

# How a Qualified Personal Residence Trust Works

The GRIT is a grantor-retained income trust. This planning technique allows a person (the grantor) to transfer assets to a trust and retain the income for a number of years, after which the remaining trust assets pass to others, e.g., children, grandchildren, etc.



By retaining the rights to the income, the value of the remaining interest is reduced, along with the potential gift tax. If the grantor lives beyond the term of years selected to receive the income, the asset will be totally removed from his or her taxable estate.

Although the use of this device was limited by the Tax Act of 1990, it is still useful when used with a personal residence of the grantor.

## Qualified Personal Residence Trust

The following example illustrates the potential tax benefits of this type of trust, with a term of 10 years or the death of the grantor, should it occur earlier:

### Assumptions:

- Value of residence: \$500,000
- Age of grantor at beginning of trust: 65
- Term of the trust: 10 years
- Gov't. rate for valuing remainder interest: 1.4%<sup>1</sup>

Value of remainder interest	\$158,365
Probability of living 10 years	78.52%
<b>Amount of taxable gift = \$341,635</b>	

Assuming the grantor lives beyond the 10-year period, he or she will have removed a \$500,000 asset (plus its growth potential during the 10 years) from the taxable estate.<sup>2</sup>

The trust instrument should be drafted so that it is a grantor trust. This makes the trust income taxable to the grantor but also allows him or her to deduct mortgage interest and property tax payments made by the trustee.

**Note:** The grantor's applicable credit amount may be used to avoid paying a gift tax on the taxable portion.

<sup>1</sup> The IRC 7520 rate for November 2011; this rate is subject to change monthly.

<sup>2</sup> If death occurs before 10 years, the value of the trust assets is includable in the grantor's gross taxable estate.