

## Internal Revenue Service

Department of the Treasury  
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Telephone Number:

In Re:

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Date:  
September 26, 2008

### LEGEND:

Mother =  
Father =  
Residence =

Son 1 =  
Son 2 =  
Trust 1 =

Trust 2 =

Date 1 =  
Date 2 =  
Date 3 =  
Year 1 =  
Modification =

Y =  
Z =

Dear :

This is in response to your April 29, 2008 letter and other correspondence requesting a ruling under § 2702 of the Internal Revenue Code with respect to the proposed transfer of a residence to a trust.

The facts submitted are as follows:

Prior to Date 1, Mother owned Residence outright. On Date 1, Mother deeded her interest in Residence to Trust 1. Trust 1 provided that Mother would retain a term interest to possess and occupy Residence for y years.

Article V, Section C of Trust 1 provides, in relevant part, that upon the expiration of the y year period, if Mother is still living, Mother's retained interest is to expire and Trust 1 is to continue for the benefit of Mother's two sons, Son 1 and Son 2 (collectively Sons). Trust 1 is to terminate and be distributed to Sons in complete liquidation of Trust 1 on the later to occur of Mother's death or the death of Mother's spouse.

Mother served as trustee of Trust 1. Trust 1 was intended to qualify as a qualified personal residence trust (QPRT) as described in § 25.2702-5(c). Mother reported the transfer of Residence to Trust 1 on a Form 709, United States Gift (and Generation-Skipping Transfer) Tax return, for Year 1.

As of Date 2 (y years after Date 1), Mother's term interest in Residence expired and the remainder interest in Residence passed to Sons.

On Date 3, Mother, in her capacity as settlor and trustee of Trust 1, with the joinder and consent of Sons, executed Modification to modify Article V, Section B of Trust 1. Modification retains the terms of the original Section B but adds a further provision that, upon the expiration of the retained term (Mother's retained interest) and upon the direction of a majority of the current remainder beneficiaries, the trustee may liquidate the trust or provide a gift to anyone the majority of the current remainder beneficiaries so chooses of a term interest in any real property of the trust estate that will be occupied by the term interest holder as their principal residence. Furthermore, such directions may include the conveyance by gift or sale, in trust or otherwise, of a term interest in any residence that is part of the trust estate.

Sons intend to create an irrevocable trust, Trust 2, to which they will transfer their interest in Residence. Trust 2 provides that Sons desires to transfer a z year term interest to possess and occupy Residence to Mother and Father (Mother's husband), or, upon conversion to an annuity trust, to transfer the annual annuity amount, for z year. Sons will convey Residence to trustee by warranty deed, delivered to the trustee of Trust 2 from Sons contemporaneous with the execution of Trust 2. The date of delivery of the warranty deed to the trustee of Trust 2 will constitute the effective date of Trust 2. Mother and Father will serve as trustees of Trust 2.

You have requested a ruling that §§ 2702(a)(1) and 2702(a)(2) will not apply to Sons' proposed transfer of Residence to Trust 2.

## LAW AND ANALYSIS

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 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 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 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.

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 § 25.2702-5(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. 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 a residence is a personal residence only if its primary use is as a residence of the term holder when occupied by the term holder. A residence is not used primarily as a residence if it is used to provide transient lodging and substantial services are provided in connection with the provision of lodging (e.g., a hotel or a bed and breakfast). A residence is not a personal residence if, during any period not occupied by the term holder, its primary use is other than as a residence.

Section 4.01(52) of Rev. Proc. 2008-3, 2008-1 I.R.B. 110, 118, provides that rulings will not ordinarily be issued on whether a trust with one term holder satisfies the requirements of § 2702(a)(3)(A) and § 25.2702-5(c) to be a QPRT. Rev. Proc. 2003-42, 2003-1 C.B. 993, provides sample trust provisions for QPRTs. The Service will recognize a trust as meeting all of the requirements of § 2702(a)(3)(A) and § 25.2702-5(c) if the trust instrument is substantially similar to the sample in section 4 of Rev. Proc. 2003-42 and the trust operates in a manner consistent with the terms of the trust instrument and is a valid trust under applicable local law.

Accordingly, based on the facts submitted and the representations made, we conclude that §§ 2702(a)(1) and 2702(a)(2) will not apply to Sons' proposed transfer of Residence to Trust 2, if the Trust 2 instrument is substantially similar to the sample in section 4 of Rev. Proc. 2003-42 and the trust operates in a manner consistent with the terms of the trust instrument and is a valid trust under applicable local law, and if Residence qualifies as a personal residence as defined in § 25.2702-5(c)(2).

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning whether the transfer of Residence to Trust 2 would result in Residence being included in the gross estate of Mother or the gross estate of Father under § 2036.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

Sincerely,

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Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes

cc: