

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B07 / PLR-104097-00

Date:

December 18, 2000

### Legend

Trust =  
Taxpayers =  
  
Son =  
Property =  
x =

Dear Sir:

We received your letter, dated February 8, 2000 and subsequent correspondence, requesting rulings regarding application of the rules for a qualified personal residence trust in § 2702 and rulings under § 2501, § 2033 and § 2039 of the Internal Revenue Code. This letter responds to your request.

The facts and representations submitted are summarized as follows: Taxpayers, a husband and wife, and Taxpayers' son (Son) will contribute cash to Trust. Taxpayers and Son will contribute cash determined in accordance with the applicable actuarial tables promulgated by the Internal Revenue Service for use in valuing life estates and remainders and the Applicable Federal Rate under § 7520 of the Internal Revenue Code for the month in which the contributions to Trust are made. The parties represent that they each have independent sources of funds. Taxpayers will have joint last-to-die life interests in Trust and Son will have a remainder interest in Trust. Trust will purchase Property. You represent that Taxpayers intend to occupy Property for at least x days per annum in accordance with § 280A.

Article First, paragraph A of the Trust Agreement provides, Taxpayers shall have the right, rent free, to the exclusive use, possession and enjoyment as a personal residence of the Property (or any successor residence acquired by the trustee as hereinafter provided) during their lifetimes, and after the death of any one of the Taxpayers, the survivor of them shall have such rights during his or her lifetime. The

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trustee shall pay over or apply any net income of the trust at the end of the calendar year to or for the benefit of Taxpayers during their lifetimes, and after the death of any one of the Taxpayers, to or for the benefit of the survivor of them during his or her lifetime. That paragraph further provides that the trust estate held under this Article First shall terminate upon the death of the survivor of the Taxpayers, and the trustee shall thereupon dispose of the principal of the trust estate, as it is then constituted, pursuant to the provisions of Article Second.

Article First, paragraph B provides that during the term of the trust under this Article First, the trustee may sell the personal residence then held in trust and use the proceeds of any such sale to acquire a successor personal residence, which shall thereafter be held hereunder for the benefit of the Taxpayers during their lifetimes, and after the death of any one of the Taxpayers, to or for the benefit of the survivor of them during his or her lifetime, subject to the provisions of paragraph D of this Article.

Article First, paragraph C provides that if cash is held by the trustee pursuant to Article Fourth, paragraph D, section 1(a) hereof, the trustee shall determine, at the end of each calendar quarter, whether the amounts held by the trust for the payment of expenses are in excess of the amounts permitted by Article Fourth, paragraph D, section 1(a) and § 25.2702(c)(5)(ii)(A)(1) and shall distribute immediately to the Taxpayers during their lifetimes, or after the death of any of the Taxpayers, to the survivor of them during his or her lifetime, any amounts in excess of the amounts so permitted.

Article First, paragraph D provides that notwithstanding the foregoing provisions, if the trust under this Article First ceases to be a qualified personal residence trust, with respect to some or all of the trust property, within thirty (30) days after the date on which the trust has ceased to be a qualified personal residence trust with respect to such property, the trustee shall distribute such property pursuant to the terms and conditions of Article Third. The trust shall cease to be a qualified personal residence trust with respect to some or all of the property held in trust for purposes of this Article First, in accordance with § 25.2702-5(c)(7), as follows: (1) if the residence ceases to be used or held for use as a personal residence of the Taxpayers during their lifetimes, or after the death of any one of the Taxpayers, of the survivor of them during his or her lifetime, within the meaning of § 25.2702-5(c)(7)(i), the trust will cease to be a qualified personal residence trust; (2) if the residence is sold, including as a result of condemnation, the trust will cease to be a qualified personal residence trust to the extent of all proceeds from the sale of the residence held by the trust, not later than the earlier of (a) the date that is two years after the date of the sale of the residence, (b) the death of the survivor of the Taxpayers within the meaning of § 25.2702-5(c)(7)(ii), or (c) the date on which the new residence is acquired by the trust; (3) if damage or destruction renders the residence unusable as a residence, the trust will cease to be a qualified personal residence trust on the date that is two years after the date of damage or destruction (or, if earlier, the death of the survivor of the Taxpayers within the meaning of § 25.2702-5(c)(7)(iii)) unless, prior to such date, (a) replacement of or repairs to the residence are completed or (b) a new residence is acquired by the trust;

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and (4) if proceeds of insurance are received by the trust as a result of the damage, destruction or involuntary conversion of the residence, the trust will cease to be a qualified personal residence trust not later than the earlier of (a) the date that is two years after the date of damage, destruction or involuntary conversion of the residence, (b) the death of the survivor of the Taxpayers within the meaning of § 25.2702-5(c)(7)(ii), or (c) the date on which the replacement of or repairs to the residence are completed or a new residence is acquired by the trust.

Article First, paragraph E provides that notwithstanding anything in this trust to the contrary, the trustee shall not sell or transfer the residence, directly or indirectly, to the Taxpayers or either of them or to an entity controlled by the Taxpayers or either of them, within the meaning of § 25.2702-2(b)(ii) and (iii), at any time during their respective life terms or at any time thereafter the trust is classified as a grantor trust within the meaning of §§ 671 through 677 of the Code as to which the Taxpayers or either of them are treated as the grantors.

Article Second, paragraph A provides that all property directed to be disposed of by this trust agreement shall be transferred, conveyed and paid over to Son, or if he shall not then survive, shall be distributed as provided in the Last Will and Testament of Son.

Article Second, paragraph B provides that notwithstanding any other provision of this Agreement, any amounts of cash held by the trustee pursuant to Article Fourth, paragraph D, section (1)(a) in excess of the amounts used to pay trust expenses due and payable on the date of termination of the trust under Article First (including expenses related to termination) shall be distributed to the estate of the survivor of Taxpayers within thirty (30) days of the death of the surviving Taxpayer.

Article Third, paragraph A provides that all property directed to be distributed pursuant to the terms and conditions of this Article Third shall be distributed by the trustee to the Taxpayers or to the survivor of them.

Article Fourth, paragraph B provides that except as otherwise provided in paragraph D of this Article, during the term of the trust created under Article First, the trustee is prohibited from holding any property in the trust estate other than one residence (or an undivided fractional interest in one residence) to be used or held for use within the meaning of § 25.2702-5(c)(7)(i) as a personal residence of the Taxpayers during their respective lives.

Article Fourth, paragraph D provides to the extent permitted by § 25.2702-5(c)(5), during the term of the trust created under Article First: (1) the trustee may hold additions of cash, in a separate bank account, in an amount which, when added to the cash already held in the account, does not exceed the amount required: (a) for payment of trust expenses (including mortgage payments, if any) already incurred or reasonably expected to be paid by the trust within six months from the date the addition is made;

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(b) for improvements to the residence to be paid by the trust within six months from the date the addition is made; (c) for the purchase of the initial residence, within three months of the date the trust is created, provided the trustee has first previously entered into or accepted assignment of a contract to purchase that residence; and (d) for purchase by the trust of a residence to replace another residence, within three months of the date the addition is made, provided the trustee has first previously entered into or accepted assignment of a contract to purchase that residence; (2) the trustee may hold improvements to the residence added to the trust estate provided the residence, as improved, meets the requirements of a personal residence as defined in paragraph C of this Article Fourth; (3) the trustee may hold the proceeds from the sale of the residence in a separate account; and (4) the trustee may hold one or more policies of insurance on the residence and may hold, in a separate account, proceeds of insurance payable to the trust as a result of damage to or destruction of the residence and amounts received as a result of the involuntary conversion (within the meaning of § 1033) of the residence.

Article Fourth, paragraph E provides the interest of the Taxpayers in any trust created hereunder may not and shall not be commuted.

You have requested the following rulings: (1) the Trust instrument satisfies all of the requirements of § 25.2702-5(c)(1); (2) Trust qualifies for the exception for personal residence trusts from the general rule under § 2702 that the value for gift tax purposes of any interest in a trust retained by a grantor or constructive grantor is zero if any family member possesses a remainder interest in Trust; (3) no gift from the life interest beneficiaries to the remainder beneficiary results from the creation of Trust, the assignment of the contract to purchase Property to the trust and the purchase by the trustee of Property with funds delivered in trust by Taxpayers and Son after the assignment has taken place; (4) the building and land constituting Property qualify as Taxpayers' principal or other residence; (5) the Trust corpus is not included in the taxable estate of either Taxpayer pursuant to § 2033 because their interest in Trust terminates at death under the terms of the Trust instrument; and (6) since the terms of Trust preclude the conversion of the residence to a cash annuity payable to either Taxpayer, § 2039 does not operate so as to cause inclusion of Property in their respective estates.

#### Ruling Requests 1, 2, 3, and 4

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

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Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or in money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

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 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 2702(c)(1) states for purposes of this section, the transfer of an interest in property with respect to which there is one or more term interests shall be treated as a transfer of an interest in trust.

Section 2702(c)(2) provides that, for purposes of this section, if two or more members of the same family acquire interests in any property described in paragraph (1) in the same transaction (or a series of related transactions), the person (or persons) acquiring the term interests in such property shall be treated as having acquired the entire property and then transferred to the other persons the interests acquired by such persons in the transaction (or series of transactions). Such transfer shall be treated as made in exchange for the consideration (if any) provided by such other persons for the acquisition of their interests in such property.

Section 2702(c)(3)(B) provides that the term "term interest" means either a life interest in property, or an interest in property for a term of years.

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

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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 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 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)(2)(iv) provides that if spouses hold interests in the same residence (including community property interests), the spouses may transfer their interests in the residence (or a fractional portion of their interests in the residence) to the same qualified personal residence trust, provided that the governing instrument prohibits any person other than one of the spouses from holding a term interest in the trust concurrently with the other spouse.

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.

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

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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)(5)(ii)(A)(1)(iii) provides that the governing instrument may permit additions of cash to the trust, and may permit the trust to hold additions of cash 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 for purchase by the trust of the initial residence, within three months of the date the trust is created, provided that no addition may be made for this purpose, and the trust may not hold any such addition, unless the trustee has previously entered into a contract to purchase the 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.

Under § 2702(c)(2), this transaction will be treated, for purposes of § 2702, as if Taxpayers acquired Property and then transferred the remainder interest to Son.

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Section 2702(c)(3)(B) defines Taxpayers retained life estate as a “term interest” for purposes of § 2702. Section 2702(c)(1) treats the “transfer of the remainder interest” as a transfer of an interest in trust for purposes of § 2702.

Based on the facts and representations submitted, we conclude that the Trust instrument satisfies all of the requirements of § 25.2702-5(c)(1). We further conclude that the building and land constituting Property qualify as Taxpayers’ principal or other residence. Therefore, Trust qualifies for the exception for personal residence trust to the general rule under § 2702 that the value for the for gift tax purposes of any interest in a trust retained by a grantor or constructive grantor is zero if any family member possesses a remainder interest in Trust. Under the facts presented, no gift from the life interest beneficiaries to the remainder beneficiary results from the creation of Trust, the assignment of the contract to purchase Property to the trust and the purchase by the trustee of Property with funds delivered in trust by Taxpayers and Son after the assignment has taken place

#### Ruling Request 5

Section 2033 provides the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 20.2033-1 provides, in part, that the gross estate of a decedent who was a citizen or a resident of the United States at the time of his death includes under § 2033 the value of all property, whether real or personal, tangible or intangible, and wherever situated, beneficially owned by the decedent at the time of his death. Real property is included whether it came in to the possession and control of the executor or administrator or passed directly to heirs or devisees.

Each Taxpayer’s interest in Trust will terminate on his or her death. Accordingly, at the time of their respective deaths, neither Taxpayer will own any interest in Trust. Therefore, based on the facts and representations submitted, we conclude that the Trust corpus will not be includible in the taxable estate of either Taxpayer pursuant to § 2033, because their respective interest in Trust terminates at death under the terms of the Trust instrument.

#### Ruling Request 6

Section 2039(a) provides that a decedent’s gross estate includes the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement, if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for the decedent’s life, or for any period not ascertainable without reference to the decedent’s death, or for any period which does not in fact end before the decedent’s death.



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The trust instrument does not provide for the conversion of the trust estate into an annuity for the benefit of the term interest beneficiaries. Based on the facts and representations submitted, we therefore conclude that § 2039 does not operate so as to cause inclusion of Property in their respective estates.

This ruling is based on the facts presented and the applicable law (including restrictive covenants) 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.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code. In particular, no opinion is expressed or implied regarding the applicability of § 2036 to this transaction. To the extent the house is not included in either of the Taxpayers' estates under § 2036, Son will have a cost basis in the trust property under § 1012.

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 the letter  
Copy for § 6110 purposes