



# California Trusts and Estates Quarterly

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## THE CURIOUS CASE OF QPRTS: UNDERUSED AND UNDERAPPRECIATED

By Bruce Givner, Esq. and Owen Kaye, Esq.\*\*

### I. INTRODUCTION

Qualified personal residence trusts ("QPRTs") have been available for nearly twenty years.<sup>1</sup> They have been recognized as excellent structures for both estate tax and asset protection planning for equity in the residence,<sup>2</sup> which is often the most emotionally important family asset. Numerous authoritative texts and articles provide guidance on important QPRT drafting and tax issues.<sup>3</sup> The IRS has issued helpful rulings.<sup>4</sup> Yet, a 2001 article noted that "QPRTs...remain underutilized,"<sup>5</sup> and empirical evidence suggests that little has changed since then.<sup>6</sup> Current economic uncertainties, which create fear in the minds of homeowners, and favorable non-tax precedent (discussed below), warrant a fresh, straightforward reconsideration of QPRTs.

### II. TRANSFER TAX ADVANTAGES

#### A. Example

A QPRT's estate and gift tax attractiveness can be illustrated with an example: Mom, age 65, owns a residence worth \$1,000,000, outright. According to the tables,<sup>7</sup> she has a 21-year life expectancy. She establishes a 20-year QPRT and names Son as trustee.<sup>8</sup> If Mom survives the term, the residence passes to Son,<sup>9</sup> and she will have to pay him fair market rent if she wishes to remain in the residence.<sup>10</sup> If, at her death, the home has appreciated in value to \$2,000,000, the entire \$2,000,000 is outside her taxable estate, saving \$900,000 of estate tax.<sup>11</sup> If Mom dies before the end of the term, the residence will revert to her estate.<sup>12</sup>

What is the size of Mom's gift? The \$1,000,000 current value will be reduced by two factors: (i) Time Value of Money: Son's ownership of the residence is delayed for 20 years, so his interest must be discounted for the time value of money;<sup>13</sup> and (ii) Mother's Reversion: Son will not receive the residence (under the QPRT) unless Mom survives the 20-year term. In other words, the QPRT provides for a contingent gift. The software<sup>14</sup> reports that in February, 2009,<sup>15</sup> the present value of Son's right to receive \$1,000,000 at the termination of the QPRT term is \$268,870. That is good leverage: three-fourths of Mom's gift tax exclusion is still available.<sup>16</sup>

#### B. Change the Facts

What if Mom has a residence with \$5,000,000 in equity?<sup>17</sup> The same structure – a 20-year QPRT gift that begins in February, 2009 – produces a \$1,344,350 gift, which exceeds Mom's gift tax exclu-

sion. Mom does not want to pay the gift tax<sup>18</sup> on the \$344,350 excess. What can she do?

*Alternative No. 1:* Mom transfers 70 percent of the home to the QPRT. The gift is reduced to \$941,045, within her \$1,000,000 lifetime transfer tax exclusion. That leaves some margin for error if the IRS audits the Federal Gift Tax Return (IRS Form 709) and disagrees with the appraisal of the residence.

*Alternative No. 2:* Mom can first make a gift of an undivided 5 percent interest in the residence to Son. How valuable is that gift? On first reflection, it would seem that \$5,000,000 (the residence value) x 5% (the interest transferred) = \$250,000 (the value of the gift). However, Mom should hire a business appraiser to opine on a tenancy in common discount. That discount might be, for example, 20 percent. As a result, the gift of 5 percent is valued as follows: \$5,000,000 (the residence value) x 5 percent (the interest transferred) x 80 percent (a 20 percent discount) = \$200,000 (the value of the gift). Of course, Mom must now enter into a written lease<sup>19</sup> with Son and pay fair market rent for the 5 percent. Reducing the value of the 5 percent gift from \$250,000 to \$200,000 is not the primary benefit of the gift of an undivided interest to Son. The primary benefit is the impact on the value of the gift, through the QPRT, of the other 95 percent of the residence. Now the gift through the QPRT is valued as follows: \$5,000,000 (the residence value) x 95 percent (the interest transferred) x 80 percent (a 20 percent discount) = \$3,800,000 (the value of the gift through the QPRT). As a result, the 20-year QPRT produces a \$1,021,706 gift, only slightly greater than the gift resulting from QPRT transfer of 70 percent of the residence. Of course, this must be fully disclosed on the Federal Gift Tax Return (IRS Form 709) to allow the IRS to evaluate the transfer and, if it chooses, challenge the valuation.<sup>20</sup>

#### C. Interest Rate Sensitivity

Bear in mind that these examples, using one of the lowest IRC section 7520 rates in history, most likely represent the worst-case gift tax QPRT scenario. Had Mom made the gift in January 2008, the \$1,000,000 20-year QPRT would have resulted in a \$168,860 gift, much less than the \$268,870 determined above for February 2009. That difference reflects a drop of 2.4 percent (from 4.4 percent to 2.0 percent) in the IRC section 7520 rate. The lower the interest rate, the higher the QPRT gift, because the lower interest rate makes the value of Mom's retained interest worth less, and makes the portion gifted to Son worth more.

### III. CREDITOR PROTECTION BENEFIT

#### A. Self-Settled Trust

A QPRT is a self-settled trust. Therefore, the retained interest is available to Mom's creditors.<sup>21</sup> In the original example of a \$1,000,000 gift through a 20-year QPRT which produced a \$268,870 gift, Mom has a retained value equal to \$731,130 (\$1,000,000 - \$268,870). That retained interest consists of two parts: (i) the chance that the residence will revert to Mom's estate

if she dies before the end of the 20-year term; and (ii) Mom's right to live in the residence rent free until the end of the 20-year term. Those rights are worth \$482,820 and \$248,310, respectively.

How might Mom's retained interests be made available to a judgment creditor? Under the terms of the QPRT, when Mom stops living in the residence, the trustee must sell the residence and use the proceeds to pay an annuity to Mom. Once Mom is receiving annuity payments, the judgment creditor will be able to attach each payment. A judgment creditor would prefer a lump sum of cash, but a stream of payments is better than nothing.

Can the judgment creditor convince a judge to evict Mom from the residence to force the QPRT trustee to sell the residence and start paying the annuity? Perhaps. However, this has not occurred in the dozen or so situations of QPRTs gone sideways that the authors are aware of. Rather, in each situation the creditor negotiated with the parent for a payoff of pennies on the dollar.

Assume a creditor obtains a \$500,000 judgment against Mom. On what basis will the negotiations with Mom's creditor take place? The answer depends upon the number of years that have transpired since the QPRT began. Assume the judgment is secured ten years after the QPRT began, in January 2019. Miraculously, the IRC section 7520 rate is still the same, but the residence is now worth \$2,000,000. The annuity calculations are still based on the original \$1,000,000 value: what is the retained interest for a 75-year old in a 10-year QPRT? The right for the residence to revert to Mom's estate if she does not survive the term is worth \$428,580 and her right to live rent free in the residence for 10 more years is worth \$140,270. This means that the QPRT trustee must now pay her an annuity of \$568,850. (That is significantly less than the \$731,130 retained value with which Mom started.) Mom will receive \$63,328 per year for 10 years.<sup>22</sup>

These are the hurdles facing the judgment creditor: (i) convince a court to evict Mom from the residence; (ii) hope that the QPRT trustee will follow the terms of the QPRT and sell the residence once Mom no longer lives there;<sup>23</sup> (iii) hope that the QPRT trustee will pay Mom the annuity;<sup>24</sup> and (iv) try to collect each annuity payment.

The uncertainty that the creditor can overcome those difficulties will motivate the judgment creditor to negotiate with Mom for a lump sum payment of cash, at a significant discount from the face amount of the judgment.

## B. Fraudulent Transfer: California Law

There are two types of fraudulent transfers: (i) a transfer made with actual intent to hinder, delay or defraud the creditor; and (ii) a transfer made without receiving reasonably equivalent value for the transfer.<sup>25</sup> What if Mom's transfer of the residence to the QPRT in February 2009, is attacked by the judgment creditor as a fraudulent transfer? If the creditor's attack succeeds, the hurdles described above will disappear, since the transfer to the QPRT will be unwound. At first glance, Mom's transfer seems vulnerable to the fraudulent transfer attack since she did not receive equivalent value

(the home was worth \$1,000,000 and the value of her retained rights ( was only \$751,370). However, has the creditor's fraudulent transfer charge been raised in a timely fashion?

The statute of limitations on fraudulent transfers is "four years – one year – seven years," meaning: (i) the normal statute is four years from the date of transfer; (ii) however, if the creditor is unaware of the transfer—and creditors are almost never aware of the transfer—then the statute is extended for another year; and (iii) in no event may the statute be extended for more than seven years from the date of the transfer.<sup>26</sup> In this regard, QPRTs have a special place, since the transfer to the QPRT requires recording the deed to the property in the name of the QPRT trustee. Recording a deed is deemed to put the world on notice. Therefore, the statute of limitations for a QPRT is the flat four years from the date of transfer. In our example, since the judgment was obtained in 2019, we will assume that the transfer to the QPRT cannot be unwound as being fraudulent.

## C. Federal Bankruptcy Law

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005<sup>27</sup> gave the bankruptcy trustee a powerful new tool: the trustee has ten years to attack a transfer to "a self-settled trust or similar device."<sup>28</sup> Thus, the transfer may be subject to attack by a bankruptcy trustee long after the drafting lawyer discarded his files and most transaction documents have been lost or discarded. To succeed, however, the trustee must prove that the transfers were made "with actual intent to hinder, delay, or defraud" a creditor. Therefore, the lawyer must document the client's solvency and reasons for the transfer when it occurs, and retain these records.

This illustrates the connection between estate tax planning and asset protection planning. Recent family limited partnership cases have criticized entities as being formed merely for tax reasons.<sup>29</sup> In contrast, the transfer of a residence to a QPRT is an example where proof of the tax motive may be crucial in a court's decision to respect the structure.

## D. *In re Earle*

An excellent example of a situation in which tax motives successfully overcame a fraudulent transfer allegation is *In re Earle*.<sup>30</sup> Mr. and Mrs. Earle lost their home in a tax sale in June 1994. Mrs. Earle redeemed the home in December 1997. In June 1998, Mrs. Earle transferred the home into a 20-year QPRT. At that time, the home was Mrs. Earle's primary asset. Less than four years later (November 2001), Mr. and Mrs. Earle filed for protection under Chapter 13 of the U.S. Bankruptcy Code.<sup>31</sup> A creditor moved to (i) change the proceeding to Chapter 7,<sup>32</sup> and (ii) set aside the QPRT as done "with actual intent to hinder, delay, or defraud creditors," in violation of Alabama's fraudulent transfer statute.<sup>33</sup>

The court carefully analyzed various "badges of fraud."<sup>34</sup> The testimony of the estate planning advisors who arranged for the QPRT transfer was crucial to the ultimate outcome of the case (favorable to Mr. and Mrs. Earle). The Federal Estate Tax Return (IRS



Form 706) for the estate of Mrs. Earle's mother-in-law, which had incurred significant estate taxes, was due in January 1998, a few months before the Earle QPRT was formed. Mrs. Earle had consulted both an accountant and an attorney in connection with that estate. The accountant "planted" the idea of a QPRT in Mrs. Earle's head. The attorney testified about the significant concerns regarding the estate tax liability and the lack of liquidity to pay the estate taxes. That attorney suggested that Mrs. Earle consider a QPRT to reduce her own potential estate tax liability. It was extremely important to the court to note that it was the suggestion of the professionals, not that of Mrs. Earle, to form the QPRT. It showed that the Earle QPRT was not created in a vacuum; Mrs. Earle and her accountant had seen her mother-in-law's estate incur estate tax liability that caused problems for the entire family. The QPRT was the idea of the professionals presumably in an effort to keep Mrs. Earle from experiencing problems similar to those experienced by her mother-in-law's estate. The estate tax reason for forming the QPRT helped overcome the allegation that the home was transferred into the QPRT primarily for the purpose of delaying, hindering, or defrauding the creditors of the bankrupt debtor. The court therefore held that the creditor had failed to prove a fraudulent transfer.

## IV. DISADVANTAGES

Before Mom decides to establish the QPRT, her advisers must bring several disadvantages to her attention.

### A. Financing Is Difficult

Once the residence is transferred to the QPRT, financing or re-financing will be more difficult. Lenders do not like to make loans to irrevocable trusts. In the current liquidity crisis, this may be even more important than in the past. Mom may be pressured by a lender to "take the residence out" of the QPRT, have the new loan recorded against title to the residence, and then reconvey the property to Son as QPRT trustee. That is not wise. First, for tax purposes, if Mom can remove the residence from the QPRT, it seems like she has retained sufficient rights over the property to cause it to be included in her estate under IRC sections 2036 or 2038. Second, if Mom can remove the residence from the QPRT, it seems like she still retains control over the property for creditor purposes. Some people try to "paper over" these transfers, to both accommodate the lender and try to maintain the QPRT's legitimacy. This entails preparing a document under which the parent (i) is acting as the QPRT trustee's agent to facilitate a new loan solely for the QPRT trustee's benefit; and (ii) agrees to immediately reconvey the property to the QPRT trustee as soon as the loan has been consummated. However, query whether this paperwork is sufficient to overcome the tax and creditor concerns. Is the benefit of saving perhaps 0.5 percent per year interest on a loan worth the tax and creditor risk?

### B. Cannot Withdraw Funds

Once the residence is transferred to the QPRT, Mom cannot receive the proceeds of a refinance. That means that Mom is not a candidate for a QPRT to the extent that she needs the equity in the

residence for retirement. That is why in many situations it is appropriate to only transfer a fraction of the residence to a QPRT.

### C. Residence is no Longer Mom's Asset

Once the residence is transferred to the QPRT, Mom cannot list it as an asset on her personal financial statement. Mom may, on her personal financial statement, indicate that she has an interest in the residence, as long as her interest is fully described. However, her net worth has immediately gone down at least by the amount of the gift.

### D. No Step-Up In Basis

Since Son receives the residence as a gift, his basis (for purposes of a sale) is the same as Mom's. By contrast, were Mom to have passed it to Son through a will or living trust, Son would have been entitled to a basis equal to the date of death fair market value of the residence.<sup>35</sup>

### E. Must Pay Rent

Although discussed above, this point cannot be overemphasized: once the QPRT term ends, if Mom wishes to remain in the residence she must enter into a written lease with Son and pay fair rental value. Mom cannot have the right to force Son to lease the residence to her. Mom cannot have the right to set the lease rate in advance (when the QPRT begins). So Mom is putting herself at the risk of the market place and Son's goodwill.<sup>36</sup>

### F. Return QPRT

In a series of recent rulings,<sup>37</sup> the IRS approved a technique which may ameliorate Mom's concern about having to pay rent at the end of the QPRT term. In these rulings, after the QPRT ended and the children gained ownership of the residence, they established a new QPRT under which the parent had additional time to live in the residence rent free.

Returning to our original example, Mom is now age 85 at the end of the 20-year term. Son, age 60, owns the residence which is worth \$2,000,000. The fair rent is \$5,000 per month. During the 20-year term, Mom's financial circumstances had changed and she can no longer afford the rent. So Son creates a QPRT giving her the right to live rent free in the residence for five years. Son has made a gift to Mom. Based on the February 2009, required interest rate, that gift is \$315,980.<sup>38</sup>

This is not a foolproof solution to the problem of the parent having to pay rent at the end of the QPRT term. The IRS was careful in each ruling to add the caveat that "no opinion is expressed or implied concerning whether the transfer... would result in Residence being included in the gross estate of [parent] under § 2036." This indicates that the IRS will be looking for situations in which to assert that the original QPRT from the parent, plus the return QPRT from the child, amounts to a transfer by the parent with a retained income interest or life estate.

## V. QPRT ALTERNATIVES

There are alternatives for Mom to consider before deciding on a QPRT.

### A. Give Residence to Son

The gift tax disadvantage of an outright gift is that the gift value would be \$1,000,000, requiring the use of Mom's entire lifetime transfer tax exclusion. The estate tax advantage is that the house is out of her estate without the need for her to survive a fixed term. The economic disadvantage is that Mom must immediately start paying rent. The creditor advantage is that the statute of limitations on fraudulent transfers starts immediately. In most situations, the distaste with paying rent immediately is the reason Mom chooses not to use this approach.

### B. Sell Residence to Son for Bargain Price

If Mom sells the residence to Son for a below market price, the part-gift, part-sale transaction will be reported on a Federal Gift Tax Return (IRS Form 709). The gift tax advantage is that Mom can precisely determine the amount of the gift. The estate tax advantage is that the house is out of her estate without the need for her to survive a fixed term. The economic disadvantage is that Mom must immediately start paying rent. The creditor advantage is that the statute of limitations on fraudulent transfers starts immediately. Again, in most situations, the distaste with paying rent immediately is the reason Mom chooses not to use this approach.

### C. Sell to Son for Fair Market Value

If Mom sells the residence to Son for fair market value, to be safe, the transaction should be reported on a Federal Gift Tax Return (IRS Form 709) showing a gift of one dollar.<sup>39</sup> The estate tax advantage is that any future appreciation will be excluded from Mom's estate. Again, Mom must immediately start paying rent. The creditor advantage is that the statute of limitations on fraudulent transfers starts immediately. Again, the distaste with paying rent immediately is the reason Mom chooses not to use this approach.

### D. Contribute Residence to a Family Limited Partnership ("FLP")

Mom can determine the amount of the gift by selecting how much of an interest in the FLP she gives to Son. Mom can pay rent to the FLP.<sup>40</sup> The estate tax exclusion depends upon Mom's retained interest in the partnership. The creditor advantage is that (i) the transfer is immediate; and (ii) if there is a judgment against Mom, her creditor is limited to the recoveries available against her limited partnership interest.<sup>41</sup>

## VI. CONCLUSION

QPRTs have been widely discussed and analyzed for almost two decades. There is very little mystery to their application, and a

great deal of flexibility available in their use. Now is the time for practitioners to review the rules and be certain clients are aware of the benefits of this marvelous structure.


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## ENDNOTES

1. The Revenue Reconciliation Act of 1990, P.L. 101-508, added Chapter 14 to the Internal Revenue Code. IRC section 2702, entitled "Special Valuation Rule in Case of Transfers of Interests in Trusts," provides that "for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or any applicable family member...which is not a qualified interest shall be treated as being zero." (IRC, §§ 2702(a)(1) and (a)(2)(A).) However, IRC section 2702(a)(3)(A)(ii) provides an exception "if such transfer involves the transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interests in such trust...." Final regulations were issued on February 4, 1992. (T.D. 8395, 57 FR 4250-4277, effective January 28, 1992; see Hastings, *Proposed Qualified Personal Residence Trust Regulations Issued*, 2 Cal. Trusts & Estates Q., Fall 1996.)
2. Stein, *Importance of Trusts in Asset Protection*, 12 Cal. Trusts & Estates Q., Winter 2007, at p. 17.
3. See, for example, Blattmachr, Slade, and Zeydel, 836-2nd T.M., *Partial Interests - GRATs, GRUTs, QPRTs (Section 2702)*; Choate, *The QPRT Manual*, Ataxplan Publications, 1st Edition; and Ware, *Using QPRTs To Maximum Advantage For Wealthy Clients*, Estate Planning (November, 2005), at p. 34. See also Hartog & McCall, *QPRTs for Co-Tenancy Interests - Do They Work?* 6 Cal. Trusts & Estates Q., Fall 2000, at p. 4.
4. IRS private letter rulings cover a broad range of topics. See, for example, PLR 9249014 (apartment in a cooperative housing corporation satisfied the definition of a "personal residence" because former Section 1034(f) provided that the residence included stock held by a tenant stockholder in a cooperative housing corporation); PLR 9249041 (residence will not fail to qualify as a "personal residence" merely because the grantor allows a friend to reside there with him or her); PLR 9626041 (grantor could lease the residence for fair market value after the expiration of the retained term without causing the residence to be included in the grantor's gross estate under IRC section 2036 because the grantor's retained economic enjoyment of the property ceases when the grantor begins paying rent); PLR 9714025 (approving the use of several QPRTs of varying terms, funding each with an undivided interest in the residence); PLR 9718007 (QPRT was a grantor trust, and the grantor was entitled to deductions for mortgage interest, taxes, and other costs applicable to the owner of the property during the retained term, without regard to whether the grantor made the payments directly or the QPRT made the payments); PLR 200751022 (leasing of a portion of the property to an unrelated party will not result in disqualification, if the property remains the grantor's personal residence); and PLR 200822011 (residence would not be included in QPRT grantor's estate under Sections 2033, 2035, 2036, 2038 or 2041 if he survived retained term and leased residence from continuing trust for fair market value rent, assuming there was no express or implied understanding that grantor would retain use or possession of residence whether or not he paid rent).
5. Anderson and Chae, *Keeping the "Family" In the Family Home: Special Planning Challenges Posed By QPRT Trusts*, 7 Cal. Trusts & Estates Q., Winter 2001, at p. 4.
6. On January 9, 2009, to a room of 50 CPAs, the question was posed: "How many of you have any clients who have their home in a QPRT?" Four hands were raised. The next question was posed: "How many of you have, in your practice, more than one client with a home in a QPRT?" Only one hand was raised. To the contrary, see Stein, *Importance of Trusts In Asset Protection*, *supra*, 12 Cal. Trusts & Estates Q., at p. 17: "The qualified personal residence trust ("QPRT") is an irrevocable trust *very frequently used* for both estate planning and asset protection." (Emphasis added.)



7. Treas. Reg. § 1.401(a)(9)-9.
8. Technically, Mom can be the QPRT trustee. See *Partial Interests – GRATs, GRUTs, QPRTs* (Section 2702), *supra*, by Blattmachr, Slade and Zeydel, section III.G.2., entitled “Who Should Be The Trustee?” However, in practice, Mom should not be the QPRT trustee. Although Mom might be, initially, concerned about naming Son as trustee, if he is rational he will follow Mom’s wishes. Why? If Son, as trustee, fails to please Mom, then Mom can change her living trust to make her lawyer the sole beneficiary of the rest of her estate. With apologies to Mr. Gunderson, see Probate Code sections 21350 et seq.
9. The preference is that the remainder beneficiary be a trust for Son’s benefit, rather than Son directly. This is both to protect Son from his own potential creditors, e.g., a future ex-spouse, and to provide a greater level of control: Mom can retain the right to remove the trustee and name a new one. (Rev. Rul. 95-58.)
10. See *Maxwell Estate v. Comr.* (2d Cir. 1993) 3 F.3d 591, for the proposition that the failure to pay fair market value rent after a gift of the residence results in estate tax inclusion; See also PLR 9448035 (grantor’s fair market rental of residence after trust term would not cause IRC section 2036(a)(1) inclusion; but IRS cautioned that failure to pay fair market value rent could cause inclusion under the reasoning of Rev. Rul. 70-155, 1970-1 C.B. 189); PLR 9249014 (lease agreement between grantor and remainderman giving the grantor the right to continue to reside in the personal residence after the trust term on the basis that the grantor would pay a fair market value rent, as well as real estate taxes and costs of maintenance, utilities and repairs, would not cause the property to be includible in the grantor’s estate under Section 2036(a)(1)).
11. That \$900,000 savings is (i) misleading and (ii) purely speculative. It is misleading because, as computed later in the text, Mom has made a gift of \$248,630, which will reduce her \$1,000,000 lifetime transfer tax exclusion. It is purely speculative because we cannot know if (i) Mom will have a taxable estate and (ii) the rate will be 45 percent when she dies.
12. Any unified credit used on creation of the QPRT is restored. See Blattmachr, Slade, and Zeydel, 836-2nd T.M., *Partial Interests – GRATs, GRUTs, QPRTs* (Section 2702), paragraph III.D.1.
13. For those not mathematically inclined, consider the wise words of Popeye’s friend Wimpy: “I will gladly pay you Tuesday for a hamburger today.”
14. Estate Planning Tools, version 2008.02, published by Brentmark Software, Inc.; Brentmark.com.
15. The IRC section 7520 rate – the rate required to be used in the computation of annuities – is 2.0 percent, one of the lowest rates since the IRS began publishing the AFR (applicable federal rate).
16. The remaining lifetime exclusion may be used with other assets and other planning, e.g., outright gifts, grantor retained annuity trusts, etc. Or it may be retained and offset the assets in her taxable estate.
17. This is a residence on Broad Beach in Malibu that in January, 2008, was worth \$10,000,000.
18.  $\$344,350 \times 45$  percent gift tax bracket = \$154,957 gift tax owed on the QPRT gift.
19. The authorities tend to focus on the payment of fair market rent. However, a written lease agreement is needed because that is what unrelated parties would have. On audit the IRS will ask for a copy of the written lease. This reflects the general attitude in transfer tax planning that “A transaction between family members is subject to heightened scrutiny to ensure that the transaction is not a disguised gift.” That phrase appears in *haec verba* in Judge Laro’s opinion in *Estate of Concetta H. Rector v. Commissioner*, T.C. Memo 2007-367 (December 13, 2007). However, similar expressions appear in *Estate of Thompson v. U.S.* (3<sup>rd</sup> Cir. 2004) 382 F.3d 367, and, due to *Thompson*, in *Estate of Wayne C. Bongard v. Commissioner*, 124 T.C. 95 (March 15, 2005), *Estate of Virginia A. Bigelow v. Commissioner*, T.C. Memo 2005-65 (March 30, 2005), and *Estate of C.P. Schutt v. Commissioner*, T.C. Memo 2005-126 (May 31, 2005).
20. Only with a Federal Gift Tax Return (IRS Form 709) that fully describes the transaction will the statute of limitations on the gift expire after three years. IRC section 2001(f) provides: “Valuation of gifts. (1) In general. If the time has expired under § 6501 within which a tax may be assessed under chapter 12 (or under corresponding provisions of prior laws) on — (A) the transfer of property by gift made during a preceding calendar period (as defined in § 2502(b)); or (B) an increase in taxable gifts required under § 2701(d), the value thereof shall, for purposes of computing the tax under this chapter, be the value as finally determined for purposes of chapter 12. (2) Final determination. For purposes of ¶(1), a value shall be treated as finally determined for purposes of chapter 12 if — (A) the value is shown on a return under such chapter and such value is not contested by the Secretary before the expiration of the time referred to in paragraph (1) with respect to such return; (B) in a case not described in subparagraph (A), the value is specified by the Secretary and such value is not timely contested by the taxpayer; or (C) the value is determined by a court or pursuant to a settlement agreement with the Secretary. For purposes of subparagraph (a), the value of an item shall be treated as shown on a return if the item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.”
21. Probate Code section 15304, entitled “Effect of Restraints When Settlor is Beneficiary,” provides: “(a) If the settlor is a beneficiary of a trust created by the settlor and the settlor’s interest is subject to a provision restraining the voluntary or involuntary transfer of the settlor’s interest, the restraint is invalid against transferees or creditors of the settlor. The invalidity of the restraint on transfer does not affect the validity of the trust. (b) If the settlor is the beneficiary of a trust created by the settlor and the trust instrument provides that the trustee shall pay income or principal or both for the education or support of the beneficiary or gives the trustee discretion to determine the amount of income or principal or both to be paid to or for the benefit of the settlor, a transferee or creditor of the settlor may reach the maximum amount that the trustee could pay to or for the benefit of the settlor under the trust instrument, not exceeding the amount of the settlor’s proportionate contribution to the trust.
22. Estate Planning Tools 2008.02, published by Brentmark Software, Inc., Leimberg & LeClair, Inc. Present Value of an Annuity, effective interest rate 2.4 percent, number of years 10, annual amount received \$63,328, produces present value of receipt of \$568,850 and actual amount received of \$633,280.
23. Does the judgment creditor have standing to enforce the QPRT? Will the court that evicted Mom from the residence force the trustee to follow the QPRT terms? What if Mom chooses not to force the trustee to sell the residence? There may be gift tax consequences, but that will surely frustrate the judgment creditor.
24. What if the trustee follows the terms of the QPRT and sells the residence, but fails to pay the annuity to Mom? Does the judgment creditor have standing to enforce the QPRT? What if Mom chooses not to force the trustee to pay the annuity? Again, there may be gift tax consequences, but that will surely frustrate the judgment creditor.
25. Civil Code section 3439.04, entitled “Transfers fraudulent as to present and future creditors; factors to determining intent,” provides, in part, as follows: “(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor’s claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation as follows: (1) With actual intent to hinder, delay, or defraud any creditor of the debtor. (2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor either: (A) Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction. (B) Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.”
26. Civil Code section 3439.09, entitled “Extinguishment of cause of action,” provides as follows: “A cause of action with respect to a fraudulent transfer or obligation under this chapter is extinguished unless action is brought pursuant to subdivision (a) of Section 3439.07 or levy made as provided in subdivision (b) or (c) of Section 3439.07: (a) Under paragraph (1) of subdivision (a) of Section 3439.04, within four years after the transfer was made or the obligation was incurred or, if later, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant. (b) Under paragraph (2) of subdivision (a) of Section 3439.04 or Section 3439.05, within four years after the transfer was made or the obligation was incurred. (c) [Despite] any other provision of law, a cause of action with respect to a fraudulent trans-




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- fer or obligation is extinguished if no action is brought or levy made within seven years after the transfer was made or the obligation was incurred."
27. P.L. 109-8, enacted April 20, 2005.
  28. Bankr. Code, 11 U.S.C. § 548(e)(1)(A). "Self-settled device" is not defined.
  29. See, e.g., *Estate of Thelma G. Hurford v. Commissioner*, T.C. Memo 2008-278 (December 11, 2008); *Estate of Concetta H. Rector*, T.C. Memo 2007-367 (December 13, 2007); *Estate of Sylvia Gore v. Commissioner*, T.C. Memo 2007-169 (June 27, 2007); *Estate of Hilde E. Ericson v. Commissioner*, T.C. Memo 2007-107 (May 1, 2007); *Estate of Lillie Rosen v. Commissioner*, T.C. Memo 2006-115 (June 1, 2006).
  30. 307 B.R. 276 (2002).
  31. From the U.S. Bankruptcy Court's official web site: "The chapter of the Bankruptcy Code providing for adjustment of debts of an individual with regular income. (Chapter 13 allows a debtor to keep property and pay debts over time, usually three to five years.)" <http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html>
  32. From the U.S. Bankruptcy Court's official web site: "The chapter of the Bankruptcy Code providing for 'liquidation,' (i.e., the sale of a debtor's nonexempt property and the distribution of the proceeds to creditors.)" <http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter7.html>
  33. Ala. Code, § 8-9 A-4(a).
  34. Compare Civ. Code, § 3439.04(b). That subsection provides: "(b) In determining actual intent under paragraph (1) of subdivision (a), consideration may be given, among other factors, to any or all of the following: (1) Whether the transfer or obligation was to an insider. (2) Whether the debtor retained possession or control of the property transferred after the transfer. (3) Whether the transfer or obligation was disclosed or concealed. (4) Whether before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit. (5) Whether the transfer was of substantially all the debtor's assets. (6) Whether the debtor absconded. (7) Whether the debtor removed or concealed assets. (8) Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred. (9) Whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred. (10) Whether the transfer occurred shortly before or shortly after a substantial debt was incurred. (11) Whether the debtor transferred the essential assets of the business to a lienholder who transferred the assets to an insider of the debtor."
  35. IRC, § 1014, entitled "Basis of property acquired from a decedent."
  36. Again, Mom retains the right to disinherit Son from the rest of her estate if he displeases her in the negotiations regarding the lease of the residence.
  37. PLRs 200814011 (April 4, 2008), 200901019 (January 2, 2009), 200904022 (January 23, 2009), and 200904023 (January 23, 2009).
  38. The value of using the house at the end of the five-year term, plus the value of having the house go into the son's estate if he dies during the five-year period is \$1,684,020. Estate Planning Tools 2008.03, using the February 2009, 2 percent IRC section 7520 rate.
  39. See IRC, § 2001(f), discussed in endnote 20.
  40. A discussion of family limited partnerships is beyond the scope of this article. Therefore, assume that the general partner is a corporation wholly owned by a trust for the benefit of Son and that Mom, through her living trust, has retained a 98 percent interest as a limited partner.
  41. A discussion of the creditor protection benefits of a family limited partnership is beyond the scope of this article. However, the creditor would rather have direct access to the residence (a position the creditor would have if Mom owned the residence outright) than be in the position of a substitute limited partner (the position the creditor will have if Mom is a limited partner in the FLP).