Internal Revenue Service

Department of the Treasury

Number: **200241039**
Release Date: 10/11/2002
Index Number: 2702.02-02

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09 - PLR-125021-02
Date:
July 10, 2002

In Re:

Legend

Taxpayer =

Property =
Trust =
X =
Y =
Year 1 =
Years 2 =
Camp =
Date 1 =
Grantee =

Dear :

We received your letter, dated April 29, 2002, and subsequent correspondence, requesting rulings regarding application of the rules for a qualified personal residence trust (QPRT) under § 2702 of the Internal Revenue Code. This letter responds to your request.

The facts and representations submitted are summarized as follows: Taxpayer proposes to transfer Property to Trust. The terms of Trust are intended to satisfy the requirements for a qualified personal residence trust found in § 25.2702-5(c) of the Gift Tax Regulations.

Property consists of X acres of land. Approximately Y acres of Property have been cleared and contain Taxpayer's vacation residence, a guesthouse, a barn, a boathouse, two sheds and a large pier and dock. Property has a moderate topography and a mixed cover of predominantly softwood forest. The shore frontage consists of ledge and rocky beach. Property is assessed and taxed as a single, undivided parcel of land. Zoning restrictions limit Property to residential and accessory uses. Other properties in the area are generally of a similar nature.

Taxpayer and his family have used Property as a vacation residence and as a personal residence for at least two weeks per year since the property was acquired in Year 1. Taxpayer, his family and occasional guests use the entire acreage as an extension of the land immediately surrounding the residence buildings (i.e., for hiking, picnicking, wildlife watching, enjoying scenic views, etc.).

During Years 2, Property was used during the summer months as a campsite for high school students participating in an educational program known as Camp. In each year that Property was used as Camp, Taxpayer received total consideration of one dollar ($1.00) under the term of a lease agreement entered into solely for purposes of satisfying liability concerns with respect to accidents and injuries incurred by participating students. No commercial activities have been conducted on Property for over 100 years.

Property is subject to a perpetual conservation easement entered into on Date 1, between Taxpayer and Grantee. The easement provides that Property may only be used for single-family, educational, and conservation purposes. Billboards, multi-family units, mobile homes and hotels are prohibited on Property. In addition, no commercial activities may be conducted on Property. The easement also restricts the construction of new buildings, alterations to the surface of Property and limits the cutting of standing lumber. A number of surrounding properties are also subject to similar conservation easements.

Paragraph 1(a) of the proposed Trust provides that all net income of the trust is to be distributed to Taxpayer in quarter annual installments or more frequently. Upon termination of Taxpayer's term interest for any reason, the trustee is directed to distribute to Taxpayer or the representatives of Taxpayer's estate any undistributed net income and the right to any accrued income not yet received.

Paragraph 1(b) provides Property is a personal residence of Taxpayer. During Taxpayer's term interest: (i) any replacement residence that may be acquired will be property that qualifies as a personal residence of Taxpayer, (ii) any repairs or improvements made are to be of such nature that the residence property then held can continue to qualify as a personal residence, (iii) the residence property is to be available for Taxpayer's use as a personal residence, and (iv) Taxpayer has the right to use, occupy, and enjoy it without liability for rent. When the residence property is no longer used for a personal residence of Taxpayer, the QPRT status of the trust will cease as to all property. Paragraph 1(g) governs the disposition of all trust property after any such cessation.

Paragraph 1(c) provides the trustee will not: (i) hold an interest in more than one residence property at a time; (ii) hold any interest in any furniture, furnishings, or other tangible personal property located in or about, or that may be used in connection with, the residence property; (iii) hold or acquire any assets of any kind, other than the residence property, except as permitted by Paragraphs 1(d) through 1(f) inclusive and applicable federal law; (iv) commute Taxpayer's term interest; (v) make any distributions of net income or principal to any person other than Taxpayer during Taxpayer's term interest; or (vi) use, apply, or otherwise deal with or dispose of the residence property or any other asset of the trust otherwise than in accordance with the requirements of applicable federal law. The trustee may not sell or otherwise transfer any interest in any personal residence held in the trust directly or indirectly to Taxpayer, Taxpayer's spouse, or any controlled or other entity in any transaction that would result in the disqualification of the trust under applicable federal law.

Paragraph 1(d) provides that the trustee may receive or acquire, and hold in separate, identifiable accounts, additions of cash not in excess of the amounts reasonably required for the following: (i) real estate taxes, assessments, other expenses related to the residence property, payments of interest and principal on any mortgage debt to which such property is subject, and other expenses of the trust that already have been incurred or that are expected to be paid within six months after the addition made for this purpose; (ii) the costs of any improvements to the residence property that are to be paid within the same period after any addition made for this purpose; or (iii) contribution to the purchase by the trust of a replacement residence within three months after the date of any addition made for this purpose if, and only if, a contract to purchase the same is in effect before such date. The trustee is authorized to apply any additions for the purposes for which they were acquired within the periods permitted by applicable federal law. At the end of each calender quarter, trustee will determine whether the amount of cash held exceeds the amount permitted to be held under applicable federal law, and, if so, immediately distribute the excess to Taxpayer. In addition, within thirty days after the termination of Taxpayer's term interest, the trustee will distribute to Taxpayer or the representative of Taxpayer's estate any amounts held under this Paragraph that are not used to pay expenses of the trust which are then due and payable, or which are directly related to the termination of the trust.

Paragraph 1(e) provides that the trustee may receive proceeds of any sale of the residence property and hold them in a separate account. The trustee is authorized to apply such proceeds in replacing the residence property. If Taxpayer's term interest has not earlier terminated, the QPRT status of the trust will cease as to any proceeds that remain on the earlier to occur of: (i) the second anniversary of the date of the sale of the residence property and (ii) the date on which the trust acquires a replacement residence. Paragraph 1(g) governs the disposition of any and all proceeds as to which such cessation occurs.

Paragraph 1(f) provides that the trustee may receive or acquire, and hold in separate identifiable accounts of the Trust: (i) insurance policies on the residence property, (ii) the proceeds of insurance resulting from damage to or destruction of the residence property, and (iii) the proceeds of any involuntary conversion of the residence property. The trustee is authorized to apply such proceeds in repairing, rebuilding, or replacing the residence property. If Taxpayer's term interest has not earlier terminated, the QPRT status of the trust will cease as to any proceeds remaining on the earlier to occur of: (A) the second anniversary of the date of the damage, destruction or involuntary conversion of the residence property and (B) the date on which the repair or rebuilding of the residence property is completed or the trust acquires a replacement residence. Paragraph 1(g) governs the disposition of any and all proceeds as to which such cessation occurs.

Paragraph 1(g) provides that if the QPRT status of the trust ceases as to any portion or all of its assets, the trustee, in accordance with applicable federal law, will convert and thereafter administer, the assets into a separate Annuity Trust in which Taxpayer's interest meets all requirements of applicable federal law for a qualified annuity interest. Each conversion will be made within thirty days after the date on which QPRT status ceases as to any portion or all of the assets of the trust.

Paragraph 1(h) provides that the trust shall terminate on the earlier to occur of: (i) the twelfth anniversary date of the trust and (ii) the date of Taxpayer's death.

Paragraph 1(i) provides that if the trust terminates on the twelfth anniversary date of the trust, the trustee will apportion all of its assets that remain after any distributions or disbursements required under Paragraphs 1(a) and 1(d) in such manner that one equal share will be apportioned to each of Taxpayer's children, then living, and one equal share, per stirpes, among the lineal descendants, then living, of any child of Taxpayer who is then deceased.

Paragraph 1(j) provides that if the trust terminates at Taxpayer's death, the trustee will distribute or apply all assets that remain after any distributions or disbursements required under Paragraphs 1(a) and 1(d) as Taxpayer designated in Taxpayer's last Will executed at any time after the date of and expressly referring to the trust. If not disposed of through Taxpayer's will, then remaining assets will be distributed to Taxpayer's wife, if living, if not, then disposed of in accordance with Paragraph 1(i) as if the twelfth anniversary of the date of the trust had occurred on the date of and just before Taxpayer's death.

Paragraph 2 provides that any assets as to which a conversion occurs under Paragraph 1(g) are to be held as a separate Annuity Trust for Taxpayer's benefit as annuitant for the unexpired portion of his term interest. The Annuity Trust is to be administered in accordance with all requirements of applicable federal law for a trust in which the term interest is a qualified annuity interest.

You have requested the following rulings: (1) Property, which Taxpayer will transfer to Trust, meets the requirements of a personal residence as defined in § 25.2702-5(c)(2)(ii), and (2) the Trust's provisions satisfy the requirements of § 25.2702-5(c) and the Taxpayer's transfer qualifies as a transfer to a QPRT.

Section 280A(d)(1) provides that a taxpayer uses a dwelling unit during the taxable year as a residence if he uses such unit (or portion thereof) for personal purposes for a number of days which exceeds the greater of (A) 14 days, or (B) 10 percent of the number of days during such year for which such unit is rented at a fair rental.

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 which is a qualified interest shall be determined under § 7520.

Section 2702(a)(3)(A)(ii) provides that § 2702(a)(2) does not apply to any transfer if the 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 this section. A transfer in trust meets the requirements of this section only if the trust is a personal residence trust (as defined in paragraph (b) of this section). 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 a qualified personal residence trust is a trust meeting all the requirements of § 25.2702-5(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.

Section 25.2702-5(c)(2)(i) provides that for the purposes of § 25.2702-5(c), a personal residence of a term holder is either (A) the principal residence of the term holder (within the meaning of § 1034); (B) one other residence of the term holder (within the meaning of § 280A(d)(1) but without regard to § 280A(d)(2)); or (C) 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 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, except as otherwise provided in paragraphs (c)(5)(ii) and (c)(8) of this section, 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 paragraph (c)(7)(i) of this section) as a personal residence of the term holder (the "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)(7)(i) provides that the governing instrument must provide that a trust ceases to be a qualified personal residence trust 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 (i) the governing instrument must provide that, within thirty days after the date on which the trust has ceased to be a qualified personal residence trust with respect to certain assets, either, (A) the assets be distributed outright to the term holder; (B) the assets be 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; or (C) in the trustee's sole discretion, the trustee may elect to comply with either paragraph (C)(8)(i)(A) or (B) of this section pursuant to their terms; and (ii)(A) for assets subject to this paragraph (c)(8) 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 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.

Based upon the facts submitted and representations made, the size of Property is comparable to that of nearby properties used for residential purposes. Accordingly, for purposes of § 25.2702-5(c)(2)(ii), Property includes adjacent land not in excess of that which is reasonably appropriate for residential purposes (taking into account the residence's size and location). In addition, the appurtenant structures located on Property are used by Taxpayer for residential purposes. Therefore, we conclude that Property is 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, as submitted, contains all provisions required by § 25.2702-5(c) and thus meets the requirements of a qualified personal residence trust. Accordingly, Taxpayer's transfer will qualify as a transfer to a qualified personal residence trust.

This ruling is based on the facts presented and the applicable law (including restrictive covenants) 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.

A copy of this letter should be attached to any gift, estate or generation-skipping transfer tax returns that you may file relating to this matter. A copy is enclosed for that purpose. Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

Sincerely,
Melissa Liquerman
Branch Chief, Branch 9
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy of this letter
Copy for section 6110 purposes