

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

June 30, 2000

Re:

Legend

Settlor A =

Settlor B =

Trust A =

Trust B =

Property =

State =

X =

Organization =

Dear :

This is in response to your letter dated June 29, 2000, and prior correspondence, in which you request several rulings concerning the application of § 2702 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows. Settlor A and Settlor B, husband and wife, own Property as tenants by the entirety. Property is located in State. Property consists of one parcel on the local tax map and is assessed as one parcel for property tax purposes. Property consists of X acres and is improved by a principal residence and two out buildings and a swimming pool. Property is similar in size to nearby properties used for residential purposes. Taxpayer uses the main house as a personal residence and has done so for many years.

Settlor A and Settlor B propose to sever the tenancy by the entirety. After severance, Settlor A and Settlor B will hold Property as tenants in common. Each Settlor will then convey his or her one-half interest to a separate qualified personal residence trust (QPRT). Trust A will hold Settlor A's one-half interest in Property, and Trust B will hold Settlor B's one-half interest.

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It is further represented that Property is encumbered by a permanent easement in favor of Organization. The easement precludes the subdivision and the development of Property in any way that would disturb the rural, woodland, or wetland character of Property. Settlor A and Settlor B represent that during the period Property is held by Trust A and Trust B, Property will either be left in its natural state or will be planted with only such cover crops that are environmentally consistent with the environmental restrictions on the property and the characterization of the property as being a watershed area. Settlor A and Settlor B represent that no commercial activity will be conducted on Property and any crops grown will not be sold for commercial purposes.

During the term of Trust A and Trust B, the respective Settlor will be entitled to the exclusive occupancy of the residence, and to the income from Property. All the trust income must be distributed to the Settlor annually. Each trust document prohibits distribution of corpus to anyone other than the Settlor.

Other than Property, each trust will hold no assets other than amounts permitted under § 25.2702-5(c)(5) of the Gift Tax Regulations. The trusts provide that the Settlor's interest in the trust may not be commuted. In addition, the trustee of each trust is prohibited from selling or otherwise transferring any interest in Property held in the trust directly or indirectly to the Settlor, the Settlor's spouse or any entity controlled by the Settlor or the Settlor's spouse, in any transaction that would result in disqualification of the trust as a qualified personal residence trust under § 25.2702-5(c) of the Gift Tax Regulations.

Each trust will terminate at the earliest of the expiration of 15 years from the date it is established or the date of the respective Settlor's death, or the date the trust ceases to be a QPRT.

If a trust terminates at the end of the 15-year term, the trustee shall distribute the trust property equally to the respective living children of the Settlor. If the Settlor dies before the 15-year term expires, the Settlor may appoint the trust property pursuant to a general testamentary power of appointment. In default of exercise, the trust property is to pass equally to the Settlor's surviving children.

If the trust ceases to be a QPRT with respect to any assets held in trust, the trustee must convert those assets to a qualified annuity trust. The trust must function as a qualified annuity trust from the conversion date until the termination of trust as specified in § 25.2702- 5(c)(8)(ii) of the Gift Tax Regulations.

You have requested the following rulings:

1. Property, to be transferred to Trust A and Trust B is a personal residence within the

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meaning of § 25.2702-5(c)(2).

2. Trust A and Trust B will constitute qualified personal residence trusts within the meaning of § 25.2702-5(c).

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 such trust retained by the transferor or any applicable family member (as defined in § 2701(e)(2)) shall be 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 that is a qualified interest is determined under § 7520.

Section 2702(a)(3)(A)(ii) provides that § 2702(a) shall not apply to any 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) provides, in part, that § 2702 does not apply to a transfer in trust meeting the requirements of that section. A transfer in trust meets the requirements of the section only if the trust is a personal residence trust as defined in § 25.2702-5(b). Section 25.2702-5(b)(1) provides that a personal residence trust is a trust the governing instrument of which prohibits the trust from holding any asset other than one residence to be used as the personal residence of the term holder. A trust meeting the requirements of a "qualified personal residence trust" as defined in § 25.2702-5(c) is treated as a personal residence trust.

Section 25.2702-5(c)(1) provides that for purposes of § 2702(a)(3)(A)(ii), a qualified personal residence trust is a trust meeting all the requirements of the section. 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 a personal residence of a term holder is either the principal residence of the term holder (within the meaning of § 1034), one other residence of the term holder (within the meaning of § 280A(d)(1) but without regard to § 280A(d)(2)), or 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).

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Section 25.2702-5(c)(2)(iii) provides that the principal residence of the term holder will not fail to meet this requirement merely because a portion of the residence is used in an activity meeting the requirements of § 280A(c)(1) or (4), (relating to the deductibility of expenses related to certain uses in a trade or business of the taxpayer), provided that such use is secondary to use of the residence as a residence. A residence is not used primarily as a residence if it is used to provide transient lodging and substantial services in connection with the provision of lodging (e.g., a hotel or a bed and breakfast).

In this case, Property is comparable in size to other adjoining and nearby residential properties. Based on the facts submitted and the representations made, we conclude that Property, including improvements, is not in excess of that which is reasonably appropriate for residential purposes within the meaning of § 20.2702-5(c)(2)(ii) and that Property is a personal residence within the meaning of § 25.2702-5(c)(2). We further conclude that Trust A and Trust B satisfy the requirements of § 25.2702-5(c) and constitute qualified personal residence trusts.

Except as we have specifically ruled herein, we express no opinion under the cited provisions or under any other provision of the Code.

This ruling is based on the facts and 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 the ruling take effect, the ruling will have no force or effect. If the taxpayer is in doubt whether there has been a change in material fact or law, a request for reconsideration of this ruling should be submitted to this office.

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

Sincerely yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4

Enclosure
Copy for section 6110 purposes