

Internal Revenue Service  
Index No.: 2702.02-02  
Number: **199906014**  
Release Date: 2/12/1999

**Department of the Treasury**

**P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044**

**Person to Contact:**

**Telephone Number:**

**Refer Reply To:**

CC:DOM:P&SI:4 - PLR-107117-97

**Date:** November 9, 1998

Re:

LEGEND:

Trust =

Taxpayer =

Spouse =

Property =

a =

b =

c =

d =

e =

g =

h =

This is in response to your authorized representative's letter, requesting rulings concerning the application of § 2702 of the Internal Revenue Code to the Trust. This letter responds to that request.

The facts and representations submitted are summarized as follows: Taxpayer owns Property, which consists of a residence situated on h acres. The residence is approximately a square feet in size. The residence includes a separate apartment of approximately b square feet, that is rented to unrelated individuals. The monthly rent is c. The home is located on a single parcel of real property consisting of h acres.

Taxpayer uses the house as Taxpayer's vacation residence for an average of approximately d days per year. For approximately e days per year, Taxpayer permits family members and friends to stay in the house without rent or other remuneration.

Taxpayer proposes to transfer the parcel of real property containing the home to the Trust, the terms of which are intended to satisfy the requirements of § 25.2702-5(c) of the Gift Tax Regulations. Taxpayer will serve as trustee of the Trust. The Trust, pursuant to Article XI, will be irrevocable.

Article III of the proposed Trust provides that the Income Term of the Trust is the period that will commence on the date of the Trust instrument and end on (i) the date that is g years after the date of the Trust instrument, or (ii) the Taxpayer's death, if sooner. At the end of the Income Term, the property in Trust will pass to a Family Trust for the lifetime benefit of Spouse. Under the terms of the Family Trust, Taxpayer's Spouse will be entitled to the use and occupancy of the residence for her remaining lifetime. Upon the Spouse's death, the remaining trust property will pass in trust for the benefit of Taxpayer's descendants.

Article III provides that during the Income Term the trustee is to hold for Taxpayer's exclusive use and enjoyment, without Taxpayer paying rent, a single residence for use as a personal residence by the Taxpayer, subject to the trustee's power of sale. The entire net income of the Trust, if any, is to be paid to Taxpayer in convenient installments, at least annually. During the Income Term, the trustee is to make no distribution of income or principal to anyone other than Taxpayer, and in no event may trustee commute Taxpayer's interest in the Trust.

Article IV, provides that for purposes of the Trust, the term "personal residence" is either (i) the Taxpayer's principle residence, within the meaning of § 1034 or (ii) one other residence of the Taxpayer, within the meaning of § 280A(d)(1), including in either case, appurtenant structures used by the Taxpayer for residential purposes (taking into account the residence's size and location). An undivided fractional interest in property which otherwise qualifies as a personal residence is included in this definition. Any improvement to the personal residence must continue to meet the

definition of personal residence. The term "personal residence" does not include any personal property (e.g., household furnishings).

Article IV provides that, except as specifically provided, pursuant to § 25.2702-5(c)((5)(ii)), the trust may not hold any assets other than the personal residence of the Taxpayer. The Trust provides in Article IV, that the trustee may receive cash additions to the Trust at any time, and the trustee may retain cash in a separate account, but in neither event in excess of the amounts, when added to the cash already held in the Trust are required for:

Payment of trust expenses (including mortgage payments) already incurred or reasonably expected to be paid by the Trust during the six-month period following the addition of the cash to the Trust; for improvements to the Property to be paid within six months from the date the addition of cash is made to the Trust; and for the purchase by the Trust within three months of the addition of cash to the Trust of a personal residence to replace another personal residence held by the Trust, but only if the trustee has previously entered into a contract to purchase the replacement residence. The Trust also requires that at least quarterly, the trustee is to determine the amount of any cash held by the trustee in excess of the amounts permitted to be held under this paragraph (2) and is to distribute immediately that excess to the Taxpayer. In addition, within thirty days following the end of the Income Term, the trustee is to distribute to the Taxpayer all cash then held by the trustee for the purposes permitted that is not required for the payment of trust expenses then due and payable.

Under Article IV, the Trust may also hold:

- (1) Proceeds from the sale of a personal residence held in a separate account by the Trust and proceeds of insurance payable to the Trust as a result of damage or destruction of the personal residence.
- (2) One or more policies of insurance on the residence.

Article IV, Paragraph C provides that if any proceeds of the sale of the residence, or proceeds of insurance received as a result of damage to or destruction of the residence, are not reinvested in a new personal residence acquired by the Trust, or expended for replacement or repair to the personal residence held by the Trust by the Termination Date (as defined below), then the Trust will cease to be a qualified personal residence trust with respect to the proceeds not reinvested or expended.

Article IV, Paragraph C, defines the Termination date as the first to occur of (i) the date that is two years after the date of sale, damage, or destruction, as the case may be, (ii) the date on which a new personal residence is acquired by the Trust, or replacement or repair is complete, or (iii) the end of the Income Term.

Article IV, Paragraph (D) provides that except in the case of sale of, damage to, or destruction of the personal residence, as described in Article IV, Paragraph C, the Trust shall cease to be a qualified personal residence trust if the residence held by the Trust ceases to be used or held for use as the Taxpayer's personal residence as described in § 25.2702-5(c)(7)(i) of the Gift Tax Regulations.

Article IV, Paragraph (E) provides that the trustee shall not sell or otherwise transfer the personal residence in any manner that conflicts with § 25.2702-5(c)(9) of the Gift Tax Regulations.

Article IV, Paragraph (F) provides that within 30 days after the Trust, or any portion thereof consisting of uninvested or unexpended sale or insurance proceeds, ceases to be a qualified personal residence trust (the "Conversion Date"), whether such cessation occurs at the end of the Income Term or at any earlier time, the trustee is to allocate all Trust income and principal as to which the cessation has occurred to a separate Qualified Annuity Trust, to be administered as provided in Article V.

Under Article V, Paragraph (A), commencing as of the "Cessation Date" and until the end of the Income Term, the trustee is to pay the Taxpayer, the Required Annuity Amount in each taxable year of the qualified annuity trust. The Cessation Date is the date of sale of the residence, or the date on which the residence otherwise ceases to be used or held for use as the Taxpayer's personal residence.

Under Article V, Paragraph (B), the Required Annuity Amount is to be a fixed amount equal to the smallest amount determined under § 25.2702-5(c)(8)(ii)(C) for the Trust or the portion of the Trust which ceased to be a qualified personal residence trust to be validly converted to a qualified annuity interest. During the term of the Qualified Annuity Trust, the Required Annuity is to be distributed in equal installments at least as often as annually. If the number of days in the Annuity Term in any taxable year of the trust is less than 365 days (366 days if the taxable year includes February 29), the Required Annuity Amount payable in such short taxable year or years is to be prorated on a daily basis.

Under Article V, Paragraph (C), the obligation to pay the Required Annuity Amount commences with the Cessation Date, but the trustee may defer distribution of the Required Annuity Amount from the Cessation Date until the Conversion Date; provided that any deferred payment must bear interest from the Cessation Date at the rate in effect on the Cessation Date under § 7520. Notwithstanding the foregoing, the trustee may reduce the aggregate deferred annuity payments by the amount of income actually distributed to the Taxpayer by the trustee during the deferral period. In addition, no additional contributions may be made to the Qualified Annuity Trust after the initial contribution.

You have requested the following rulings:

(1) The real property that the Taxpayer proposes to transfer to the Trust will meet the requirements of a personal residence under § 25.2702-5(c)(2).

(2) The Trust meets the requirements of a qualified personal residence trust (QPRT) under § 25.2702-5(c).

(3) The property placed in the Trust will not be includible in the Taxpayer's gross estate if the Taxpayer survives the Income Term of the Trust.

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 the 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 that is a qualified interest is determined under § 7520.

Section 2702(a)(3)(A)(ii) provides an exception to § 2702(a)(2) for 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 the trust.

Section 25.2702-5(a) provides that a transfer in trust meeting the requirements of a "qualified personal residence trust" as defined in § 25.2702-5(c) will be treated as satisfying the requirements of § 2702(a)(3)(A)(ii).

Section 25.2702-5(c)(1) provides that, in order to qualify as a QPRT, the provisions of the governing instrument must satisfy all the requirements of a QPRT throughout the term of the trust.

Section 25.2702-5(c)(2)(i) provides that a personal residence of a term holder is either the personal 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).

Section 25.2702-5(c)(3) provides that, in general, the governing instrument of a QPRT must require that any 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, the governing instrument of a QPRT 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 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)(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 QPRT 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 the governing instrument must provide that, within 30 days after the date on which the trust ceases to be a QPRT with respect to certain assets, the assets must be either distributed outright to the term holder, or 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. If the assets are 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 generally, 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 § 671, et. seq.)

Based on the information submitted and the representations made, we conclude that:

(1) Property, as described above, constitutes a personal residence of the Taxpayer. Under the facts presented, the rental of the apartment is incidental to the use of the Property as a residence, within the meaning of § 25.2702-5(c)(2)(C)(iii). We conclude that the Property also meets the other requirements of a personal residence under § 25.2702-5(c)(2).

(2) The Trust instrument contains the provisions required to be incorporated into a QPRT under § 25.2702-5(c). Accordingly, Trust meets the requirements of a QPRT under § 25.2702-(5)(c).

(3) At the end of the Income Term of Trust, if Spouse is living and still married to Taxpayer, the Trust property will pass to Family Trust for the lifetime benefit of Spouse. Upon Spouse's death, the property will continue to be held in trust for the benefit of Taxpayer's descendants. If Taxpayer survives the Income Term, Taxpayer will not be considered to have retained any interest in the transferred property that would subject the property to inclusion in Taxpayer's gross estate under §§ 2035, 2036, 2037, and 2038, assuming there is no agreement, expressed or implied, regarding Taxpayer's continued use of the property after expiration of the Income Term. (Under Rev. Rul. 70-155, 1970-1 C.B. 189, co-occupancy by the donor with the donee, where the donor and donee are husband and wife, does not of itself support an inference of an agreement or understanding as to retained possession or enjoyment by the donor.) Therefore, in the

absence of an agreement, the Property placed in Trust by Taxpayer will not be includible in the Taxpayer's gross estate if the Taxpayer survives the Income Term of the Trust.

Except as 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.

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

Sincerely yours,

---

George Masnik  
Chief, Branch 4  
Office of the Assistant Chief  
Counsel  
(Passthroughs and Special  
Industries)

Enclosure

Copy of letter for section 6110 purposes