

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER
OFFICE OF TAX AND REVENUE



OTR TAX RULING 2007-01

Subject: Recordation, Transfer Tax Exemptions for Qualified Personal Residence Trust

Advice has been requested as to whether a transfer to a qualified personal residence trust (“QPRT”) for the benefit of the grantor’s children is subject to the District’s recordation and transfer taxes under the facts described below.

FACTS

A grantor transfers real property used as personal residence to a QPRT, as defined in Internal Revenue Code (“IRC”) § 2702((a)(3)(ii), for the benefit of the grantor’s children, some of whom may not be minors.

ISSUE

Is a transfer of a personal residence to a QPRT for the benefit of the grantor’s children regardless of whether they are minor or adult children, exempt from the District recordation and transfer taxes under D.C. Official Code §§ 42-1102 and 47-902, respectively.

CONCLUSION

As discussed below, a transfer by parents of a personal residence to a QPRT for their children is exempt from both the District recordation and transfer taxes, whether or not the children are minors.

LEGAL ANALYSIS

A. Use of a QPRT

A parent wishes to give his or her personal residence to the children as a gift but retains the right to use the property for a term of years. Generally, upon the termination of the term of years, the remainder interest passes to the children. The parent transfers

the personal residence to the children through the use of an irrevocable trust known as the QPRT.¹

The use of a QPRT provides many of the same benefits as a revocable trust, avoiding probate, for example. A QPRT may be more advantageous than a revocable trust, however, because the use of the QPRT provides a reduced gift tax, and the personal residence is not included in the gross estate if the parents survive the term of years

Additionally, there is no requirement in any applicable federal estate or gift tax statute or regulation that the transfer of the personal residence must be to a minor.

B. The Orleans Case

The issue of whether a transfer of a personal residence from a parent to a trust for the benefit of a child without actual consideration is exempt from recordation tax first arose in District of Columbia v. Orleans, 406 F. 2d 957 (D.C. Cir. 1968).² The Orleans case involved old D.C. Code § 45-722(7) (1967), the recordation exemption statute. The current exemption statute, Code § 42-1102(7), contains identical language. Code § 45-722 (1967) provides an exemption from the recordation tax for:

(7) [d]eeds between husband and wife, or parent and child, without actual consideration therefor.

While the transfer tax was not at issue in the case, the decision would be as equally applicable today to that tax since the current transfer tax exemption statute, D.C. Official Code § 47-902(5), contains the same exemption language as the recordation tax.

In Orleans, the United States Court of Appeals for the District of Columbia held that the tax exemption provided for recording deeds between parent and child made without actual consideration applies to conveyances of real property made by parents to trustees under a trust established for the benefit of their children. In that case, the District, invoking the maxim that exemptions are to be strictly construed, argued that the exemption language applied only to an outright conveyance from parent to child and not to a conveyance in trust. The court rejected this argument holding that:

...the force of the maxim is outweighed by the clear manifestation of legislative purpose that the recordation tax is not applicable to conveyances from parents to children that have no “actual” consideration. To construe this provision as inapplicable whenever conveyances are made in trust form would virtually nullify the exemption so far as minor children are concerned. Use of trustees for making gifts of real property to

¹ A QPRT is commonly used because it provides a gift tax advantage. A QPRT is defined in IRC § 2702(a)(3)(A)(ii) which excepts a QPRT from the special valuation rules of IRC § 2702.

² Under M.A.P. v. Ryan, 285 A.2d 310 (D.C. Cir. 1971), a decision of the United States Court of Appeals for the District of Columbia, rendered before February 1, 1971, constitutes the case law of the District of Columbia.

minor children is not only routine, but is virtually a necessity, possibly in legal contemplation and in any event in terms of commercial realities. What lawyer would counsel a client to execute a lease from or mortgage to a minor owning real estate?

Orleans at 958. Even though the court refers, at one point, to “minor children” in its discussion, the facts of the case, as gleaned from the lower court opinion, Julius Orleans, Trustee, et al. v. District of Columbia, Docket No. 2035, Daily Washington Law Reporter, Jan. 5, 1968, at 1 (D.C. Tax Ct., Dec. 8, 1967) indicate that at the time the trust indenture was executed on October 27, 1965, the four children were 22, 17, 15, and 14. Therefore, three of the children were minors but one child, age 22, was an adult.

Nevertheless, the appellate court held that the exemption from recordation tax under D.C. Official Code § 45-722(7) (1967), applied. It is reasonable not to place undue emphasis on the use of the word “minor” given that one child was, in fact, an adult. Moreover, since the exemption statute upheld by the court did not use the word “minor,” it appears that the court’s reference to “minor” was to emphasize the practical difficulties of executing a lease or mortgage from a parent to a child in a case in which three of the four children were minors. The holding was not that a conveyance to an adult child did not qualify.

Current statutes exempt a deed issued between a parent and child, without actual consideration, from the recordation tax and transfer tax but do not require that the child be a minor. Specifically, D.C. Official Code § 42-1102(7) exempts

[d]eeds between husband and wife, or parent and child, without actual consideration therefor.... (Emphasis added.)

