

Mother paid a gift tax in Year 1 for the value of the remainder interest for the children.

As of Date 2 (8 years after Date 1), Mother's term interest in Residence expired and the remainder interest in Residence passed to Son 1 and Son 2. Mother is currently leasing Residence from Son 1 and Son 2.

Son 1 and Son 2 (collectively known as Settlor) intend to create an irrevocable trust, Trust 2, to which they will transfer their interest in Residence. Article I, Section A of Trust 2 provides that the Settlor desires to transfer a one year term interest to possess and occupy Residence to Mother or, upon conversion to an annuity trust, to transfer the annual annuity amount, for one year. Settlor conveys the Residence to trustee by warranty deed, delivered to the trustee of Trust 2 from Settlor 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. Son 1 and Son 2 will serve as trustee of Trust 2.

Article V of Trust 2 provides that upon the death of Settlor during the term, the residence and all income and principal of the trust estate shall be distributed to Settlor's estate. Upon expiration of the term, the term interest shall expire and the trust shall liquidate by distribution of the entire trust estate to Settlor.

You have requested a ruling that Trust 2 is a qualified personal residence trust within the meaning of § 25.2702-5(c).

LAW AND ANALYSIS

Section 2702(a)(1) of the Internal Revenue Code 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 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) 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 (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(51) of Rev. Proc. 2007-3, 2007-1 I.R.B. 108, 115, provides that rulings will not ordinarily be issued on whether a trust with one term holder 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 operates consistent with the terms of the trust instrument and is a valid trust under local law.

In this case, because of the unusual facts presented, it is appropriate to issue a ruling whether Trust 2 qualifies as a QPRT. Assuming Residence meets the requirements of a personal residence under § 25.2702-5(c)(2), we conclude that the terms of Trust 2 satisfy the requirements for a QPRT as set forth in § 25.2702-5(c) and, therefore, Settlor's transfer of Residence to Trust 2 qualifies under the exception in § 2702(a)(3)(A)(ii).

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 Mother under section 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) of provides that it may not be used or cited as precedent.

Sincerely,

Lorraine Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes