Internal Revenue Service

Department of the Treasury
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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:PSI:4 – PLR-111603-99
Date: APRIL 09, 2007

Re:

Legend:
Taxpayer A
Taxpayer B
Trust 1

Trust 2

Trust 3

Trust 4

Decedent
Partnership
Date 1
Date 2
Date 3
Date 4
Date 5
$X
State
Policy
Policy 2

Dear :

This is in response to your letter, dated May 22, 2006, and prior correspondence requesting several rulings concerning the gift and estate consequences of a split-dollar life insurance arrangement.

Taxpayers A and B, husband and wife, have four adult children. On Date 1, Taxpayers' four children each established an irrevocable trust, Trusts 1-4 (collectively "Trusts"), for the sole benefit of each child's respective descendants. Taxpayers A and B have no beneficial interest in the Trusts. An unrelated third party is the current trustee of the Trusts. In addition, each Taxpayer has renounced the right to serve as trustee of the Trusts.

On Date 2, a trust created under the will of Decedent for the benefit of Taxpayer A loaned $X to each Trust. The Taxpayers represent that they have made no contributions to the Trusts and will make no contributions to the Trusts in the future.

The Trusts purchased a second-to-die life insurance policy (Policy) on the lives of Taxpayers A and B. The Policy lists the Trusts as joint owners and each trust is designated as the beneficiary of 25 percent of the policy proceeds.

On Date 3, Taxpayers and trustees of the Trusts formed a limited partnership under State law (Partnership). The Taxpayers each own a 1% general partnership interest and a 47% limited partnership interest. The Trusts each own a 1% limited partnership interest. On Date 4, prior to January 28, 2002, the Partnership and the Trusts entered into a collateral assignment split-dollar life insurance agreement (Agreement). Under the Agreement, during the joint lives of Taxpayers A and B, the Trusts will pay that portion of the annual premium due equal to the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. After the death of the first insured to die, the Trusts will pay the portion of the annual premium equal to the lesser of (i) the applicable amount provided in the P.S. 58 tables set forth in Rev. Rul. 55-747, 1955-2 C.B. 228 or (ii) the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. The Partnership will pay the balance of any premium amount. The Agreement further provides that upon the death of the last to die of Taxpayer A and Taxpayer B, Partnership is to be paid from the Policy proceeds an amount equal to the greater of (i) the cash surrender value of the Policy immediately prior to the death of the survivor of the last to die of Taxpayer A and Taxpayer B, or (ii) the net premiums paid by the Partnership. In the event the Agreement is terminated prior to death of the last to die of Taxpayer A and Taxpayer B, then the Partnership is entitled to receive an amount equal to the cash surrender value of the Policy.

To secure the Partnership's right to repayment, the Trusts executed a collateral assignment of the Policy to the Partnership. The collateral assignment provides that the

Trusts shall retain and possess all incidents of ownership, including, the sole and exclusive right to surrender or cancel the policy for its cash surrender value; the right to designate and change the beneficiary of the death benefits; the right to elect and exercise any optional mode of settlement or dividend payment permitted by the Policy; and the sole right to obtain loans secured by the Policy or make withdrawals from the Policy.

It is further represented that on Date 5, a date after September 17, 2003, while Taxpayer A and Taxpayer B were alive, the Agreement was terminated. At the time Agreement was terminated, the Policy had a cash surrender value of zero. Immediately after the Agreement was terminated, as part of a negotiated agreement with the insurance company, the insurance company waived the surrender charges with respect to the Policy, and the Policy was exchanged by the life insurance company for a new policy (Policy 2), a fully paid up policy but with a significantly lower death benefit. The Trusts are listed as the joint owners of Policy 2 and each Trust is listed as the designated beneficiary of 25% of the proceeds.

You have requested the following rulings:

1. The payments prior to Date 5 by the Partnership of the portion of the premium for which it was responsible under the Agreement did not constitute deemed gifts to the Trusts by the Taxpayers.

2. No portion of the proceeds of the Policy payable to the Trusts will be includible in the gross estate of the second to die of the Taxpayers under either section 2036 or 2042.

Ruling Request 1:

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by section 2501 shall apply 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(b) provides that, where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift. Under section 25.2511-1(b)(1), the transfer of property by a corporation to an individual constitutes a gift from the shareholders of the corporation to the individual.

