

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
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Legend

Taxpayer/Donor =
1

Taxpayer/Donor =
2

Property =

State =

Trust 1 =

Trust 2 =

x =

Son 1 =

Son 2 =

Son 3 =

Son 4 =

Dear Sir and Madam:

We received your letter, dated May 9, 2000, requesting rulings regarding application of the rules for a qualified personal residence trust in § 2702 of the Internal Revenue Code. This letter responds to your request.

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The facts and representations submitted are summarized as follows: Taxpayer 1 and Taxpayer 2 (collectively referred to as Taxpayers), husband and wife, own Property located in State. Property includes an 8.7 acre main lot, a one-seventh undivided interest in a 16.7 acre woodland preserve, and easements granting rights of access. One of the rights of access runs between the 8.7 acre main lot and the 16.7 acre woodland preserve. Property is assessed as a single lot for property tax purposes. You represent other properties within the community are of substantially the same size and character.

The main lot is improved by Taxpayer's vacation house and a guest house which does not include a separate kitchen and is not rented out by the Taxpayers. You represent that Taxpayers use Property for personal purposes for more than 14 days per year.

Taxpayer 1 proposes to transfer his undivided one-half interest in Property to Trust 1. Taxpayer 2 proposes to transfer her undivided one-half interest in Property to Trust 2. The terms of both trusts are identical.

Article First of the Trust 1 and Trust 2 instruments state from the date this trust is established until the termination date, the Donor shall be entitled to occupy the Residence for his personal use, and shall be solely responsible for real estate taxes, insurance, costs of maintenance and repair, and all other costs in connection with the Residence which would be the responsibility of the holder of a legal life estate in such property. The termination date of this trust shall be the x anniversary of the date on which this trust instrument is executed, or if sooner, the date of the Donor's death. If the termination date is the date of the Donor's death, the then remaining trust property shall be distributed to the Donor's executors or administrators, to be disposed of as part of the Donor's estate. Except as otherwise provided in Article Second below, if the termination date is the x anniversary of the date of execution of this trust instrument, the then remaining trust property shall be distributed in equal shares, one share to each of the Donor's children, Son 1, Son 2, Son 3, and Son 4, who is then living, and one share to the executors or administrators of each of them who is then deceased, to be disposed of as part of the particular child's estate.

Article Second provides the trust under Article First above is intended to be a qualified personal residence trust within the meaning of § 25.2702-5(c) (or any successor regulations), and this trust instrument shall be construed in accordance with this intent. The trust under Article First shall be subject to the following additional provisions, which shall continue in effect throughout the term of the trust.

Article Second, paragraph (a) provides no distributions of income or corpus may be made to any beneficiary other than the Donor prior to the termination of the Donor's interest provided in Article First above. In addition, any income of the trust must be distributed to the Donor at least as often as annually.

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Article Second, paragraph (b) states except as otherwise provided in this Article, the trustees may not hold any asset, including without limitation any tangible personal property, other than one residence to be used as a personal residence by the Donor. For purposes of this trust instrument, the term "personal residence" shall have the meaning given to it by § 25.2702-5(c)(2) (or any successor regulation).

Article Second, paragraph (c) provides the trustees may accept additions of cash to the trust, and may hold such additions in a separate account, in an amount which, when added to the cash already held in the account for such purposes, does not exceed the amount required (i) for payment of trust expenses (including any mortgage payments) already incurred or reasonably expected to be paid by the trust within six months from the date the addition is made; (ii) for improvements to the Residence to be paid by the trust within six months from the date the addition is made; or (iii) for the purchase by the trust of a personal residence for the Donor to replace the Residence previously held hereunder within three months after the addition is made; provided that no addition is made for this last purpose, and the trust may not hold any such addition, unless the trustees have previously entered into a contract to purchase the replacement personal residence. Any improvements to the Residence made pursuant to this paragraph (c) must not cause the Residence to fail to meet the requirements of a personal residence as herein defined.

