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Department of the Treasury

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Date: February 8, 1999

LEGEND:

Taxpayer =

Community =

Property =

Trust =

This is in response to your letter dated September 11, 1998, and prior correspondence in which you requested rulings concerning a qualified personal residence trust.

Taxpayer owns fee simple title to Property located in Community. The Property consists of land improved by a single family residence. The only other structure on the property is a two car garage. The remaining property is generally wooded and is used for recreational purposes. The property is used exclusively as a personal residence by Taxpayer and no individual, other than Taxpayer, has the right to use or occupy the property. No commercial activity is conducted on the property.

Under the Community ordinances that regulate zoning of real property, the land is zoned exclusively for agricultural purposes and requires a minimum of acreage for residences, unless special exceptions are approved by the Zoning Committee. To rezone a parcel the Planning and Zoning Committee must find that the rezoning is in the public interest. Thus, the ordinance precludes the subdivision of Property except in unusual circumstances.

Taxpayer proposes to transfer Property to a qualified personal residence trust to be established by the Taxpayer.

Taxpayer's spouse will serve as the trustee for the term of the qualified personal residence trust. The proposed trust will terminate at the earlier of 16 years from the date it is established or the date of the Taxpayer's death. During the term of Trust, Property will be held exclusively for the use and occupancy of the Taxpayer. The entire net income from Trust will be paid, at least annually, to the Taxpayer. Also, during the term of Trust, no income may be paid to anyone other than the Taxpayer. All cash or cash equivalents will be paid to the Taxpayer at the termination of Trust.

Under the terms of Trust, the trustees are prohibited from selling or transferring the residence directly or indirectly, to the Taxpayer, Taxpayer's spouse, or an entity controlled by the Taxpayer or Taxpayer's spouse during the term of Trust, or at any time after the original term of Trust to any trust held under this trust agreement that is a grantor trust under §§ 671 to 677 of the Internal Revenue Code. For purposes of the preceding sentence, a sale or transfer to another grantor trust of Taxpayer or Taxpayer's spouse is considered a sale or transfer to Taxpayer or the Taxpayer's spouse. The term "control" is defined in § 25.2701-2(b)(5)(ii) and (iii) of the Gift Tax Regulations. If the property is sold during the term, any proceeds from such sale will continue to be held as part of the trust for the period specified in Trust; i.e., the sales proceeds shall continue to be held as part of the trust until the earliest of (a) the date that is 2 years from the date of sale, or (b) the date on which a replacement residence is acquired by Trust.

In addition to holding Property, Trust provides that it may hold cash in a separate account to: 1) pay Trust expenses already incurred or reasonably expected to be paid by the trust within six months of the date of addition; 2) make improvements within six months of addition of the cash; or 3) allow the trustee to purchase a replacement personal residence within three months from the date of the addition of cash. In addition, the trustee may hold in separate accounts any proceeds from the sale of the personal residence and policies of insurance on the residence and any proceeds received under an insurance policy held by Trust. Trust also provides that any cash in excess of the amount necessary for these purposes must be distributed to the Taxpayer.

In addition, Trust prohibits the holding of any asset other than assets specifically described above, and prohibits commutation of the Taxpayer's interest at any time before the termination date of Trust.

Under Article X of the proposed trust, if, prior to the expiration of the term of Trust, Property ceases to be used or

held for the use as a personal residence of Taxpayer, Trust shall cease to be a qualified personal residence trust and the trustee shall convert the trust assets to a qualified annuity interest that must meet the requirements of § 25.2702-3. Those requirements are set forth in Article X.

If Taxpayer dies within 16 years of the creation of Trust, Trust will terminate and all trust assets and accrued but undistributed income will be distributed pursuant to a general power of appointment held by Taxpayer. If Trust terminates at the end of the 16 year term, Taxpayer's children become the primary beneficiaries of Trust. If the trustee determines that it is in the best interest of the beneficiaries to retain the residence, then Taxpayer and Spouse have the first option to lease the residence at fair rental value. If the trustee determines that it is not in the best interest of the beneficiaries to retain the residence, the residence will be sold at fair market value and all the income from Trust will be paid to the beneficiaries until the death of Taxpayer and Spouse. At the death of Taxpayer and Spouse all Trust assets will be distributed to or for the benefit of the beneficiaries.

You request a ruling that Property qualifies as a personal residence of Taxpayer under § 2702(a)(3)(A)(ii) § 25.2702-5(c)(2). You also request a ruling that the proposed trust meets the requirements of a qualified personal residence trust under § 25.2702-5(c).

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.

Section 2702(a)(3)(A)(ii) provides an exception to § 2702(a)(2) in the case of 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) provides, in part, 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 qualified personal residence trust, the provisions of the governing instrument must satisfy all the requirements of a qualified personal residence trust throughout the term of the trust.

Section 25.2702-5(c)(5) provides that, in general, 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 as a personal residence of the term holder. Under §25.2702-5(c)(7), 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 dependent of the term holder) and is available at all times for use by the term holder as a personal 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). 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)(8) provides that the governing instrument must provide that, within 30 days after the date on which the trust ceases to be a qualified personal residence trust 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.

Under § 25.2702-5(c)(9) in general, 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 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 (pursuant to §§ 671 through 678.)

In this case, parcels in proximity to Property generally contain a similar amount of acreage. Further, zoning requirements in Community preclude subdivision of Property. The structures on the property are used for residential purposes and are not being used for a commercial purpose. Consequently, we conclude that Property, as described above, constitutes a personal residence within the meaning of § 2702(a)(3)(A)(ii) and § 25.2702-5(c)(2).

In addition, we conclude that the proposed trust agreement, as submitted, meets the requirements of a qualified personal residence trust under § 25.2702-5(c).

A copy of this letter should be attached to any gift, estate or generation-skipping transfer tax returns that you may file relating to these matters. No opinion is expressed regarding the tax treatment of these transactions under any other provision of the Code or regulations.

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

Sincerely yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4

Enclosure:
Copy for section 6110 purposes