

Rosen Seymour Shapss Martin & Company LLP

Certified Public Accountants & Profitability Consultants

Issue: 8

July 2009



LIFELINES BLAST

Greetings!

Welcome to the Fiduciary Services Group's Lifelines Blast! (a publication of Rosen Seymour Shapss Martin & Company). Here is where you will receive periodic updates on all your trust and estate needs.

We welcome your questions or comments about topics discussed or related ones. Please feel free to contact us at 212-303-1012 or e-mail us at awillinger@rsmcpa.com and let us know how we can be of assistance.

Sincerely,

Alan M. Willinger, CPA, JD
Partner-in-Charge of Fiduciary Services

Qualified Personal Residence Trusts

A special kind of irrevocable trust can be used to transfer your residence to your children at a significantly reduced gift tax cost and with no estate tax, yet allow you to continue to live in the residence for as long as you wish. This special type of trust is known as a qualified personal residence trust (QPRT). (QPRTs are sometimes also referred to as "residence GRITs" or "house GRITs".) Here's how it works.

During your lifetime, you transfer your residence to the trustee, who (if state law permits) can be yourself. The trustee must allow you to continue to use the residence rent-free for a fixed number of years specified in the trust instrument (the "fixed term"), which should be a term you are likely to survive. During the fixed term, you will continue to pay mortgage expenses, real estate taxes, insurance, and expenses for maintenance and repairs, and will continue to deduct mortgage interest and real estate taxes on your individual income tax

In This Issue

[Qualified Personal Residence Trusts](#)

[Estate Tax Marital Deduction: Don't "Over Qualify"](#)



RSSM

Rosen Seymour
Shapss
Martin &
Company LLP

757 Third Avenue
New York, NY
10017

Telephone: 212-
303-1800

Facsimile: 212-
755-5600

Email:

info@rsmcpa.com

Please visit our
website at
www.rsmcpa.com

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return. When the fixed term ends, the residence is distributed to your children, or remains in further trust for them.

Even after the fixed term ends, you can continue to use the residence in one of two ways. First, rather than immediately distributing the residence to your children, the residence can be retained in trust for your spouse's lifetime, thus assuring that the residence is available to you. Second, you can enter into a lease with your children which will allow you to live in the residence for as long as you wish. (If you do so, however, you must pay fair market value rent to your children after the fixed term ends in order to keep the residence from being subject to estate tax on your death.)

Although your transfer of the residence to the trust is a taxable gift, you are allowed to subtract, from the fair market value of the residence, the value of your right to live rent-free in the residence for the fixed term. Thus, the amount of the taxable gift will usually be substantially less than the fair market value of the residence. If the amount of the gift is less than your available exclusion from the gift tax (\$1 million, reduced by amounts allowed for gifts in previous years), no gift tax will be due as a result of your gift to the trust.

If you survive the fixed term of the QPRT, the value of the residence will not be included in your estate for estate tax purposes. Even if you don't survive the fixed term, the estate tax consequences will be no worse than they would have been if you hadn't created the trust in the first place. Even though federal tax legislation enacted in 2001 repeals the estate tax, the repeal is not effective until 2010.

A QPRT is an effective way to remove a residence's value from your estate at a greatly reduced gift tax cost.

Estate Tax Marital Deduction: Don't "Over Qualify"

There are no limits on how much of a marital deduction your estate can qualify for. Thus, if your entire estate goes to your surviving spouse, your estate will owe no federal estate tax. Many taxpayers take this simple approach. In the long run, however, it can cost your family hundreds of thousands of dollars in extra estate taxes. Here's what's involved.

Every individual is entitled to a "unified" credit entitling him to transfer \$3.5 million in cash or property free of federal estate tax. (The estate tax is scheduled to be repealed on January 1, 2010, and to be reinstated, with a \$1 million exemption, on January 1, 2011.) Property doesn't have to be transferred to the individual's spouse to qualify for this credit. A husband and wife, therefore, can transfer a total of \$7 million (\$3.5 million each) to their children (or other

beneficiaries) in 2009, free of estate tax. If the first of them to die leaves everything to the surviving spouse, however, he will have failed to take advantage of his unified credit. At the later death of the spouse, assets with a value of \$3.5 million passing to the children will be "sheltered" by her credit, but the rest of the "parental" estate will be taxed.

Example (1). Harry dies in 2009 with an estate of \$7 million, which he leaves in its entirety to his surviving spouse, Wilma. Harry's estate has no estate tax liability due to the marital deduction. Wilma dies later in 2009 with the \$7 million comprising her estate. (For the sake of simplicity, assume that there will be no appreciation in the value of the property after Harry's death.) After applying the unified credit that applies in 2009, the estate tax bill for Wilma's estate will be \$1,575,000.

Example (2). The facts are the same as above except that Harry leaves only \$3.5 million to Wilma and leaves the balance of his estate (\$3.5 million) to their children. In this case, Harry's estate will still owe no estate tax due to the combined effect of the marital deduction and unified credit. At Wilma's later death, her estate will be \$3.5 million, instead of the \$7 million in the first example. Now, after applying the unified credit that Wilma's estate will be entitled to, the estate tax bill will be zero. By keeping \$3.5 million of Harry's estate from qualifying for the marital deduction, \$1,575,000 in estate taxes are avoided.

Property passing to the spouse. One reason an estate may over qualify for the marital deduction is that property may go to the surviving spouse automatically—that is, not under the taxpayer's will. Two common examples are jointly owned property and life insurance.

If a married couple owns property jointly with survivorship rights, the surviving spouse obtains complete ownership by operation of law outside the estate. Under the estate tax rules, half the value of the property is included in the gross estate but qualifies for the marital deduction since it goes to the surviving spouse. Similarly, if the surviving spouse is the beneficiary of life insurance which is included in the estate, the marital deduction applies.

Accordingly, to avoid "over qualifying" for the marital deduction, it is important to know what property is already targeted to go to the surviving spouse. Then steps can be taken within your estate plan to make sure enough assets are set aside to take advantage of the unified credit.

If you are hesitant to remove \$3.5 million or more of your assets from your spousal bequest for fear of leaving your spouse with insufficient property to meet her needs after your death, special

arrangements can be made to achieve your goals. One way is to place assets in trust with your spouse receiving the income interest for life and with your children receiving the assets at the spouse's death. The trust can be set up to avoid qualifying for the marital deduction at your death, thus avoiding inclusion in your surviving spouse's estate at her death.

If you wish to discuss how you can save perhaps hundreds of thousands of dollars using the estate planning technique described above, or to explore other estate planning techniques, please call us at your earliest convenience.

FIDUCIARY SERVICES GROUP

Rosen Seymour Shapss Martin & Company LLP

RSSM's Fiduciary Services Group offers a wide range of fiduciary services. We assist and guide fiduciaries as they perform their duties and fulfill their obligations. In appropriate circumstances, we can also serve as trustee, and/or executor for you and your family. We will provide your family with protection and security by helping you plan for the future with incapacity protection, probate avoidance, planning for minor children, distribution planning and estate tax planning. Our team approach allows us to provide you with the most basic protection and our experience enables us to assist you with the most complex arrangements, including charitable giving and sophisticated estate tax strategies.

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Rosen Seymour Shapss Martin & Company LLP | 757 Third Avenue | New York | NY | 10017