Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-109971-06
Date: JUNE 21, 2007

Re:

LEGEND:

Grantor	-
Child A	-
Child B	-
BA	-
Trust 1	-
Trust 2A	-
Trust 2B	-
Trust 3A	-
Trust 3B	-
Trust 4	-
Date 1	-
Date 2	-
Date 3	-
Date 4	-
Date 5	-
Date 6	-
Date 7	-
$X	-
X	-
X1	-
Y	-
Y1	-
Z	-
Company A	-
Company B	-
Company C	-
Company D	-

Bank -
Buy-Sell Agreement -

Policy 1 -
Policy 2 -
Policy 3 -
Policy 4 -
Policy 5 -
Policy 6 –
Policy 7 –
State1 -
State2 -
State 3 -

Dear :

This is in response to a letter dated May 2, 2007, and prior correspondence, submitted by your authorized representative, requesting rulings under §§ 2042 and 678 of the internal Revenue Code.

Grantor died on Date 1. On Date 2, prior to his death, Grantor created and funded a revocable trust, Trust 1. Under the terms of Trust 1, at the death of Grantor, the trustee is directed to distribute certain assets equally between two separate trusts for the benefit of Grantor's children, Child A and Child B.

In addition, on Date 3, Grantor created and transferred $X to each of two irrevocable trusts, Trust 2A and Trust 2B for the respective benefit of Child A and Child B, and their descendants. No additional contributions have been made to either trust. Under Trust 2A, the trustee is authorized to distribute all or part of the trust income and principal to provide for Child A's support. To the extent income is not distributed, it is to be accumulated for future distributions for Child A's support. The trustee may also make additional principal distributions for the support of Child A's spouse and descendants. Child A has the right to withdraw the full amount of each direct or indirect transfer to Trust 2A that constitutes a completed gift under § 2511. This power lapses at the end of each year to the extent that the lapse would not constitute the release of a general power of appointment under § 2514. At Child A's death, the trust corpus is to be distributed pursuant to Child A's exercise of a limited power to appoint the trust corpus to any person other than Child A's estate, his creditors, or the creditors of his estate.

Trust 2B contains substantially identical provisions, except that Child B is the primary beneficiary of that trust.

Company A is an active business incorporated in State 1, engaged in sales manufacturing and distribution. Company A owns a 99% limited partnership interest in Company C. Company C, a limited partnership, operates Company A's business in State 3. Company B, a limited liability company organized under the laws of State 2, manages the State 3 operations for Company C.

Currently, the outstanding stock of Company A is owned as follows: X percent of the outstanding stock is owned by Trust 3A, a revocable trust created by Child A on Date 4; Y percent of the outstanding stock is owned by Trust 3B, a revocable trust created by Child B on Date 5; Z percent of the outstanding stock is owned by Trust 4, a revocable trust created by BA, an unrelated business associate of Child A and Child B, on Date 6. BA acquired these shares under the terms of an employment agreement.

The outstanding membership interests in Company B are owned as follows: Trust 3A currently owns X1 percent of the outstanding membership interests in Company B; Trust 3B currently owns Y1 percent of the outstanding membership interests; Trust 1 owns the balance of the membership interests.

In addition, Child A, Child B and BA own life insurance policies pursuant to the terms of a buy-sell agreement covering Company A and Company B. Specifically, Child A currently owns Policy 1 insuring Child B's life and Policy 2 insuring BA's life. Child B owns Policy 3 on Child A's life and Policy 4 on BA's life. Trust 4 (BA's revocable trust) owns Policy 5, a joint life policy payable on the death of the survivor of Child A and Child B. In addition Trust 4 owns Policy 6 insuring the life of Child A and Policy 7 insuring the life of Child B.

On Date 7, Child A, Child B and BA, in their individual capacities, and in their capacities as officers, etc. of Company A and Company B and as trustees respectively of Trust 3A, Trust 3B and Trust 4, executed an amendment and restatement of the buy-sell agreement (Buy-sell Agreement) covering Company A and Company B. Article 3 of the Buy-sell Agreement governs the purchase of the corporate stock. Section 3.3 of the Buy-sell Agreement applies in the event of the death of a shareholder. Under Section 3.3(b), generally, on the death of a shareholder, if one or more of Policies 1-7 are maintained on the shareholder's life, then the proceeds of the policy or policies must be used by the surviving shareholders to purchase the deceased shareholder's stock in Company A and his or her membership interest in Company B, to the extent the proceeds do not exceed the fair market value of those interests (as that term is defined in the Agreement.) Under section 3.7(a)(1)-(3), Child A, Child B and BA may assign his or her rights and duties under Article 3 of Buy-sell Agreement to certain trusts with respect to which the respective shareholder is a grantor.

Section 1.6 and Section 5.1 authorize the establishment of an "Insurance LLC" which is defined as a limited liability company or other entity designated to hold insurance on the life of one or more shareholders for the purpose of satisfying the

obligation of one or more shareholders to purchase Company A stock. Further, Section 3.7(c) provides that the Insurance LLC will be the vehicle to secure use of life insurance proceeds under Section 3.3. Each shareholder that is required to buy or sell stock under Section 3.3 is required to sign an agreement instructing the Insurance LLC manager to disburse the proceeds of the relevant policy or policies as provided in Section 3.3.

In accordance with the terms of Buy-sell Agreement, Child A, Child B and BA propose to organize Company D, a State 2 limited liability company, and to execute a Company D Operating Agreement (Operating Agreement). Under Section 2.1, Child A, Child B and BA will each transfer to Company D their respective ownership interests in Policies 1-7. Company D will be designated as the owner and beneficiary of the policies.

Under section 2.2(b), Child A, Child B, and BA may assign their respective membership “rights and duties” with respect to Company D to certain trusts, including, for example Trusts 2A, 2B, 3A, 3B, and 4.

Under Section 2.3, the company will maintain a separate capital account for each member in a manner that complies with Treas. Reg. section 1.704-1(b)(2)(iv).

Under section 5.1 of the Operating Agreement, management of the company is vested in the Managers and not in the members. Bank, a national banking association, is designated as the initial manger of Company D. Under sections 5.1 and 6.5, the members may remove or select a replacement manager by majority vote of the members. Any replacement must be a corporate trustee or an individual who is bonded and who is not a related or subordinate party (as defined under section 672(e) of the Internal Revenue Code) with respect to the members or their assignees. Section 5.2 provides that, subject to the voting rights of the members, the manager shall have the power, on behalf of the company to do all things appropriate to carry out the business and affairs of the company. Section 12.43 (a) provides that in no event may an individual whose life is insured under any of Policies 1-7 have any right to vote on Company D’s exercise of incidents of ownership with respect to any of Polices 1-7 regardless of which member is insured under the Policy.

Under section 2.2(b) each member or his or her assignee is required to make contributions to the Company D equal to the premium on the insurance policies contributed by the member. The contribution will be allocated to the member’s capital account. Further, in accordance with section 2.3(b) of the Operating Agreement, on the death of an insured, the proceeds of the insurance policy or policies will be allocated to the capital account of the member who contributed the policy (or that member’s assignee.) Under section 4.1(b), the company will distribute the proceeds of the policy to the members in proportion to their respective capital accounts maintained with respect to that policy. However, such distribution will be made only if the Company

Manager determines that all obligations have been satisfied or are assured to be satisfied with respect to the policy under Agreement (i.e., the buy-sell agreement).

Section 9.2 provides that Company D will be dissolved on the occurrence of certain specified events, one of which is the written consent of all the members. On dissolution, the Manager is directed to distribute all insurance policies, to the extent possible, consistent with the intent of Buy-sell Agreement.

You have requested the following rulings:

1. That neither Child A, Child B, or BA will possess incidents of ownership under section 2042 of the Internal Revenue Code with respect to policies owned by Company D.
2. That under section 678, Trust 2A and 2B will be treated as grantor trusts.

Ruling Request 1

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 policy (or other instrument) or by operation of law only if the value of such reversionary interest exceeds 5% 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 the term "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.

