



TRUSTEE REFERENCE GUIDE

# QPRT

## Compliance Guide

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Trustee Obligations Upon Sale of a Residence Held in a Qualified Personal Residence Trust

- › 2-Year Reinvestment Window | Reg. § 25.2702-5(c)(7)
- › Conversion to Grantor Retained Annuity Trust | Reg. § 25.2702-5(c)(8)
- › Tax Consequences of Early Termination | IRC § 2036
- › Post-Sale Decision Flowchart
- › Required Trust Document Provisions Checklist

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## 1 OVERVIEW & REGULATORY FRAMEWORK ›

A Qualified Personal Residence Trust (QPRT) is an irrevocable trust created pursuant to IRC §2702 and Reg. §25.2702-5(c) that holds a grantor's primary or secondary residence for a specified term. The trust accomplishes an estate freeze by removing future appreciation from the grantor's taxable estate at a discounted gift tax cost. The governing instrument must comply precisely with Treasury Regulations, and the trustee bears ongoing administrative obligations that intensify when the residence is sold during the term.

### Foundational Regulatory Authority

**Reg. §25.2702-5(c)** — QPRT qualification requirements

**Reg. §25.2702-5(c)(7)** — Sale of residence and reinvestment window

**Reg. §25.2702-5(c)(8)** — Mandatory conversion to qualified annuity interest

**Reg. §25.2702-5(c)(9)** — Prohibition on sale to grantor/related parties

**IRC §2036** — Estate inclusion upon retained interest or early termination

**Rev. Proc. 2003-42** — IRS sample QPRT instrument and annotations

### What Triggers Trustee Action

The trustee must take immediate, documented action upon any of the following events occurring during the QPRT term:

- › Sale, transfer, or involuntary conversion of the residence held by the trust
- › Cessation of use of the property as the grantor's personal residence
- › Receipt of insurance or condemnation proceeds related to the residence
- › Acquisition of a replacement residence at a price less than full sale proceeds
- › Expiration of the two-year reinvestment window without a replacement purchase

## 2 THE 2-YEAR REINVESTMENT WINDOW ›

The sale of the residence does not automatically terminate QPRT status, provided the trust instrument expressly permits the trustee to hold sale proceeds and the trustee administers those proceeds in strict compliance with Reg. §25.2702-5(c)(7).

### Statutory Framework

Under Reg. §25.2702-5(c)(7)(ii), a QPRT may continue to hold sale proceeds—without loss of QPRT qualification with respect to those assets—until the earliest of three triggering dates:

Trigger	Description	Consequence
<b>1. Two-Year Anniversary</b>	The date exactly two years after the date of sale of the residence	QPRT status terminates as to all remaining sale proceeds on this date
<b>2. End of QPRT Term</b>	The termination date of the grantor's retained term interest in the trust	Proceeds distributed per trust instrument to remainder beneficiaries
<b>3. New Residence Acquired</b>	The date the trustee purchases and titles a replacement residence in the trust	QPRT status continues; see partial reinvestment rules for excess proceeds

### Critical Governing Instrument Requirement

The trust instrument must expressly authorize the trustee to hold sale proceeds in a separate account. This is not implied by silence. If the instrument lacks this provision, the trust ceases to be a QPRT immediately upon sale, regardless of the trustee's actual conduct. Reg. §25.2702-5(c)(7)(ii); see also Rev. Proc. 2003-42.

### Permissible Use of Proceeds During the Window

While held during the two-year window, proceeds must be maintained in a segregated account and may only be used for the following purposes:

- › Purchase of a replacement personal residence to be held in the QPRT
- › Capital improvements to an existing QPRT residence (if one still exists)
- › Payment of trust expenses attributable to the residence (e.g., carrying costs, insurance, taxes)

### Prohibited Uses During Reinvestment Period

Proceeds may NOT be distributed to the grantor during the window period except as a GRAT annuity payment following a mandatory conversion. Any distribution to the grantor that does not comply with Reg. §25.2702-5(c)(8) will be treated as a transfer subject to IRC §2702, with the grantor's retained interest valued at zero — nullifying the original estate planning benefit.

### Trustee's Administrative Obligations During the Window

- › **Segregate proceeds immediately:** Open a separate investment account titled in the name of the QPRT within 10–15 days of closing. Do not commingle with other trust assets.

- › **Document the sale date:** Confirm the exact closing date in the trust records; the two-year clock runs from that date, not from receipt of funds.
- › **Track the deadline:** Calendar both the two-year anniversary and the QPRT term end date; act on whichever occurs first.
- › **Maintain investment compliance:** The regulations do not restrict investment type for proceeds, but prudent investor standards under applicable state law still apply.
- › **Report to grantor:** Provide the grantor with written notice of the window deadline, the mandatory-conversion consequences, and available options.
- › **Engage counsel proactively:** Contact estate planning counsel no later than 18 months after sale to evaluate reinvestment vs. GRAT conversion strategy.

**Note:** For insurance or condemnation proceeds ("qualified proceeds" under Reg. §25.2702-5(c)(3)), the same two-year reinvestment window applies, measured from the date proceeds are received.

### 3 CONVERSION TO A GRAT ›

If proceeds are not reinvested in a replacement residence by the applicable deadline, the trustee must convert the non-reinvested portion of the proceeds to a qualified annuity interest meeting the requirements of a GRAT under Reg. §25.2702-3. This conversion preserves the estate freeze benefit for the remaining QPRT term; failure to convert properly results in full inclusion of those assets in the grantor's estate.

#### When Conversion Is Required

- › **Full conversion:** No replacement residence is purchased at any point — all proceeds must convert to GRAT upon expiration of the window (or term end, if earlier)
- › **Partial conversion:** Replacement residence purchased at a price less than the full sale proceeds — excess proceeds must be converted or distributed per the trust instrument
- › **Multiple conversions:** Rev. Proc. 2003-42 contemplates successive cessation events during a single QPRT term; the trustee must create a separate GRAT share for each cessation event

#### The Annuity Calculation — A Critical Detail

The annuity amount payable in the converted GRAT is calculated using the §7520 rate and mortality tables in effect at the date of the original QPRT creation, not the date of conversion. This is a counterintuitive but mandatory rule under Reg. §25.2702-5(c) (8).

Variable	Governing Rule	Practical Implication
<b>§7520 Rate</b>	Rate in effect at QPRT creation date	A higher original rate produces a lower annuity obligation — may be favorable or unfavorable depending on timing
<b>Mortality Tables</b>	Tables in effect at QPRT creation	Grantor's age at creation (not conversion) is used; retain original QPRT valuation workpapers
<b>Annuity Commencement</b>	Annuity right begins on the cessation date (date of sale)	Payments backdated to sale date; deferred payments bear compound interest at §7520 rate in effect on sale date
<b>Partial Reinvestment Formula</b>	$\text{Annuity} = \frac{\text{Full annuity} \times (\text{Excess proceeds})}{\text{FMV of all trust assets on conversion date}}$	Document the FMV of all trust assets on conversion date with contemporaneous appraisal or account statement

#### Preserve Your QPRT Creation Workpapers

The original QPRT valuation actuarial workpapers — including the §7520 rate, IRS actuarial tables, grantor's age at creation, and Form 709 gift tax return — must be retained indefinitely. These are required inputs for any future GRAT conversion calculation and are not reconstructible from IRS databases.

#### GRAT Administration Requirements After Conversion

Once converted, the GRAT share must comply with all requirements of Reg. §25.2702-3, including:

- › Annuity paid no less frequently than annually to the grantor
- › Payment may be deferred until 30 days after the new residence is purchased (if partial reinvestment occurs), but accrued payments bear compound interest at the §7520 rate in effect on the sale date
- › The annuity amount is fixed — no adjustments for investment performance
- › The GRAT share must be administered as a separate account within the trust
- › Annuity payments are not deductible by the trust and are treated as grantor trust distributions for income tax purposes
- › The governing instrument of the QPRT must contain all provisions required by §25.2702-3 for a qualified annuity interest — if the original instrument lacks these provisions, judicial reformation may be required before conversion

### GRAT Provision Gap Risk

If the original QPRT instrument does not contain the annuity provisions required by Reg. §25.2702-3, the trust cannot validly convert to a GRAT. The trustee's only remaining option is to distribute proceeds to the grantor — destroying the estate planning benefit. Review the instrument proactively, and pursue nonjudicial or judicial reformation if necessary before the window expires.

## 4 TAX CONSEQUENCES OF EARLY TERMINATION ›

"Early termination" encompasses any event that causes the QPRT to lose its qualified status before the grantor's retained term interest expires, and most critically, the grantor's death during the trust term. The tax consequences are severe and generally negate the original estate planning strategy.

### A. Termination by Grantor's Death During the Term

This is the most significant early termination risk. If the grantor dies during the retained term interest, the full fair market value of the trust assets at the date of death is included in the grantor's gross estate under IRC §2036(a)(1) (retained right to use and possession).

Consequence	Detail
<b>Estate Inclusion</b>	Full date-of-death FMV of trust assets included in taxable estate — not the discounted remainder value originally gifted
<b>Gift Tax Credit</b>	The grantor's estate receives a credit for gift taxes actually paid (or the taxable gift amount applied against lifetime exemption) — the original transfer is not "unwound"
<b>Income Tax Basis</b>	Trust assets receive a stepped-up (or stepped-down) income tax basis equal to the estate inclusion value under IRC §1014 — a potential silver lining
<b>GST Planning</b>	ETIP rules under IRC §2642(f) prevent effective GST exemption allocation during the term; upon inclusion in the estate, GST exemption may be allocated at death but at date-of-death values
<b>Net Effect</b>	The estate planning benefit is eliminated, but the situation is not worse than if no QPRT had been created — the property simply returns to the estate

### B. Termination by Failure to Reinvest and Failure to Convert

If the trustee allows the two-year window to expire without either purchasing a replacement residence or converting the proceeds to a GRAT, and without distributing the proceeds to the grantor, the trust is in a state of regulatory non-compliance. The IRS position is that the trust ceases to be a QPRT and the retained interest is valued at zero, meaning the original gift equals the full value transferred — a retroactive gift tax exposure.

- › **Gift tax:** The original transfer is recharacterized as a gift of the full fair market value of the property, not the discounted remainder interest
- › **Interest and penalties:** If the gift was underreported due to the QPRT discount, the IRS may assert gift tax deficiencies with interest and accuracy-related penalties
- › **Estate inclusion:** Depending on the facts, IRC §2036 or §2038 may still cause estate inclusion if the grantor retained use or control
- › **Income tax:** Trust remains a grantor trust for income tax purposes — no separate tax filing required, but all income and gain remain reportable by the grantor

### C. Voluntary Early Termination (Distribution to Grantor)

The trust instrument may permit the trustee to distribute proceeds directly to the grantor upon sale rather than holding them or converting to a GRAT. This is technically permissible under the regulations but has significant consequences:

- › The QPRT ceases with respect to distributed assets — estate freeze benefit is permanently lost for those assets
- › The grantor receives a potentially large cash distribution that re-inflates the taxable estate
- › No gift tax recapture occurs, but the remainder beneficiaries lose the benefit of the original discount
- › This option is generally inadvisable unless the grantor has an immediate liquidity need and the remaining QPRT term is short

#### D. Income Tax Considerations Upon Sale

Because a QPRT is a grantor trust during the term, all income tax consequences of a sale fall on the grantor personally:

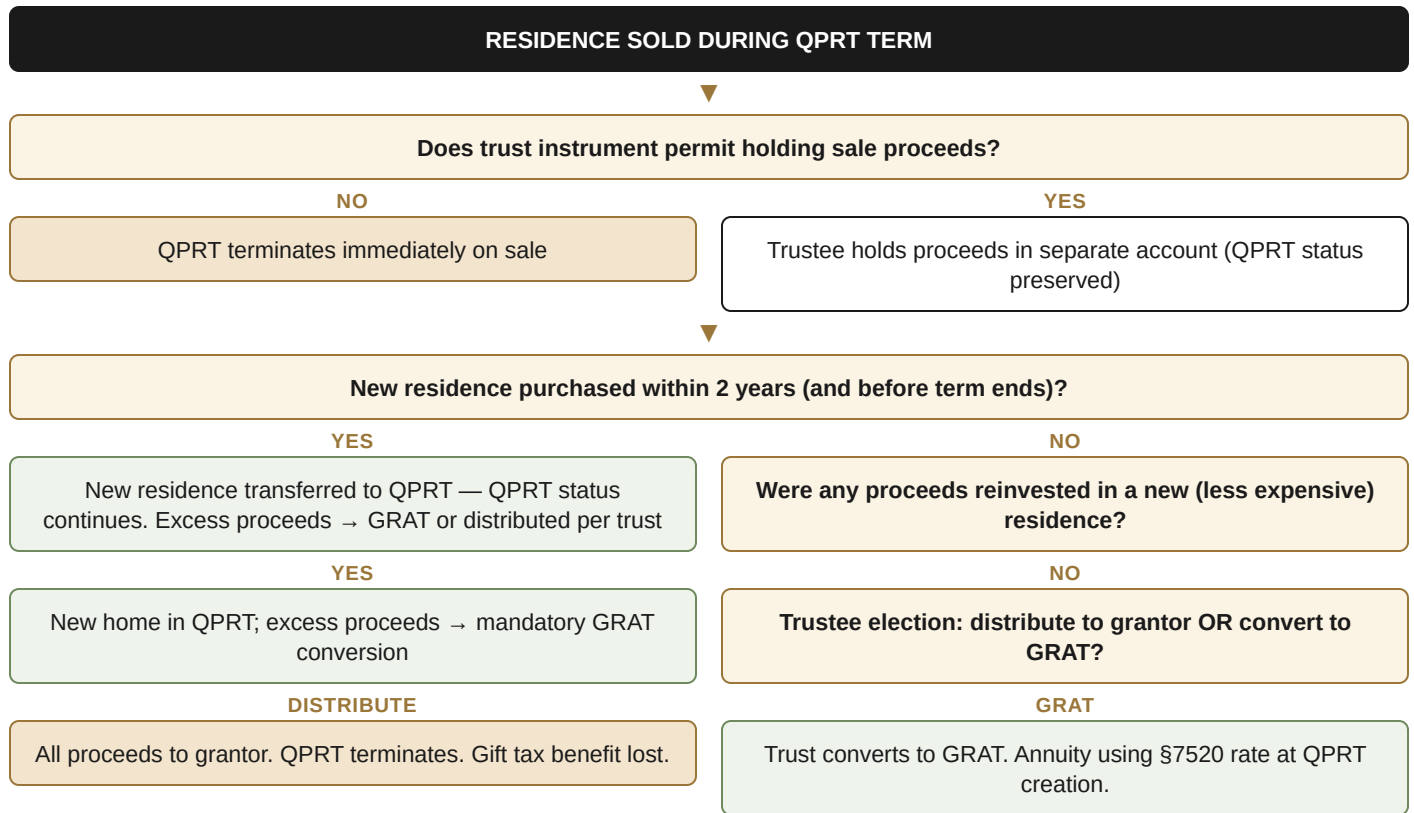
- › **IRC §121 exclusion:** The grantor (not the trust) may be eligible for the \$250,000/\$500,000 primary residence exclusion, because the trust's ownership is attributed to the grantor for income tax purposes. However, the grantor must meet the use and ownership tests
- › **Capital gains:** Any gain in excess of the §121 exclusion is taxable to the grantor at long-term capital gains rates (assuming the property was held over 12 months)
- › **Depreciation recapture:** If any portion of the residence was used for business or rental, depreciation recapture under §1250 applies
- › **No Form 1041 required:** The trust does not file a separate income tax return during the QPRT term
- › **AMT:** Large capital gains may trigger or increase alternative minimum tax exposure — coordinate with the grantor's CPA

#### Sale to Related Parties — Absolute Prohibition

Reg. §25.2702-5(c)(9) absolutely prohibits the sale or transfer of the residence to the grantor, the grantor's spouse, or any entity controlled by either, during the QPRT term or any post-term period when the trust remains a grantor trust. Violation causes the trust to fail as a QPRT retroactively. There are no exceptions. This prohibition survives even if the grantor is paying fair market value.

## 5 POST-SALE DECISION FLOWCHART >

The following flowchart illustrates the trustee's decision tree upon sale of a residence held in a QPRT. Each path identifies the applicable regulatory provision and the resulting consequence. Trustees should document the decision-making process in the trust's administrative records contemporaneously.



**SPECIAL CASE:** Grantor dies during term → trust assets included in grantor's gross estate at date-of-death FMV (IRC §2036). All gift tax benefits are nullified.

QPRT POST-SALE DECISION FLOWCHART | Reg. §25.2702-5(c)(7)-(8)  
Sources: Reg. §25.2702-5(c)(7)(ii); Reg. §25.2702-5(c)(8); Rev. Proc. 2003-42; IRC §2036

## 6 REQUIRED TRUST DOCUMENT PROVISIONS CHECKLIST ›

The following checklist identifies the trust instrument provisions that must exist for a QPRT to validly hold sale proceeds during the reinvestment period and to permit conversion to a GRAT. Review the governing instrument against each item before any sale is contemplated. Missing provisions may require reformation.

### PART I — CORE QPRT QUALIFICATION PROVISIONS

- Trust is irrevocable and expressly denominated a Qualified Personal Residence Trust [Reg. §25.2702-5(c)(1)]
- Instrument limits trust assets to a single personal residence, insurance policies on the residence, and limited cash for specified purposes [Reg. §25.2702-5(c)(4)–(5)]
- Instrument restricts all distributions to the term holder (grantor) only during the retained term [Reg. §25.2702-5(c)(2)]
- Instrument expressly prohibits sale or transfer of the residence to the grantor, grantor's spouse, or controlled entity during term or grantor trust period [Reg. §25.2702-5(c)(9)]
- Instrument specifies the exact term of the retained interest with a fixed end date or definite term of years
- Instrument provides for reversion to grantor's estate if grantor dies during the term (or alternatively, names remainder beneficiaries and describes disposition upon grantor's death) [Reg. §25.2702-5(c)(6)]

### PART II — SALE PROCEEDS HOLDBACK PROVISIONS

- Instrument expressly authorizes the trustee to sell the residence during the QPRT term [Reg. §25.2702-5(c)(7)]
- Instrument expressly authorizes the trustee to hold proceeds from the sale of the residence in a separate account following a sale [Reg. §25.2702-5(c)(7)(ii)(C) — CRITICAL]
- Instrument specifies that QPRT status terminates with respect to held proceeds on the earliest of: (i) two years after the sale date; (ii) termination of the term interest; or (iii) acquisition of a new residence [Reg. §25.2702-5(c)(7)(ii)]
- Instrument requires proceeds to be maintained in a segregated account, separate from all other trust assets
- Instrument authorizes trustee to invest proceeds in income-producing assets during the holdback period consistent with applicable state prudent investor standards
- Instrument specifies the trustee's obligations upon expiration of the holdback period (i.e., triggers mandatory GRAT conversion or distribution)

### PART III — REPLACEMENT RESIDENCE PROVISIONS

- Instrument authorizes trustee to purchase a replacement personal residence using sale proceeds and to hold such residence in the QPRT [Reg. §25.2702-5(c)(7)(ii)(C)(3)]
- Instrument requires replacement residence to be acquired within two years of the sale date (or before term end, if earlier)
- Instrument addresses partial reinvestment — authorizes trustee to purchase a less expensive replacement residence and specifies treatment of excess proceeds (GRAT conversion or distribution)
- Instrument prohibits purchase of replacement residence from the grantor, grantor's spouse, or controlled entity

