

**Internal Revenue Service**

**Department of the Treasury**

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2702.00-00

**Washington, DC 20224**

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**Person to Contact:**

**Telephone Number:**

**Refer Reply To:**

CC:DOM:P&SI:7:PLR-113601-98

**Date:**

March 25, 1999

Legend:           Taxpayer:  
                    Apartment:

Date 1:  
Trust:

EIN:

X:  
Date 2:  
Date 3:

Dear               :

This letter responds to the letter dated , and later correspondence from your authorized representative requesting rulings concerning the income and gift tax consequences of the creation of a trust. In addition, you have requested an extension of time under section 301.9100-1 of the Procedure and Administration Regulations to modify the trust in order to qualify as a qualified personal residence trust under section 2702 of the Internal Revenue Code.

You represent the facts to be as follows. Taxpayer's principal residence (Apartment) is located in a cooperative apartment building. Taxpayer acquired the cooperative stock shares and proprietary leases to the Apartment.

On Date 1, Taxpayer executed Trust, which was intended to qualify as a qualified personal residence trust. Taxpayer had originally intended to transfer the legal title to the shares and proprietary leases to the Trust, but the co-op association that governs the Apartment disapproved her request to do so. For this reason, Taxpayer instead transferred beneficial title to the shares and leases to the Trust, and continues to hold legal title as a nominee.

On Date 2, the gift tax return for the transaction was filed. On Date 3, which was within 90 days after the due date

for filing the gift tax return, your authorized representative requested a ruling that the trust, as executed, was a qualified personal residence trust within the meaning of section 2702.

Trust, as executed, did not meet the requirements for a qualified personal residence trust under section 2702. Accordingly, you propose certain amendments which are intended to meet the requirements of section 2702. The reformation, however, was not completed prior to the due date (including extensions) for filing the return.

Under the provisions of the trust instrument, as amended, Taxpayer has the right to reside in the Apartment for three years. The Taxpayer will possess all the rights of a life tenant and will be entitled to all the income during the three-year term. The terms of the trust, as amended, provide that, if Taxpayer dies before the three-year term expires, the balance of the principal of the trust will be distributed to the Taxpayer's estate, her creditors, the creditors of her estate, or any other person as Taxpayer may appoint by her Will. In default of this power of appointment, the trust corpus will be distributed to certain family members as provided under the terms of the trust. Taxpayer represents that, as determined under section 7520 of the Code, the present value of the reversionary interest retained by Taxpayer exceeds X of the value of the property transferred to Trust, which is greater than 5% of the value of property transferred to the trust.

If Taxpayer survives the three-year term, the assets will continue in trust, but Taxpayer's son and two grandchildren will become the beneficiaries. At the end of the Trust term, Taxpayer and the Trustees shall, at the option of Taxpayer, permit Taxpayer to occupy the residence at a fair market rent for such period as the Taxpayer wishes.

The trust, as amended, provides that the trustee is prohibited from holding any asset other than the residence during the retained three year term. The trustee may accept cash contributions to permit the trust to satisfy specified trust expenses or to pay the cost of improvements to the residence. Any cash held in excess of the permissible amounts must be distributed to Taxpayer not less frequently than quarterly. The Taxpayer's interest in the trust may not be commuted.

The trust, as amended, further provides that the trustees may hold proceeds from the sale of the residence in a separate account for a period not to exceed two years from the date of sale. Proceeds from insurance or as a result of damage, destruction, or involuntary conversion may be held by the trustee for a period not to exceed two years if the trustee intends to

use the proceeds for the purchase, construction, reconstruction, and/or repair of the personal residence. If the residence is damaged to such an extent that it cannot be used as a residence, the trust will cease to be a QPRT on the earlier of the date which is two years after the damage or destruction or the expiration of the retained term unless, prior to this date, the residence is replaced or repairs to the residence are completed.

The terms of the trust, as amended, provide that if, for any reason, the residence ceases to be held as Taxpayer's personal residence, during the retained term and prior to the Taxpayer's death, the trust will either terminate with all assets being distributed to the Taxpayer or the trustee may, within 30 days, convert the QPRT into a qualified annuity trust.

Trust, as amended, provides that the trustees may not sell or otherwise transfer the residence, directly, or indirectly, to the Grantor, any spouse of the Grantor, or to any entity controlled by the Grantor or any spouse of the Grantor, during the initial term or at any time after the initial term if the trust is a grantor trust.

The amount of the annuity to be paid to the Taxpayer at least annually after the conversion is determined by dividing the lesser of the interests retained by the Taxpayer in property transferred to the trust or the value of the trust assets as of the conversion date, by the annuity factor for the Taxpayer's interest in the trust, determined under section 7520, as of the date of the transfer.

You have requested that we rule as follows:

(1) Trust, as amended, qualifies for the personal residence exception to section 2702; and,

(2) Taxpayer will be considered to be the owner of the entire corpus and income of the Trust for income tax purposes under section 673(a) and 677(a) of the Code.

(3) An extension of time to amend Trust to qualify as a qualified personal residence trust is granted;

Ruling Request 1:

Section 2702(a) of the Code deals generally with the valuation, for gift tax purposes, of an interest transferred in trust to or for the benefit of a member of the transferor's family where the transferor retains an interest in the trust. Section 2702(a)(3)(A)(ii), however, provides that section 2702(a) shall not apply to any transfer if such 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 a term interest in the trust.

Section 25.2702-5(a) of the Gift Tax Regulations states, in part, that a qualified personal residence trust (as defined in section 25.2702-5(c)) is treated as a personal residence trust.

Section 25.2702-5(c) contains the following provisions applicable to a qualified personal residence trust:

(1) IN GENERAL. A qualified personal residence trust is a trust meeting all the requirements of this paragraph (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.

(2) PERSONAL RESIDENCE - (i) IN GENERAL. For purposes of this paragraph (c), a personal residence of a term holder is either-

(A) The principal residence of the term holder (within the meaning of section 1034);

(B) One other residence of the term holder (within the meaning of section 280A(d)(1) but without regard to section 280A(d)(2)...

It is represented that the Apartment is the principal residence of the Taxpayer, and section 1034(f) of the Code provides that the residence of a taxpayer shall include stock held by a tenant-stockholder in a cooperative housing corporation. Therefore, the Apartment meets the definition of a "personal residence" as set forth in section 25.2702-5(c)(2)(A) of the regulations.

After a review of the governing instrument of the trust, as amended, we find that it contains the provisions required by section 25.2702-5(c) of the regulations. Therefore, the trust is a qualified personal residence trust within the meaning of section 25.2702-5(c) and as such is not subject to the provisions of section 2702(a) of the Code.

#### Ruling Request 2:

Section 671 of the Code provides the general rule that when the grantor or another person is treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person

those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

Sections 673 through 677 of the Code specify the circumstances under which the grantor is treated as the owner of a portion of a trust.

Section 1.671-3(a) of the Income Tax Regulations provides that when a grantor or other person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing his tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example, if a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), the grantor takes into account in computing the grantor's income tax liability all items of income, deduction, and credit (including capital gains and losses) to which the grantor would have been entitled had the trust not been in existence during the period the grantor is treated as the owner.

Section 1.671-3(b) of the Income Tax Regulations provides that if a grantor or another person is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus.

Section 1.671-3(b)(3) of the regulations provides that both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or power over corpus alone that does not come within the provisions of section 1.671-3(b)(2). For example, if a grantor is treated under section 673 as the owner of a portion of a trust by reason of a reversionary interest in corpus, both ordinary income and other income allocable to corpus are included in the portion.

Section 673(a) of the Code provides that the grantor shall be treated as the owner of any portion of a trust in which the grantor has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion. Section 673(c) provides that for purposes of section 673(a), the value of the grantor's reversionary interest shall be determined by assuming the maximum exercise of discretion in favor of the grantor.

Under the terms of Trust, Grantor has retained a general power of appointment over the trust property during the initial

term. That power constitutes a reversionary interest for purposes of section 673 of the Code. The value of the interest retained by Grantor exceeds 5 percent of the value of the property transferred to Trust. Accordingly, Grantor will be considered the owner of the entire trust under section 673(a) of the Code.

Ruling Request 3:

Section 25.2702-5(a)(2) provides that a trust that does not comply with one or more of the regulatory requirements under (b) or (c) of the regulations under section 2702 will, nonetheless, be treated as satisfying these requirements if the trust is modified, by judicial reformation, (or nonjudicial reformation if effective under state law), to comply with the requirements.

Section 25.2702-5(a)(2) further provides that in the case of a trust created after December 31, 1996, the reformation must be commenced within 90 days after the due date (including extensions) for the filing of the gift tax return reporting the residence under section 6075 and must be completed within a reasonable time after commencement. If the reformation is not completed by the due date (including extensions) for filing the gift tax return, the grantor or grantor's spouse must attach statement to the gift tax return stating that the reformation has been commenced or will be commenced within the 90-day period.

Section 301.9100-3(a) provides that requests for extension of time for regulatory elections that do not meet the requirements of section 301.9100-2 must be made under this section. Requests for relief subject to this section will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

Based on the facts submitted and the representations made in this case, we conclude that the requirements of sections 301.9100-1 and 301.9100-3 have been met. An extension of time for meeting the requirements of section 25.2702-5(a)(2) is granted until 30 days after the date of this letter. The modification of the trust must comply with the requirements of section 2702 and the regulations thereunder, and the nonjudicial reformation must be effective under state law. Accordingly, provided that the requirements of section 25.2702-5(a)(2) are met and the modifications are made as represented, the trust will be a qualified personal residence trust within the meaning of section 25.2702-5(c).

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 this 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.

Except as we have specifically ruled herein, we express or imply no opinion about the tax consequences of the transaction under the cited provisions or under any other provision of the Code. Specifically, no opinion is expressed regarding the period following the first three years of Trust.

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

Sincerely yours,

Paul F. Kugler

Paul F. Kugler  
Assistant Chief Counsel  
(Passthroughs and Special Industries)

Enclosures:

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