CUMMINGS & LOCKWOOD LLC

WHAT ARE THE ESTATE AND INCOME TAX IMPLICATIONS OF THE QPRT?

Estate taxes.

The objective of the QPRT is to reduce estate taxes by removing the residence from the donor’s estate. If the donor’s death occurs after the QPRT has ended, the calculation of the donor’s taxable estate for federal estate tax purposes will only take into account the value of the original gift (the children’s future interest in the residence when the trust was created), and all appreciation in value after the date of the gift will have been removed from the donor’s estate. If the donor dies before the completion of the term of years specified in the QPRT, the trust will end and the property will be distributed to the donor’s estate to be disposed of by the donor’s Will. The tax advantages will be lost, but there will be no tax detriments—taxes will be calculated as though the QPRT had never been created.

Capital gains.

On the downside, if the donor has survived the QPRT term, the residence will not receive a “step?up” in its income tax cost basis to estate tax value because the residence will not have been taxed in the donor’s estate. For this reason, the QPRT is best suited for a home likely to stay in the family until the children’s deaths, when the residence will get the desired step?up in basis (although there will be no basis step-up if the residence remains in a trust for children). However, even if the property is later sold by the children or other trust beneficiaries, the capital gains tax (at least under current tax law) will be less than the estatetax that would have been due had the QPRT not been created.

Income taxes.

During the QPRT term, the donor will be treated for income tax purposes as if he or she were still the owner of the property; e.g., the donor can deduct real estate taxes on his or her personal income tax return. If the property is sold by the QPRT, a capital gains tax will be due in the same amount as if the donor still owned the property. The donor must pay any such capital gains tax out of his or her own funds, which can produce a good estate tax result because payment of the tax further reduces the donor’s taxable estate if the proceeds of the sale are reinvested by the Trustee in another personal residence.