Rev. Rul. 64-328, 1964-2 C.B. 11, considers a situation where an employer and employee enter into a "split-dollar" life insurance arrangement, in which the employer pays the portion of the premiums equal to the increases in the cash surrender value and the employee pays the balance of the premiums, if any. On the employee’s death, the

employer is entitled to receive an amount equal to the policy's cash surrender value or, at a minimum, an amount equal to the employer's premium payments. The designated beneficiary is entitled to receive the remainder of the proceeds. The ruling concludes that the substance of the transaction is that the employer provides the funds representing the investment element in the contract. The earnings on these funds would ordinarily inure to the employer. However, the earnings on the investment element in the contract are used to provide all, or a portion, of the cost of the employee's insurance protection at either no cost to the employee or a cost less than the employee would pay absent the arrangement. Thus, the employee receives an economic benefit that is includible in gross income. The value of the economic benefit received by the employee that is included in income is an amount equal to the cost of one-year term life insurance protection to which the employee is entitled from year to year less the portion of the cost of insurance protection provided by the employee (if any). The ruling also concludes that the same income tax result follows if the transaction is cast in some other form that results in a similar benefit to the employee.

Rev. Rul. 64-328 further provides that the cost of life insurance protection as shown in the table contained in Rev. Rul. 55-747, 1955-2 C.B. 228 (P.S. 58 Rates) may be used to compute the value of the one-year term life insurance protection provided to the employee. Rev. Rul. 66-110, 1966-1 C.B. 12, amplified Rev. Rul. 64-328, and held that the insurer's published premium rates for one-year term insurance may be used to measure the value of the current life insurance protection if those rates are available to all standard risks and are lower than the P.S. 58 rates. Rev. Rul. 67-154, 1967-1 C.B. 11, amplified Rev. Rul. 66-110 by holding that an insurer's published term rates must be available for initial issue insurance (as distinguished from rates for dividend options) in order to be substituted for the P.S. 58 rates set forth in Rev. Rul. 55-747.

Rev. Rul. 76-490, 1976-2 C.B. 300, considers a situation where an employer makes premium payments on a group term life insurance policy that the insured employee irrevocably assigned to an irrevocable trust. The ruling concludes that for gift tax purposes, each premium payment made by the employer is deemed an indirect transfer by the employee to the assignee of the policy (the irrevocable trust) that is subject to gift tax under section 2501. Under the facts in the ruling the employer made all premium payments on the policy.

In Situation 2 of Rev. Rul. 78-420, 1978-2 C.B. 67, a corporation enters into an split-dollar life insurance arrangement with an employee's spouse pursuant to which the corporation agrees to pay that part of the annual premiums on a policy insuring the employee's life to the extent of the annual increase in the cash surrender value. The spouse, who owns the policy and has the right to select the beneficiary, pays the balance of the premiums. The corporation is entitled to receive, out of the proceeds of the policy upon the death of the employee, an amount equal to the cash surrender value

of the policy or at least an amount equal to the funds it has provided for premium payments. The ruling concludes that the arrangement is subject to the rules of Rev. Rul. 64-328, and therefore, the employee must include in gross income the value of the life insurance protection provided by the corporation, less the portion of the premium paid by the spouse. Further, in accordance with Rev. Rul. 76-490, the value of the life insurance protection that is included in the employee's gross income is deemed to be transferred from the employee to the spouse for purposes of section 2511 and is subject to federal gift tax under section 2501.

Notice 2001-10, 2001-1 C.B. 459, revoked Rev. Rul. 55-747 and provided that, subject to a transitional rule in Part IV. B.1, the Treasury Department and the Internal Revenue Service would no longer treat or accept the P.S. 58 rates set forth therein as a proper measure of the value of current life insurance protection for Federal tax purposes.

Notice 2002-8, 2002-1 C.B. 398, revoked Notice 2001-10. Part III.1 of Notice 2002-8 provides that, pending the consideration of comments and publication of further guidance, Rev. Rul. 55-747 remains revoked, as provided in and with the transitional relief described in Part IV.B.1 of Notice 2001-10.

Notice 2002-8, Part III.2, provides that in the case of split-dollar life insurance arrangements entered into before the effective date of future guidance, taxpayers can use the premium rates in Table 2001 to determine the value of current life insurance protection on a single life that is provided under a split-dollar life insurance arrangement. Notice 2002-8 also provides that taxpayers should make appropriate adjustments to the Table 2001 rates if the life insurance protection covers more than one life.

Notice 2002-8, Part III.3, provides that for arrangements entered into before the effective date of future guidance (and before January 29, 2002), taxpayers may, to the extent provided by Rev. Rul. 66-110, as amplified by Rev. Rul. 67-154, continue to determine the value of current life insurance protection by using the insurer's lower published premium rates that are available to all standard risks for initial issue one-year term insurance.

Notice 2002-8, Part IV.2, provides generally that, for split-dollar life insurance arrangements entered into before the date of publication of final regulations, in cases where the value of current life insurance protection is treated as an economic benefit provided by a sponsor to a benefit person under a split-dollar life insurance arrangement, the Service will not treat the arrangement as having been terminated (and thus will not assert that there has been a transfer of property to the benefited person by reason of termination of the arrangement) for so long as the parties to the arrangement

continue to treat and report the value of the life insurance protection as an economic benefit provided to the benefited person.

Final regulations regarding the income, employment and gift taxation of split dollar life insurance arrangements were promulgated in T.D. 9092, 68 F.R. 54336 (September 17, 2003), 2003-2 C.B. 1055. These regulations apply to any split-dollar life insurance arrangement (as defined in the regulations) entered into after September 17, 2003. The regulations also provide that if an arrangement is entered into on or before September 17, 2003, and is materially modified after September 17, 2003, the arrangement is treated as a new arrangement entered into on the date of the modification. Section 1.61-22(j).

Rev. Rul. 2003-105, 2003-2 C.B. 696, declared as obsolete Rev. Rul. 79-50, 1979-1 C.B. 139, Rev. Rul. 78-420, Rev. Rul. 66-110 (except as provided in Part III.3 of Notice 2002-8), and Rev. Rul. 64-328. However, Rev. Rul. 2003-105 also provides that in the case of any split-dollar life insurance arrangement entered into on or before September 17, 2003, taxpayers may continue to rely on these revenue rulings to the extent described in Notice 2002-8, but only if the arrangement is not materially modified after September 17, 2003.

In the instant case, the Agreement was executed prior to September 17, 2003. On Date 5, after September 17, 2003, the parties terminated the Agreement and the insurance company that issued the Policy exchanged the Policy for Policy 2. The rules promulgated in T.D. 9092 do not apply with respect to the Agreement because the Agreement was entered into before September 18, 2003, and the Date 5 termination of the Agreement did not result in the Taxpayers entering into a new split-dollar life insurance arrangement (as defined in the regulations).

We conclude that the payment of the Policy premiums by the Partnership prior to Date 5, pursuant to the terms of the Agreement, did not result in a gift by the Taxpayers under section 2511, provided that the amounts paid by the Trusts for the life insurance benefit that the Trusts received under the Agreement was at least equal to the amount prescribed under Rev. Rul. 64-328, Rev. Rul. 66-110, and Notice 2002-8.

We specifically express no opinion concerning the federal gift tax consequences of the termination of the Agreement, followed by the issuance of Policy 2 to the Trusts. We also express no opinion concerning the federal gift tax consequences between Taxpayer A and B of the second-to-die polices.

Ruling Request 2:

Section 2035(a) provides that if the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death and the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2036(a) of the Code provides that the value of the decedent's gross estate includes the value of all property to the extent of any interest transferred by the decedent in which the decedent has retained for life either a right to receive the income from the property, or the right to designate the persons who will possess or enjoy the property or the income from the property.

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 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 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, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes 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.

Any incidents of ownership in a life insurance policy held by the partnership are effectively held by the partners as individuals. Rev. Rul. 83-147,1983-2 C.B. 158.

In the instant case, Taxpayers did not retain any interests in the Trusts that would cause the corpus of the respective trusts to be included in the Taxpayers' gross estates under section 2036. Further, the Partnership held no incidents of ownership in the Policy under the terms of the Agreement, as described above. See, Rev. Rul. 79-129, 1979-1 C.B. 306. Thus, no incidents of ownership in the Policy or Policy 2 will be attributed to Taxpayers as a result of their ownership interest in the Partnership, nor would Taxpayers be treated as relinquishing any incidents of ownership in the Policy or

Policy 2 for purposes of section 2035, if either Taxpayer was to die within three years of the termination of the Agreement on Date 5. No portion of Policy or Policy 2 will be includible in the gross estate of the second to die of Taxpayer A or Taxpayer B.

Under a power of attorney on file with this office, we are sending a copy of this letter to Taxpayers A and B.

Except as expressly set forth in this letter, we express no opinion concerning the Federal tax consequences of this transaction under any provision of the Internal Revenue Code (including for example, section 61).

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,

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

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: