

This is in response to your March 14, 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, Father and Mother owned a residence outright. On Date 1, Father and Mother deeded their interest in that residence to Trust 1, established by Father. Trust 1 provides that Father will retain a term interest of x years to possess and occupy the personal residence held by Trust 1. At the expiration of the x year period, Trust 1 continues for the benefit of Father's issue. Article III of Trust 1 provides that the trustee may hold proceeds from the sale of the residence for a period not later than the earlier of two years from the date of sale, the expiration of the retained term, or the date on which a replacement residence is acquired. Under Article V of Trust 1, after the expiration of the retained term, upon the death of the second to die of Father and Mother, Trust 1 will terminate and be distributed per stirpes to Father's issue in complete liquidation of Trust 1. Father is serving 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) of the Gift Tax Regulations. In Year 1, Father reported the transfer of the residence to Trust 1 on Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. In Year 2, Trust 1 sold the residence held in the trust. In Year 2, the trustee used the cash proceeds from the sale and cash contributed by Father to purchase Residence. See § 25.2702-5(c)(5)(i)(A)(1)(iv). In Year 3, Father reported the cash transfer to Trust 1 on Form 709.

On Date 2, Father as Settlor and Trustee, with the joinder and consent of Father's children, Son, Daughter 1, and Daughter 2, (collectively known as Children) executed Modification to modify Article V of Trust 1. Modification retains the original terms of Article V but adds a further provision that, upon the expiration of the retained term (Father's term 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 a principal residence.

On Date 3 (x years after Date 1), Father's term interest in Residence expired. Upon the receipt of a favorable letter ruling from the Internal Revenue Service, pursuant to Modification, the remainder interest in Residence will be conveyed by warranty deed from Trust 1 to Son, Daughter 1 and Daughter 2.

On or before Date 4, Children will create an irrevocable trust, Trust 2. Article I, Section A of Trust 2 provides that Children desire to transfer a y year term interest to possess and occupy Residence to Father and Mother (collectively known as Beneficiary) (or, upon conversion to an annuity trust, to transfer the annual annuity

amount, for y year). Children will convey Residence to trustee by warranty deed, delivered to the trustee of Trust 2 from Children 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 trustee of Trust 2.

Article V of Trust 2 provides that upon the death of either Beneficiary during the term, Residence and all income shall continue for any surviving Beneficiary; if none, Residence shall revert to and be distributed outright to Children. Upon expiration of the term, the term interest shall expire and the trust shall liquidate by distribution of the entire trust estate to the individuals who are Children, as tenants in common, or per stirpes to the issue of one of the deceased Children.

You have requested a ruling that §§ 2702(a)(1) and 2702(a)(2) will not apply to Children's 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 (QPRT) (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 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.

In this case, based on the facts submitted and the representations made, we conclude that §§ 2702(a)(1) and 2702(a)(2) will not apply to Children's 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), and assuming the purchase of Residence as a replacement satisfied the requirements under § 25.2702-5(c)(5)(i)(A)(1)(iv).

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 Father or Mother 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) provides that it may not be used or cited as precedent.

Sincerely,

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