

Internal Revenue Service

Department of the Treasury

Number: **200406045**
Release Date: 2/06/2004
Index Number: 2702-00.00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-168975-02

Date:

OCTOBER 22, 2003

Re:

Legend

Settlor =

Child =

Trust A =

Trust B =

Trust C =

Date =

Residence =

State =

Dear :

This is in response to your letter dated September 26, 2003, and prior correspondence, requesting a ruling concerning the application of § 2702 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows. Settlor executed the Trust A agreement on Date, and proposes to transfer Residence to Trust A. Residence, located in State and is zoned residential.

Trust A is intended to qualify as a Qualified Personal Residence Trust (QPRT) as described in § 25.2702-5(c) of the Gift Tax Regulations. Under the terms of Trust A, the Settlor is entitled to the exclusive use, possession and enjoyment of the interest in property held by the trustee for a period of 6 years or until either the prior death of Settlor or an earlier cessation (date upon which the residence ceases to be a qualified personal residence). Distributions of corpus to anyone other than the Settlor is prohibited. If Settlor survives the six-year term, Trust A terminates and the remainder is distributed to Trust B. If Settlor dies within the six-year term, the trust estate is to be distributed pursuant to Settlor's exercise of a testamentary general power of appointment, or in default of exercise, to Trust C.

PLR-168975-02

Trust A is to hold no assets, other than Residence and amounts permitted under § 25.2702-5(c)(5) of the regulations. All Trust A income must be distributed to the Settlor annually. Trust A provides that the Settlor interest in the trust may not be commuted.

If Trust A ceases to be a QPRT with respect to any assets held in trust, the trustees must either distribute the trust corpus to Settlor, or hold the assets as a qualified annuity interest described in Article IV of Trust A, with respect to which the Settlor is the sole beneficiary. The trust as converted must pay a qualified annuity from the conversion date until the termination of trust as specified in § 25.2702-5(c)(8)(ii) of the regulations.

Trust A expressly prohibits the trustees from selling or otherwise transferring any interest in Residence held in the trust directly or indirectly to Settlor, the spouse of Settlor or any entity controlled by Settlor or the spouse of Settlor as required by § 25.2702-5(c)(9) of the regulations.

You have requested the following rulings:

1. Residence is a personal residence within the meaning of § 25.2702-5(c)(2).
2. Trust A constitutes a “qualified personal residence trust” within the meaning of § 2702(a)(3)(A)(ii) of the Internal Revenue Code and § 25.2702-5 of the regulations.
3. The interest retained by Settlor in any annuity trust created constitutes a qualified interest within the meaning of §§ 2702(a)(2)(B) and 25.2702-3.

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)(1) 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). 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. A trust of which the term holder is the grantor that otherwise meets the requirements of a personal residence trust or a qualified personal residence trust is not a personal

PLR-168975-02

residence trust or a qualified personal residence trust if, at the time of the transfer the term holder already holds term interests in two trusts that are personal residence trusts or qualified personal residence trusts of which the term holder was the grantor.

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)(5) provides that, in general, except as otherwise provided in § 25.2702-5(c)(5)(ii) and (c)(8), 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 § 25.2702-5(c)(7)(i)) 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)(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).

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).

Section 25.2702-5(c)(8) provides that, within 30 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 must be distributed outright to the term holder; (B) the assets must 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 described in § 25.2702-3; or (C) in the trustee’s discretion, the trust may elect to comply with either (A) or (B).

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

PLR-168975-02

retained term interest of the trust or at any time after the retained term interest that the trust is a grantor trust.

In this case, based on the facts submitted and the representations made, we conclude that Residence is a personal residence within the meaning of § 25.2702-5(c)(2). Further we conclude that Trust A is a qualified personal residence trust within the meaning of § 25.2702-5(c) of the regulations. Further, the annuity interest provided under Article IV under Trust A meets the requirements of § 25.2702-3.

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), the ruling will have no force or effect. If the taxpayers are 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,

Associate Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4

Enclosure
Copy for section 6110 purposes

CC: