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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-161853-02

Date:

OCTOBER 14, 2003

Re:

LEGEND:

A -  
B -  
Corporate  
Trustee -  
Trust -  
Date 1 -

Dear :

This is in response to your letter dated September 5, 2003, and prior correspondence, requesting gift, estate, and generation-skipping transfer (GST) tax rulings regarding a purchase by Trust of a life insurance policy.

On Date 1, A created and funded an irrevocable trust, Trust. Under the terms of Trust, the co-trustees (B, A's spouse, and Corporate Trustee) have absolute discretion to distribute income and corpus to A's children and their descendant's for such person's care, health, education, maintenance, support, purchase or improvement of home, to establish a professional practice, or acquire an interest in a business. Upon the death of A, or earlier if the Trust fails to qualify as a grantor trust for federal income tax purposes, the trustees are to segregate any shares of stock of a corporation which is an S corporation for federal income tax purposes. The segregated stock is to be held in separate trusts (hereinafter referred to as separate trusts), one trust for each child or deceased child of A. The remainder of any Trust assets are to be held in trusts (hereinafter referred to as remainder trusts), one trust for each child or deceased child of A.

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Under the terms of the separate trusts, the net income is to be paid quarterly to the designated child (or in the case of a trust created for a deceased child, the child's descendants). The trustees also have absolute discretion to distribute corpus to such child (or child's descendant's as the case may be) for care, health, education, maintenance, support, purchase or improvement of home, to establish a professional practice, or acquire an interest in a business. Upon the death of a child, any remaining corpus that has not been appointed pursuant to a testamentary special power of appointment, is to be held in further trust, under terms and conditions described above, for the child's descendant's.

Under the terms of the remainder trusts, the trustees have absolute discretion to distribute income and corpus to A's child and that child's descendants for such person's care, health, education, maintenance, support, purchase or improvement of home, to establish a professional practice, or acquire an interest in a business. Upon the death of a child, any remaining corpus that has not been appointed pursuant to a testamentary special power of appointment, is to be held in further trust, under terms and conditions described above, for the child's descendant's.

In the case of the Trust, separate trusts, and remainder trusts, no income or principal may be distributed for support or maintenance of a beneficiary if A or B is legally obligated to support such beneficiary.

Under the terms of Trust, the Corporate Trustee may be replaced by the vote of three designated advisors. Under Article XVII, a trustee, by written instrument, may renounce in whole or in part any one or more powers, authorities or discretion given by Trust or by law to that trustee. Under Article XXIV, A may not be appointed trustee, nor may A remove a trustee or appoint a successor trustee.

Trust purchased a joint and survivor life insurance policy on the lives of A and B. It is represented that Trust will make ten annual premium payments and that the Trust should have adequate income each year to fully pay the annual premium. B, as trustee, also executed a written instrument renouncing her right as trustee to: (1) change the beneficiary of the policy; (2) revoke any change of beneficiary; (3) assign the policy; (4) revoke any assignment of the policy; In addition, B has renounced any right to make contributions to Trust and to appoint a successor advisor.

It is represented that A funded Trust, but that B has consented to treat the gift as made one-half by A and one-half by B under § 2513. Further, it is represented that sufficient GST exemption under § 2631 was allocated to Trust, such that Trust has a zero inclusion ratio for GST tax purposes.

You have requested the following rulings:

(1) The purchase by Trust of the life insurance policy with trust assets will not be a treated as a gift by A or B.

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(2) B possesses no incidents of ownership over the life insurance policy and the proceeds of the policy will not be included in A or B's gross estate under section 2042 of the Internal Revenue Code.

(3) The purchase and maintenance by the Trust of the life insurance policy will not create a new transferor for purposes of section 2652 of the Code and will have no effect on the Trust's inclusion ratio for GST tax purposes.

### Gift Tax Rulings

Section 2501(a)(1) provides for the imposition of a gift tax on the transfer of property by gift. Section 2511(a) provides that the gift tax applies to a transfer by way of gift 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 25.2511-2(b) of the Gift Tax Regulations provides that a gift of property is complete to the extent the donor has so parted with dominion and control as to leave him no power to change its disposition, whether for his own benefit or for the benefit of another.

Section 25.2512-8 provides, in part, that transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor.

In the present case, neither A or B have any beneficial interest in Trust. Trust has purchased the life insurance policy using funds held in trust. Further, it is represented that neither A nor B will make any additional transfers to Trust for the purpose of paying premiums on the policy. Under these circumstances, we conclude that the purchase by Trust of the life policy with Trust assets will not be treated as a gift by A or B.

### Estate Tax Rulings

Section 2042(1) provides for the inclusion in the gross estate the proceeds of insurance on the decedent's life receivable by the decedent's estate.

Section 2042(2) provides that the value of a decedent's gross estate shall include the proceeds of all life insurance policies on the decedent's life receivable by beneficiaries, other than the executor of the decedent's estate, to the extent that the decedent possessed at his death any incidents of ownership exercisable either alone or in conjunction with any other person. An incident of ownership includes a reversionary

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interest arising by the express terms of the instrument or by operation of law only if the value of such reversionary interest exceeds 5 percent of the value of the policy immediately before the death of the decedent.

Section 20.2042-1(c)(2) of the Estate Tax Regulations provides that "incidents of ownership" is not limited in its meaning to ownership of a policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy.

Section 20.2042-1(c)(4) provides that a decedent is considered to have an incident of ownership in an insurance policy on his life held in trust if, under the terms of the policy, the decedent, either alone or in conjunction with another person or persons, has the power, as trustee or otherwise, to change the beneficial ownership of the policy or its proceeds or the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust.

In Rev. Rul. 84-179, 1984-2 C.B. 195, the decedent transferred a life insurance policy on his life to decedent's spouse and subsequently, on the spouse's death, reacquired incidents of ownership over the policy as the trustee of a testamentary trust established by the spouse. The ruling holds that under these circumstances, the decedent will not be considered to possess incidents of ownership in the policy for purposes of section 2042(2), provided the decedent did not furnish consideration for maintaining the policy and could not exercise the powers for the decedent's personal benefit. The ruling further holds that the result would be the same if the decedent, acting as trustee, purchased a policy as a trust asset, did not contribute assets to the trust or maintain the policy with personal assets and could not exercise the powers for personal benefit. The ruling states, however, that where the decedent's powers over the policy could have been exercised for the decedent's benefit, the decedent would be treated as possessing incidents of ownership in the policy without regard to how those powers were acquired and without consideration of whether or not the decedent was the source of the funds used to pay the premiums. See Estate of Fruehauf v. Commissioner, 427 F.2d 80 (6th Cir. 1970).

In the present case, Trust purchased and owns the life insurance policy. Trust is also the designated beneficiary of the policy proceeds and Trust will also make all future premium payments from Trust assets. Accordingly, we conclude that A will not possess any incidents of ownership, under § 2042(2) and § 20.2042-1(c)(2), in the policies owned by Trust. Further, we conclude that the proceeds of the policies payable to the trustee of Trust will not be includible, under § 2042(2) in the gross estate of A.

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Further, in the present case, it is represented that B has not transferred any property to Trust, nor will B make any transfers to Trust in the future to maintain the policy. Accordingly, notwithstanding that B is a trustee of Trust, we conclude that B will not possess any incidents of ownership, under § 2042(2) and § 20.2042-1(c)(2), in the policies owned by Trust and the proceeds of the policies payable to the trustee of Trust will not be includible, under § 2042(2) in the gross estate of B. Rev. Rul. 84-179.

### Generation-Skipping Transfer Tax Issues

Section 2601 imposes a tax on every generation-skipping transfer made by a transferor to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986.

Section 2602 provides that the amount of tax imposed by § 2601 is the taxable amount multiplied by the applicable rate. Section 2641 provides that the applicable rate is the product of the maximum Federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2642(a) provides, in part, that the inclusion ratio with respect to any property transferred in a generation-skipping transfer will be equal to the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. The applicable fraction, generally, is a fraction the numerator of which is the amount of the GST exemption allocated to the trust, and the denominator of which is the value of the property transferred to the trust.

Section 2631 provides that for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of \$1 million (adjusted for inflation under § 2631(c)) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Under § 2652(a)(1) and § 26.2652-1(a)(1), generally, the transferor for purposes of the GST tax is the individual with respect to whom the property was last subject to Federal estate or gift tax. Section 2652(a)(2) and § 26.2652-1(a)(4) provide that, if, under section 2513, one-half of a gift is treated as made by an individual and one-half is treated as made by the spouse of the individual, then for purposes of the GST tax, each spouse is treated as the transferor of one-half of the entire value of the property transferred by the donor spouse, regardless of the interest the electing spouse is actually deemed to have transferred under § 2513.

In the present case, A and B have treated A's transfer to Trust, as made one-half by each under § 2513. Under § 2652(a)(2), if the requirements for signifying consent

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under § 2513(b) were satisfied, A and B are each deemed the transferor for Federal GST tax purposes of one-half of A's gift to Trust. It is represented that A and B have each allocated sufficient GST exemption to the Trust such that Trust will have an inclusion ratio of zero for GST tax purposes. As noted above, it is represented that the insurance policy was purchased with current trust assets and all future premium payments will be paid from Trust assets. Accordingly we conclude that the purchase of the insurance policy by Trust, will not effect the identity of the transferors of Trust for GST tax purposes, nor will the purchase effect the inclusion ratio with respect to Trust.

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.

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 requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

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George Masnik  
Branch Chief, Branch 4  
(Office of Associate Chief Counsel  
Passthroughs and Special Industries)

Copy enclosed for Section 6610 purposes

CC: