The Qualified Joint Purchase Residence Trust

by Mark A. Schaum, Esquire, CPA

A personal residence can be a significant asset in one's estate that, absent any estate planning, will be valued for estate tax purposes at its full fair market value on the date of the owners' death. In general, the government places severe limitations on the ability of a person to retain a lifetime interest in property while giving away the remainder interest to a family member (See Internal Revenue Code (I.RC) Section 2702). An exception is made for personal residences held in a Qualified Personal Residence Trust (QPRT) meeting the requirements set forth in IRC Section 2702.

Before one can appreciate the potential benefits of a Joint Purchase QPRT, it is helpful to understand how a typical QPRT works. In a typical QPRT, the owner makes a taxable <u>gift</u> of the remainder interest of his residence to his children while retaining a lifetime interest for a selected period of time. While the gift is taxable for gift and estate tax purposes, typically no tax will be paid because the owner will be able to apply his unused applicable estate tax exemption (currently $650,000) against the gift. The owner can choose the period of time for which the residence is retained, but must bear in mind two conflicting considerations. First, the longer the retention period, the smaller the taxable gift will be. Second, if the owner does not survive the full term of the life interest selected, the estate will have to value the residence for estate tax purposes at the full value of the residence at the date of death. Thus, while making the gift smaller is a desirable goal, if the period retained is too long, the technique will fail and not result in any estate tax savings. While dying before the expiration of the retained term is an awful result in itself, it is particularly awful if an alternative gift strategy was sacrificed at the expense of the QPRT.

There is another reason why clients are reluctant to establish a typical QPRT. If the owner manages to survive the selected term of the QPRT, the house then reverts to the remainder beneficiaries of the trust which are usually the owner's children. Thus, to be able to remain in the residence, the children essentially have to lease the home back to the parent or parents. While in many cases this might not be much of a concern, it certainly scares a lot of people away from this transaction. Lastly, this technique will usually not be desirable if the owner has already utilized their estate tax exemption with other gifting strategies because then the owner will have to pay a gift tax.

A number of experts in the estate planning arena have interpreted the exceptions of IRC Section 2702 exceptions to permit a joint purchase of a personal residence between parents and their children using a QPRT. In a joint purchase, the parent or parents <u>purchase</u> a lifetime interest in

the home and the children purchase the remainder interest. The purchase prices of these interests are determined by using an IRS life expectancy table and applying the federal interest rate under Section 7520 for the month of purchase.

Example

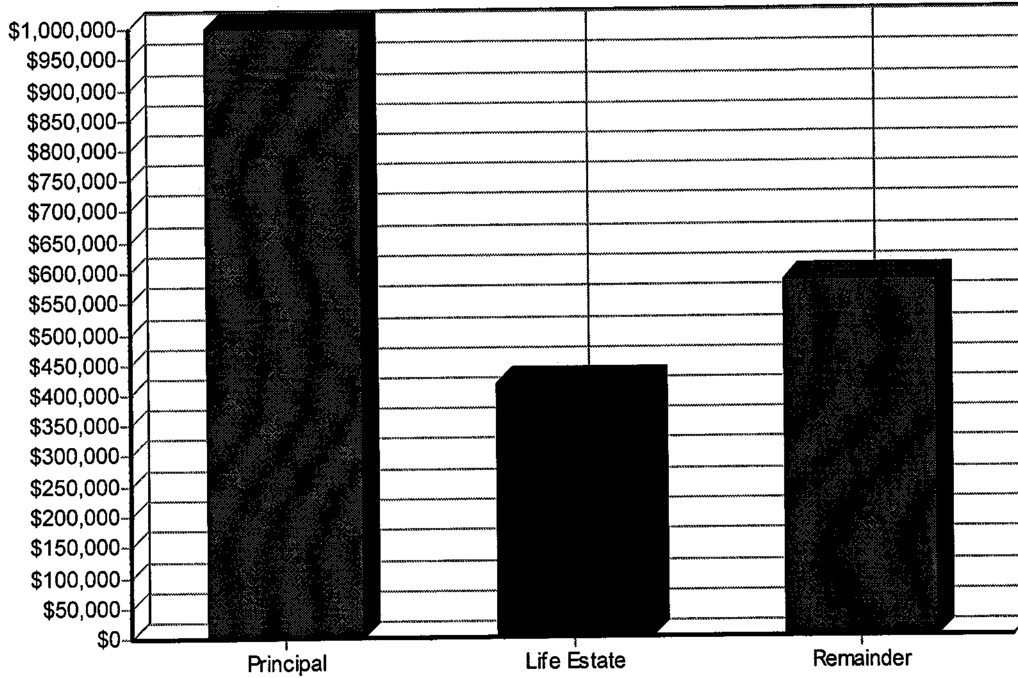
Husband and wife, ages 63 and 60, desire to purchase a $1,000,000 residence with their children. Applying the IRS table, the cost of husband and wife's joint- life interest (using the July 2011 Section 7520 rate of 2.4%) will be $416,080 or 41.6% of the purchase; and the cost of the remainder interest to be purchased by their children will be $583,920 or 58.39% of the purchase price-see calculation attached . How do the children come up with the money to buy their remainder interest? This can be an obstacle, but there are usually creative ways in which this can be accomplished. Let's now assume that husband and wife are both no longer living in twenty years at a time when the residence has appreciated to a value of $2,000,000. The following benefits may be reaped:

1. The entire $2,000,000 would be excluded from inclusion in the parents estates.
2. There was no use of the parents' estate tax exemptions and the parents were able to utilize these exemptions for other strategies or apply them at death.
3. A gift tax return did not have to be filed.
4. The parents were able to live in the residence for as long as they lived without having to rent it back from their children.
5. The parents did not have to guess how long they were going to live and could, therefore, plan for future estate tax liability with greater certainty (assuming there is an estate tax) .

Therefore, before purchasing a new residence, it may be a good idea to talk to an estate planning attorney that is knowledgeable about this technique.

Transfer Date:	7/2011
§7520 Rate:	2.20%
Calculation Type:	Life
Principal:	$1,000,000
Lives:	2
Ages:	63, 60

	Life Estate	Remainder
Factor:	0.41608	0.58392
Value:	$416,080.00	$583,920.00



Annuity, Life Estate and Remainder Factors

Annuity Factors
For income, estate, or gift tax planning purposes, or for general financial planning purposes, it is often necessary to know the present value of a continuing series of payments to be received in the future. When the payments are regular and fixed in amount, they can be valued as an annuity.

The two simplest forms of annuities are annuities payable for a term of years and annuities payable for a life (or lives). There are also many possible variations, such as annuities payable for the shorter of a term or life, annuities with a guaranteed term (i.e., payable for the longer of a term or life), annuities that terminate upon the first death among several lives (instead of last-to-die), and deferred annuities that start at a future date. This program calculates only annuities for a term, for a life (or up to three joint lives), or the shorter of a term or life (or lives).

The present value of an annuity is usually determined by multiplying the total annual payments by a factor. When the annuity is payable annually and at the end of each year, the factor is nothing by the comparable life estate factor (see the Life Estate and Remainders Factors explanation below), divided by the assumed discount rate (i.e., the section 7520 rate). When annuities are payable semi-annually, quarterly, or monthly, or at the beginning of each payment period instead of at the end, the base factor must be adjusted

The factors calculated by this program are based on rules and regulations under Section 7520 of the Internal Revenue Code, and methods used by the IRS consistent with those rules and regulations. This means that future values are discounted to present values using the interest rate required under Section 7520 (120% of the federal mid-term rate for the month, rounded to the nearest 2/10ths of a percent) and using Table 80CNSMT or 90CM mortality values.

Life Estate and Remainder Factors
A term of years is the right to use, possess, and enjoy the property or the income it produces for a specified number of years. That right continues until the term expires (regardless of whether or not the person enjoying the property or the income it produces during that term continues to live. If the "term tenant" dies, the right can be left by will or passed to a family member through intestacy laws).

A life estate is the right to use, possess, and enjoy property or the income it produces for the life of a specified person. That measuring life (using age nearest birthday) can be the life of the holder of the interest or may be measured by the life of some other person (a so called "estate per autre vie").

A life estate can be payable for more than one life. For example, the right to live on or enjoy the income from property (in or out of trust) can extend for joint lives of you and your spouse or you and any other person or persons. Note that the life income beneficiary receives no right to enjoy the principal and the life estate therefor ends at the death of the "measuring life". But if one person holds a life estate (e.g. a parent) and another person is used as the measuring life (e.g., a child), the holder of the estate could give it away, sell it, or leave it in his or her will and it will continue in the new owner's hands - until the death of the measuring life.

A remainder interest is the right to use, possess, or enjoy property when the prior interest (term or life) ends. Mathematically, the value of a remainder interest is found by subtracting the present value of the prior interest from the entire fair market value of the property.

Terms of years, life estates, and remainder interests are key estate planning concepts. To make these time value of money computations, you must use a discount rate issued monthly by the federal government called the "Section 7520 rate". This is computed from the average market yield of U.S. obligations. Except in the case of charitable contributions, you use this so-called Section 7520 rate for the month the valuation is to be made.