Article Second, paragraph (d) states if any addition of cash is made to the trust under paragraph (c) above, the trustees must determine, at least quarterly, the amounts held by the trust for payment of expenses in excess of the amounts permitted by paragraph (c) and such amounts must be distributed immediately thereafter to the Donor. In addition, upon termination of the Donor's interest, any amounts held by the trustees for the purposes permitted by paragraph (c) that are not used to pay trust expenses due and payable on the termination date (including expenses directly related to termination) must be distributed outright to the Donor, if he is then living or, if the trust terminates by reason of the Donor's death, to the executors or administrators of the Donor's estate, in either case within thirty days of the termination date.

Article Second, paragraph (e) provides the Residence may be sold and the trustees may hold the proceeds from such sale in a separate account. However, the trust shall cease to be a qualified personal residence trust, and paragraph (g) shall apply, with respect to all such proceeds of sale, and with respect to any proceeds of insurance held as provided in paragraph (f) below, held by the trustees not later than the first to occur of (i) the second anniversary of the date of sale (or of damage or destruction as the case may be), (ii) the termination date, and (iii) the date on which a new Residence is acquired by the trust (or on which replacement or repairs to the Residence are completed as the case may be).

Article Second, paragraph (f) states the trustees may hold one or more policies of insurance on the Residence. In addition, the trustees may hold, in a separate

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account, proceeds of insurance payable to the trust as a result of damage to or destruction of the Residence. For purposes of this paragraph, amounts (other than insurance proceeds payable to the trust as a result of such damage or destruction) received as a result of the involuntary conversion (within the meaning of Section 1033 of the Internal Revenue Code of 1986, as amended) of the Residence shall be treated as proceeds of insurance. However, if damage or destruction renders the Residence unusable as a residence, the trust shall cease to be a qualified personal residence trust, and paragraph (g) shall apply, on the second anniversary of the date of damage or destruction (or on the termination date, if earlier) unless, prior to such date, replacement of or repair to the Residence is completed, or a new Residence is acquired by the trustees.

Article Second, paragraph (h) provides the interest of the Donor in this trust may not be commuted.

Article Second, paragraph (i) states improvements to the Residence may be added to the trust and the trust may hold such improvements; provided that the Residence as improved is a personal residence as herein defined.

Article Second, paragraph (l) provides notwithstanding any other provisions of this instrument, the trustees are prohibited from selling or transferring the Residence, directly or indirectly, to the Donor, the Donor's spouse, or an entity controlled by the Donor or the Donor's spouse, including any trust which is a grantor trust with respect to the Donor or the Donor's spouse (as defined in Sections 671 through 677 of the Code). This prohibition shall continue after the termination date, for so long as the Residence is held in a trust hereunder which is a grantor trust with respect to the Donor or the Donor's spouse (as so defined).

You have requested the following rulings: (1) the Property constitutes a residence and adjacent land not in excess of that which is reasonably appropriate for residential purposes within the meaning of § 25.2702-5(c), and (2) Trust 1 and Trust 2 will meet the requirements for qualified personal residence trusts under § 25.2702-5(c) and therefore, the transfers to Trust 1 and Trust 2 will qualify for the exception to § 2702(a) that is provided in § 2702(a)(3)(A)(ii).

Section 280A(d)(1) provides that a taxpayer uses a dwelling unit during the taxable year as a residence if he uses such unit (or portion thereof) for personal purposes for a number of days which exceeds the greater of (A) 14 days, or (B) 10 percent of the number of days during such year for which such unit is rented at a fair rental.

Section 2702(a)(1) provides that solely 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 the trust

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retained by the transferor or any applicable family member (as defined in § 2701(e)(2)) is determined as provided in § 2702(a)(2).

Section 2702(a)(2) provides that the value of any retained interest that is not a qualified interest is treated as being zero. The value of any retained interest which is a qualified interest shall be determined under § 7520.

Section 2702(a)(3)(A)(ii) provides that § 2702(a)(2) does not apply to any transfer if the 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.

Section 25.2702-5(a)(1) of the Gift Tax Regulations provides, in part, that § 2702 does not apply to a transfer in trust meeting the requirements of this section. A transfer in trust meets the requirements of this section only if the trust is a personal residence trust (as defined in paragraph (b) of this section). A trust meeting the requirements of a qualified personal residence trust (as defined in § 25.2702-5(c)) is treated as a personal resident trust.

Section 25.2702-5(c)(1) provides that a qualified personal residence trust is a trust meeting all the requirements of § 25.2702-5(c). These requirements must be met by provisions in the governing instrument, and these governing instrument provisions must by their terms continue in effect during the existence of any term interest in the trust.

Section 25.2702-5(c)(2)(i) provides that for the purposes of § 25.2702-5(c), a personal residence of a term holder is either (A) the principal residence of the term holder (within the meaning of § 1034); (B) one other residence of the term holder (within the meaning of § 280A(d)(1) but without regard to § 280A(d)(2)); or (C) an undivided fractional interest in either.

Section 25.2702-5(c)(2)(ii) provides that a personal residence may include appurtenant structures used by the term holder for residential purposes and adjacent land not in excess of that which is reasonably appropriate for residential purposes (taking into account the residence's size and location). The fact that a residence is subject to a mortgage does not affect its status as a personal residence. The term personal residence does not include any personal property (e.g., household furnishings).

Section 25.2702-5(c)(3) provides that the governing instrument must require that income of the trust be distributed to the term holder not less frequently than annually.

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Section 25.2702-5(c)(4) provides that the governing instrument must prohibit distributions of corpus to any beneficiary other than the transferor prior to the expiration of the retained term interest.

Section 25.2702-5(c)(5) provides that, in general, except as otherwise provided in paragraphs (c)(5)(ii) and (c)(8) of this section, the governing instrument of a qualified personal residence trust must prohibit the trust from holding, for the entire term of the trust, any asset other than one residence to be used or held for use (within the meaning of paragraph (c)(7)(i) of this section) as a personal residence of the term holder (the "residence"). Under § 25.2702-5(c)(5)(ii), the trust may hold certain assets listed in that section in addition to the personal residence.

Section 25.2702-5(c)(6) provides that the governing instrument must prohibit commutation (prepayment) of the term holder's interest.

Section 25.2702-5(c)(7)(i) provides that the governing instrument must provide that a trust ceases to be a qualified personal residence trust if the residence ceases to be used or held for use as a personal residence of the term holder. A residence is held for use as a personal residence of the term holder so long as the residence is not occupied by any other person (other than the spouse or a dependent of the term holder) and is available at all times for use by the term holder as a personal residence.

Section 25.2702-5(c)(8) provides that (i) the governing instrument must provide that, within thirty days after the date on which the trust has ceased to be a qualified personal residence trust with respect to certain assets, either, (A) the assets be distributed outright to the term holder; (B) the assets be converted to and held for the balance of the term holder's term in a separate share of the trust meeting the requirements of a qualified annuity interest; or (C) in the trustee's sole discretion, the trustee may elect to comply with either paragraph (C)(8)(i)(A) (or (B) of this section pursuant to their terms; and (ii)(A) for assets subject to this paragraph (c)(8) to be converted to and held as a qualified annuity interest, the governing instrument must contain all the provisions required by § 25.2702-3 with respect to a qualified annuity interest.

Section 25.2702-5(c)(9) provides that the governing instrument must prohibit the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse during the retained term interest of the trust or at any time after the retained term interest that the trust is a grantor trust.

Based on the facts and representations submitted, we conclude that Property constitutes a residence and adjacent land not in excess of that which is reasonably appropriate for residential purposes within the meaning of § 25.2702-5(c). In addition, we conclude that Trust 1 and Trust 2 will meet the requirements for qualified personal

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residence trusts under § 25.2702-5(c) and therefore, the transfers to Trust 1 and Trust 2 will qualify for the exception to § 2702(a) that is provided in § 2702(a)(3)(A)(ii).

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

A copy of this letter should be attached to any gift, estate or generation-skipping transfer tax returns that you may file relating to this matter. A copy is enclosed for that purpose. Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
James C. Gibbons
Assistant to the Branch Chief
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy of this letter
Copy for § 6110