

Internal Revenue Service

Department of the Treasury

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Re:

Legend

Settlor A =

Settlor B =

Property =

Trust A =

Trust B =

This is in response to your letter dated January 29, 1999, and other submissions in which you request several rulings concerning the application of § 2702 of the Internal Revenue Code.

Settlor A and B propose to each transfer a 50% undivided interest in Property to separate qualified personal residence trusts, Trusts A and B. Property consists primarily of a main dwelling, tennis cottage, and a caretaker's house.

Each trust provides that the respective Settlor will be entitled to the use and occupancy of the interest in Property held by their respective trusts for a term of 25 years. If a Settlor does not survive the 25-year term, the trust corpus is to be distributed to the Settlor's estate. If the Settlor survives the 25-year term, the trust corpus continues to be held in trust for the benefit of the Settlor's issue.

Each trust contains language that satisfies the requirements of § 25.2702-5(c)(9) of the Gift Tax Regulations prohibiting the reacquisition of the property by the Settlor.

If, for any reason, the residence ceases to be held as the Settlor's personal residence during the retained term, the trust will either terminate and all assets will be distributed to the Settlor, or the trustee may, within 30 days, convert the trust assets and hold the assets in the form of a qualified annuity interest described in § 25.2702-3(b).

Settlors have requested the following rulings:

1. The Property qualifies as a personal residence of each Settlor within the meaning of § 25.2702-5(c)(2)(i) and (ii).
2. Each trust constitutes a qualified personal residence trust within the meaning of § 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 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 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)(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)(3) provides that the governing instrument 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 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)(6) provides that the governing

instrument must prohibit commutation (prepayment) of the term holder's interest.

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.

Section 25.2702-5(c)(9) provides generally that the trust instrument must prohibit the trustee from selling the residence, directly or indirectly, to the grantor, or the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse during the original term interest of the trust, or any time after the original term of the trust that the trust is a grantor trust described in § 671 through § 678 of the Code.

In this case, we conclude that Property constitutes a personal residence of Settlor A and Settlor B within the meaning of § 2702(a)(3)(A)(ii) and § 25.2702-5(c)(2). Furthermore, because Trusts A and B contain all the provisions required under § 25.2702-5(c) and § 25.2702-3, each trust constitutes a qualified personal residence trust within the meaning of § 25.2702-5(c).

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 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,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4

Enclosure
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