details, we should explain the transfer tax parameters so that you can assess your level of exposure.

Federal Transfer Taxes

Everyone does not pay the federal estate tax, because there is a reasonably high credit or exclusion. The amount of this credit is $5.43 million in 2015. There was a base of $5 million put into place for the 2011 calendar year, and there have been ongoing adjustments to account for inflation since then.

The maximum rate of the federal estate tax is 40 percent.

When you first hear about the estate tax, you may consider giving gifts to your heirs while you are living in an effort to avoid the tax. This is not an effective strategy, because there is also a federal gift tax. It is unified with the estate tax.

The $5.43 million exclusion that we have in 2015 encompasses large gifts that you give along with the value of your estate. As a result, if you give away $5.43 million in tax-free gifts while you are living, the entirety of your estate would potentially be subject to the estate tax.

Qualified Personal Residence Trusts

If you are like most people, your home is your most valuable asset. When you convey your home into a qualified personal residence trust, you are removing the home from your taxable estate.

However, you name a beneficiary who will assume ownership of the home after the term of the trust expires. Because the beneficiary will be receiving the home as a gift, the gift tax is applicable.

When you are drawing up the trust agreement, you decide on a term that is called the retained income period. During the retained income period, you continue to live in the home as usual, so your life is not disrupted right away when you implement this strategy.

The Internal Revenue Service will take the retained income period into account when the taxable value of the gift is being calculated.

To provide an explanation of the rationale, suppose you wanted to sell the house on the open market with the stipulation that the buyer could not assume ownership for 15 years. No one would pay full market value for the home under these circumstances. For this reason, the taxable value of the home is going to be significantly less than true fair market value.

At the conclusion of the term, the beneficiary would assume ownership of the property, and the gift tax liability would be reduced because of the retained income period.

There is an important piece of information that you must understand when you are deciding on the duration of the retained income period. The taxable value will be tied the duration of the period. For this reason, on the one hand, longer is better.

However, the strategy completely falls apart if you pass away before the expiration of the retained income period. The home would once again become part of your taxable estate. This is something to keep in mind when you are creating the trust.

Summary

Federal transfer taxes are a factor if you have been quite successful from a financial perspective. There is a federal estate tax credit or exclusion that stands at $5.43 million in 2015. This is the amount that you can transfer before the estate tax would kick in.

There is also a federal gift tax that is unified with the estate tax. The $5.43 million exclusion is a unified lifetime exclusion. It encompasses lifetime gifts along with the estate that you are passing on to your heirs.

If your estate is going to be exposed to the estate tax, you could potentially reduce the taxable value of your home through the creation of a qualified personal residence trust.

To learn more about qualified personal residence trusts and other estate tax efficiency tools, schedule a consultation with a licensed estate planning attorney.

Your attorney will become apprised of your situation, answer all of your questions, and make the appropriate recommendations.

ABOUT THE AUTHOR

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Roy Litherland has been providing legal services in Santa Clara and Santa Cruz Counties continuously since 1975.

Roy has an undergraduate degree in accounting from Indiana State University, and a Juris Doctor degree from Indiana University, where he graduated cum laude. In law school he was a recipient of the Dean Faust Award and received awards and honors in income taxation and estate and gift taxation.

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