

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

December 19, 2001

**LEGEND**

Configuration =

Property =

Taxpayers =

Dear

This is in response to your letter dated September 19, 2000, and subsequent correspondence, in which you requested rulings concerning Taxpayers' proposed subdivision of Property into Lot A and Lot B and subsequent transfer of Taxpayers' individual one-half interests in Lot A into proposed Qualified Personal Residence Trusts ("QPRTs").

The facts and representations submitted are summarized as follows. Property consists of an approximately acre parcel that Taxpayers own and occupy as their principal residence. Property is improved by a main house with an adjacent root cellar, a detached garage, an adjacent , a , a , and a residence. When family and friends visit Taxpayers, they are permitted to occupy the adjacent cottage for no rent. Taxpayers rent the residence to Property's former and space in the barn to a for storage and commercial purposes. In addition, Taxpayers permit a farmer to farm part of Property to qualify approximately acres of Property for a reduced local real estate tax rate.

Taxpayers propose to subdivide Property into Lot A and Lot B and transfer their one-half interests in Lot A to QPRTs, the material terms of which will be identical. Taxpayers represent that Lot A will consist of approximately acres in Configuration. Lot A will contain the following structures: (i) the main house with an adjacent root cellar; (ii) the detached garage; (iii) the adjacent cottage; and (iv) the . Taxpayers represent that they will continue to occupy Lot A as their principal residence. Taxpayers represent that no rental or farming activity will take place on Lot A during the term of the proposed QPRTs. Finally, Taxpayers represent that Lot B will consist of the

PLR-138692-01

remaining approximately      acres. The barn and the      residence will be situated on Lot B. Rental and farming activity may continue to take place on Lot B.

In connection with this proposed subdivision and transfer into proposed QPRTs, you have requested the following rulings:

1. Lot A and its structures constitute a personal residence within the meaning of section 2702(a)(3)(A)(ii) of the Internal Revenue Code and 25.2702-5(c)(2) of the Gift Tax Regulations.
2. Taxpayers' transfers of their contingent remainder interests in their proposed QPRTs to their children will be completed gifts for gift tax purposes, the value of which will be equal to the fair market value of Taxpayers' interests in Lot A, reduced by: (a) the present value of Taxpayers' retained income interests in Lot A, determined under section 7520; and (b) Taxpayers' retained contingent reversions in Lot A, determined under section 7520.

#### RULING 1:

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 section 2701(e)(2)) shall be determined as provided in section 2702(a)(2).

Section 2702(a)(2)(A) provides that the value of any retained interest which is not a qualified interest shall be treated as being zero.

Section 2702(a)(2)(B) provides that the value of any retained interest which is a qualified interest shall be determined under section 7520.

Section 2702(a)(3)(A)(ii) provides that section 2702 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(c)(2)(i) provides that, for purposes of section 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 section 1034); (B) one other residence of the term holder (within the meaning of section 280A(d)(1) but without regard to section 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 term personal residence does not

PLR-138692-01

include any personal property (e.g., household furnishings).

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 a personal residence if, during any period not occupied by the term holder, its primary use is other than as a residence.

Taxpayers represent they will continue to occupy Lot A and use its structures as their principal residence. Taxpayers further represent that no rental or farming activity will take place on Lot A during the term of the proposed QPRTs. Accordingly, we conclude that Lot A and its structures constitute a personal residence within the meaning of section 2702(a)(3)(A)(ii) and section 25.2702-5(c)(2). Except as specifically ruled herein, we express no opinion regarding whether the proposed QPRTs will meet the requirements for qualified personal residence trusts under section 25.2702-5(c).

#### RULING 2:

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511(a) provides that the gift tax imposed by section 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2702(a) provides that the value of an interest in trust retained by the transferor shall be determined under section 7520 if the retained interest is a qualified interest as defined in section 2702(b) or shall be zero if the retained interest is not a qualified interest. However, section 2702(a)(3) provides that section 2702(a) does not apply in the case of a transfer in trust which meets the requirements for a qualified personal residence trust.

Section 25.2511-2(b) provides that, as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or the benefit of another, the gift is complete.

Section 25.2512-5(d)(2) provides that, when the donor transfers property in trust or otherwise and retains an interest therein, generally, the value of the gift is the value of the property transferred less the value of the donor's retained interest. However, if the donor transfers property after October 8, 1990, to or for the benefit of a member of the donor's family, the value of the gift is the value of the property transferred less the value of donor's retained interest as determined under section 2702.

PLR-138692-01

If Taxpayers properly execute the proposed QPRTs and the proposed QPRTs qualify as qualified personal residence trusts under section 25.2702-5(c), Taxpayers' transfers of their contingent remainder interests in the QPRTs will be completed gifts for gift tax purposes. The value of Taxpayers' gifts will be equal to the fair market value of Taxpayers' interests in Lot A transferred to their QPRTs, minus: (a) the present value of Taxpayers' retained income interests in Lot A, determined under section 7520; and (b) the present value of Taxpayers' retained contingent reversions in Lot A, determined under section 7520.

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. 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. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the Taxpayers.

The rulings contained in this letter are based upon information and representations submitted by Taxpayers 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.

Sincerely yours,  
By: James F. Hogan  
Senior Technician Reviewer, Branch 9  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: Copy of this letter for section 6110 purposes