



LISA CAPUTO

# Protecting your home from Estate Tax

**L**ike most individuals residing in the Bay Area, the value of your home may constitute a large portion of the total value of your estate. If this is the case, you might want to consider establishing a Qualified Personal Residence Trust (QPRT).

A QPRT is an estate planning vehicle that allows you to transfer your home to your children at a substantially reduced value for gift tax purposes. This in turn reduces the value of your estate for estate tax purposes because the home is no longer considered part of your estate when you pass away. It works like this:

You would contribute your principal residence (or a vacation home may also be used) to an irrevocable trust; however, you are allowed to reside in the residence rent free. You choose the number of years you wish for the trust to be in existence. When the trust terminates, the property in the trust is distributed to your children or other family members you have designated as beneficiaries of the trust. In some cases, the trust continues for their benefit. When you place property into the trust, you will have made a gift. The value of that gift is determined based on a number of factors such as your age, the value of the property and federally published IRS rates. The following is an example of how the gift is calculated.

**Example:**

Assuming a 4% federal rate, if the trust will run for 10 years and a residence with a value of \$1 million is initially

placed into the trust, the value of the (nontaxable) interest retained by a 65 year old would be \$486,450. The taxable portion of the QPRT gift would be \$513,550 (\$1,000,000 less \$486,450). So at the end of the 10 year term, a home worth \$1 million would have been transferred using a value for gift tax purposes of only \$513,500. Furthermore, if the property is worth more than \$1 million at the time of your death, the future appreciation is not includable in your estate for estate tax purposes because you no longer own the home.

The longer the term you specify the lower the value of the gift. If the term you selected is long enough you could possibly eliminate any gift tax liability. Everyone has an exemption today of \$1 million from the federal gift tax. The amount of the gift involved with the creation of a QPRT reduces this exemption and must be reported on a gift tax return. The gift tax return is due when you file your individual income tax return for the year in which the gift is made. There is no need to file a separate income tax return for this trust because it is considered a "grantor trust" for income tax purposes.

It is important that you select a term of years you are likely to survive because if you die before the term is over, the entire home is included in your estate. However, if you survive the term, the tax savings are substantial.

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