Section 20.2042-1(c)(6) provides that, in the case of economic benefits of a life insurance policy on the decedent's life that are reserved to a corporation of which the decedent is the sole or controlling shareholder, the corporation's incidents of ownership will not be attributed to the decedent through stock ownership to the extent the proceeds of the policy are payable to the corporation. However, if any part of the

proceeds of the policy are not payable to or for the benefit of the corporation, and thus are not taken into account in valuing the decedent's stock holdings in the corporation for purposes of section 2031, any incidents of ownership held by the corporation as to that part of the proceeds will be attributed to the decedent through the stock ownership where the decedent is the sole or controlling shareholder.

In Estate of Knipp v. Commissioner, 25 T.C. 153 (1955), acq. in result, 1959-1 C.B. 4, aff'd on another issue, 244 F.2d 436 (4th Cir. 1957), cert. denied, 355 U.S. 827 (1957), a partnership in which the decedent was a 50% general partner, owned 10 insurance policies on the decedent's life at his death. The partnership paid the premiums on all of the policies, and the insurance proceeds were payable to the partnership. The court found that the partnership purchased the policies in the ordinary course of business and held that the decedent, in his individual capacity, had no incidents of ownership in the policies and, therefore, the policies were not includible in the decedent's gross estate under the predecessor to section 2042(2).

Rev. Rul. 83-147, 1983-2 C.B. 158, considers whether incidents of ownership in an insurance policy owned by a general partnership would be attributed to the insured general partner. In the revenue ruling, a general partnership obtained a whole life insurance policy on the life of one of its partners. The partnership made the premium payments in partial satisfaction of the insured partner's distributive share of partnership income and the insured partner's child was designated as the beneficiary of the policy. When the partner died, the face amount of the policy was paid to the child. The revenue ruling distinguishes Estate of Knipp, supra, on the basis that, in Estate of Knipp, the insurance proceeds were paid to the partnership and the inclusion of the proceeds in the gross estate under section 2042 would have resulted in "unwarranted double taxation" of a substantial portion of the proceeds because the proceeds were reflected in the value of decedent's partnership interest. In contrast, in the revenue ruling, the proceeds are payable to a third party for a purpose unrelated to the general partnership business, and thus, would not be included in the value of the partnership interest included in the gross estate. Accordingly, the ruling concludes that under these circumstances, the incidents of ownership are treated as held by the insured general partner in conjunction with the other partners. The ruling further states that the IRS does not agree with any implication in Estate of Knipp that incidents of ownership possessed by a partnership should not be attributed to an insured partner when the proceeds are payable other than to or for the benefit of the partnership.

In the present case, the terms of the Operating Agreement preclude Child A, Child B, and BA from exercising any control over the management and investment decisions of Company D or from taking part in the control of Company D’s business, to sign for or bind Company D, to participate in the day-to-day affairs and management of Company D, or to take part in or vote in the management and operations of Company D. Further, an individual member whose life is insured under a policy owned by Company D can not vote on Company D’s exercise of incidents of ownership with respect to any of Policies 1-7. If Company D is dissolved the manger is directed to distribute the life insurance polices consistent with the terms of the Buy-Sell Agreement.

Prior to the transfer of the policies to Company D, Child A did not have any incidents of ownership in the policies that insured his life that where owned by Child B, and Trust 4. Similarly, Child B and BA did not have incidents of ownership in any policy that insured Child B and BA, respectively. Accordingly, based solely on the facts submitted and representations made, assuming the Company D operating agreement is not amended in any respect, it is concluded that Child A, Child B, and BA will not possess any incidents of ownership under section 2042 with respect to the policies contributed either outright or by Trust 4 to Company D.

Ruling Requests 2

Section 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 677(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Section 678(a) provides, in general, that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely by himself to vest the corpus or the income there from in himself, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

Based solely on the facts and representations submitted, we conclude that, assuming no additional contributions are made to Trust 2A and Trust 2B, Child A will be treated as the owner of Trust 2 and Child B will be treated as the owner of Trust 2B for federal income tax purposes under sections 671 and 678.

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. We are specifically expressing no opinion regarding the transfer tax consequences if either A, B, or BA assign their respective membership rights with respect to Company D.

Pursuant to a Power of Attorney on file, a copy of this letter is being sent to your authorized representative.

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
(Passthroughs and Special Industries)

Enclosures
Copy for section 6110 purposes
Copy of this letter