### PART IV — GRAT CONVERSION PROVISIONS (§25.2702-3 COMPLIANCE)

- Instrument contains all provisions required for a qualified annuity interest under Reg. §25.2702-3 **[Reg. §25.2702-5(c)(8)(ii)(A) — CRITICAL]**
- Instrument specifies that the annuity right begins on the cessation date (date of sale or other qualifying event) **[Reg. §25.2702-5(c)(8)(ii)(B)]**
- Instrument provides that the annuity is calculated using the §7520 rate and mortality tables in effect at the date of QPRT creation **[Reg. §25.2702-5(c)(8)]**
- Instrument requires annuity payments at least annually
- Instrument specifies that deferred annuity payments (where permitted) bear compound interest at the §7520 rate in effect on the cessation date
- Instrument allows for multiple separate GRAT shares in the event of successive cessation events during the QPRT term **[Rev. Proc. 2003-42, Annot. 16]**
- Instrument specifies that the GRAT shares are administered as separate shares within the trust, each with its own annuity obligation
- Instrument requires the trustee to convert non-reinvested proceeds to a GRAT share within 30 days of the cessation event (or expiration of holdback period)

#### PART V — INSURANCE PROCEEDS (QUALIFIED PROCEEDS)

- Instrument addresses receipt of insurance proceeds resulting from damage or destruction of the residence **[Reg. §25.2702-5(c)(3)]**
- Instrument requires reinvestment of insurance proceeds in a replacement residence within two years of receipt
- Instrument authorizes the trustee to hold insurance proceeds during the reinvestment period consistent with the rules applicable to sale proceeds

#### PART VI — ADMINISTRATIVE AND TRUSTEE PROVISIONS

- Instrument identifies successor trustees and specifies trustee succession procedure — critical to ensure trustee availability for the full QPRT term
- Instrument grants trustee full power to execute sale contracts, deeds, and closing documents on behalf of the trust
- Instrument does not restrict trustee from retaining legal counsel, appraisers, or financial advisors at trust expense in connection with a sale
- Instrument does not contain any provision permitting the grantor to repurchase the residence (would trigger §2036 estate inclusion) **[Reg. §25.2702-5(c) / Greenleaf Trust, 2024]**
- Instrument specifies governing law jurisdiction (important for trustee duties, prudent investor standards, and judicial reformation procedures)
- Instrument does not contain a general power of appointment in the grantor (would cause estate inclusion under IRC §2041)

#### If Any Item Is Unchecked

A missing provision does not necessarily mean the QPRT has failed — it means the trustee must assess the risk before a sale occurs. Options include: (1) nonjudicial modification (where permitted by state UTC), (2) judicial reformation to correct scrivener's error, or (3) consultation with IRS counsel regarding the scope of the deficiency. Do not proceed with a sale until counsel has reviewed any gaps.

## 7 TRUSTEE ACTION TIMELINE SUMMARY ›

The following timeline summarizes the trustee's key obligations and deadlines following the sale of a QPRT residence. All deadlines should be calendared and documented in the trust administrative file.

Timeframe	Required Action	Regulatory Basis
<b>Day 0 (Closing)</b>	Confirm sale date in trust records • Notify estate planning counsel • Begin segregating proceeds	Reg. §25.2702-5(c)(7)
<b>Within 10–15 days</b>	Open separate QPRT proceeds account in trust name • Do not commingle with existing trust assets	Reg. §25.2702-5(c)(7)(ii)(C)
<b>Within 30 days</b>	Provide written disclosure to grantor of window deadline, conversion consequences, and election options • Retain in trust records	Best practice; trustee duty of disclosure
<b>Month 6–12</b>	Evaluate market conditions for replacement residence purchase • If GRAT conversion likely, engage actuary to compute annuity amount using QPRT creation §7520 rate	Reg. §25.2702-5(c)(8)
<b>Month 18</b>	Final strategic review with counsel: reinvest vs. convert • Verify trust instrument has GRAT provisions if conversion is anticipated	Reg. §25.2702-3; Rev. Proc. 2003-42
<b>Year 2 (Deadline)</b>	If no replacement residence acquired: execute GRAT conversion within 30 days of window expiry • OR distribute to grantor per instrument (if authorized) • Document trustee election in trust records	Reg. §25.2702-5(c)(7)(ii); (c)(8)
<b>Post-Conversion</b>	Administer GRAT share as separate account • Ensure annual annuity payments timely made to grantor • File Form 709 if GST exemption allocation needed at ETIP close	Reg. §25.2702-3; IRC §2642(f)

### Sources and Regulatory References

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