D.C. Official Code § 47-902(5) similarly provides an exemption from the transfer tax for:

[t]ransfers between husband and wife, parent and child...without actual consideration therefore.... (Emphasis added.)

DCMR § 500.5 lays any doubt to rest by providing that

[t]he term ‘child’ includes both minor and adult children.

Moreover, while the appellate court’s opinion did not discuss whether the trust was revocable or irrevocable, there is no implication that its holding would not apply to both.

C. Recordation and Transfer Tax Exemptions for Revocable Trusts

Apart from the Orleans case, there is also relevant discussion in two other Code sections which permit exemptions for the use of revocable trusts. The legislative history of these Code sections is helpful in understanding the Council’s concern in permitting use of a revocable trust, still an important device, and the reason for the enactment of several related exemptions. Code § 42-1102 and Code § 47-902 exempt certain deeds from the recordation and transfer tax, respectively. Relevant to this ruling, Code §§ 42-1102 (17), (18) and (19) exempt a deed of real property from the recordation tax for

(17) [a] deed by a transferor that conveys bare legal title to the trustee of a revocable trust, without consideration for the transfer, where the transferor is the beneficiary of trust;

[18] [a] deed to property transferred to a beneficiary of a revocable trust as the result of the death of the grantor of the revocable trust;

[19] [a] deed to property transferred by the trustee of a revocable trust if the transfer would otherwise be exempt under this section if made by the grantor of the revocable trust....

Similarly, Code §§ 47-902 (12), (13), and (14) provide identical exemption language from the transfer tax for the above transfers.

These exemptions were added by the “Revocable Trust Tax Exemption Amendment Act of 1991” (“Act”).

The Report of the Committee of the Whole (“Committee Report”) on Bill 9-53 creating the Act indicates the City Council’s intention to reverse regulations subjecting certain transfers of real property into or out of revocable trusts to transfer and deed recordation taxes. See 9 DCMR §§ 512.1 and 611.1. The Committee stated:

[a]ccording to trust and estate planning experts, these costs are high enough to discourage many individuals who would otherwise establish revocable trusts from doing so, thus depriving themselves and their families of a useful and elsewhere commonly accepted way of planning for mental and physical disability late in life. Court intervention, as in the form of a conservatorship proceeding, becomes the only means by which intended trustees or beneficiaries can gain control of an incompetent or incapacitated individual’s real property for the benefit of the individual. After the property owner’s death, probate is the only avenue available for settling an estate. These kinds of proceedings can often prove time-consuming and expensive.

The effect of the Bill 9-53 would be to nullify the existing rules [subsequent to 1984] by explicitly exempting certain transfers into or out of a revocable trust from the transfer and deed recordation taxes. By doing so, the Committee seeks to maximize the options considered by those who wish to plan for the disposition of their assets in the event of future disability. (Emphasis added.)

The Committee Report further stated that enactment of the bill’s provisions relating to transfer and recordation tax, respectively, would “nullify 9 DCMR 611.1 by exempting certain transfers into or out of a revocable trust from the transfer tax” and

“nullify 9 DCMR 512.1 by exempting certain transfers into or out of a revocable trust from the deed recordation tax.”³ (Emphasis added.)

The Committee Report, however, indicated that for many years prior to 1984 the practice in the District and in Virginia and Maryland was to treat transfers into revocable trusts as nontaxable. “While legal title to real property changes, in the technical legal sense, upon the establishment of a revocable trust and the naming of a trustee, beneficial ownership is retained by the grantor and can be revoked at any time.”

The Act restored prior practice in this area by ensuring that certain transfers to revocable trusts were exempt from District recordation and transfer taxes. The Act also did not require that a transfer of property to a revocable trust must be for the benefit of a minor in order to invoke the exemption. Moreover, it is clear that the Council never intended to limit the holding of the Orleans case just to transfers to revocable trusts when it enacted the above exemptions for transfers to those trusts.

Many of the sound reasons providing for disability late in life, avoiding probate, for example, that led to the Council’s recognition of the revocable tax exemption, would apply to the use of the QPRT. It is a valid inference to assume that if a QPRT had been in use when revocable trusts were exempted under the statute, that their use would have been specifically exempted from the recordation and transfer taxes as well.

Thus, from a reading of the Orleans case, D.C. Official Code §§ 42-1102(7) and 47-902(5), and the history of the enactment of the revocable trust exemptions, there is no requirement that a child has to be a minor. Moreover, DCMR § 500.5 defines a “child” to include both minor and adult children. Importantly, there is no requirement in the federal gift and estate statutory framework that requires that a child be a minor. For the District to interpret its recordation and transfer tax exemption statutes differently would be anomalous.

Nor should there be any confusion as to which exemption is applicable. The exemption for the use of a QPRT is the one from a parent to a child. The fact that a QPRT must be irrevocable does not diminish its entitlement to this exemption. The exemptions for revocable trusts discussed above are still valid but do not narrow the parent-child exemption.

Accordingly, the transfer of a personal residence to a QPRT by parents for the benefit of their children is exempt from both the District recordation and transfer taxes whether or not the children are minors.

³ A notice of proposed rulemaking was published on September 7, 2007, thus conforming to the Committee Report’s stated intent to nullify them. The notice of proposed rulemaking will be followed by a notice of final rulemaking.