Internal Revenue Service

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Person To Contact:
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Date: AUGUST 19, 2008

Legend

A =
B =
Trust =
Date 1 =
Date 2 =
Date 3 =
Policy 1 =

Policy 2 =

Agreement =

Child A =
Child B =
Child C =

Dear :

This is in response to your letters, submitted by your authorized representatives in which you requested rulings concerning the federal gift, estate, and generation-skipping transfer tax consequences of a split-dollar life insurance agreement between Trust and A and B involving two life insurance policies.

On Date 1, A and B, husband and wife, established an irrevocable trust, Trust, for the benefit of their grandchildren. The trustees of Trust are A and B's children, Child

A, Child B, and Child C. Under the terms of the Trust, any net income is to be paid in equal shares to the grantors' grandchildren, at least annually. In addition, the trustees have discretion to distribute principal to the grandchildren, but in no event can the trustees distribute principal in discharge of their respective legal obligations. Also, any contribution to the Trust may, subject to certain limitations, be withdrawn by the trust beneficiaries. Generally, the withdrawal right lapses 35 days after the date of the contribution. After the death of the survivor of A and B, the trust is to be divided into separate shares with a separate share to be held in further trust, per stirpes, for the then living descendants of A and B.

On Date 2, Trust purchased Policy 1 and Policy 2, two second-to-die life insurance policies on the lives of A and B. The Trust was designated owner and beneficiary of the policies.

On Date 3, which was before 2001, A and B and the trustees entered into a collateral assignment split-dollar life insurance agreement (Agreement). Under the Agreement, Trust is designated the owner of Policy 1 and Policy 2. The owner may exercise all rights of ownership except the right of the collateral assignees (A and B) upon termination of the Agreement to be repaid.

While A and B are living, Trust is obligated to pay that portion of the annual premiums equal to the economic benefit cost of current life insurance protection on the joint lives. The amount Trust will pay is the lesser of (1) an amount determined in accordance with U.S. Treasury Department pronouncements, rulings and regulations including, without limitation, any table recognized by the U.S. Treasury Department pronouncements, rulings, and regulations; or (2) the current published one-year term rates for second-to-die policies available to all standard risks of the insurance company issuing the insurance policy. After the death of the first to die of A and B, Trust will pay that portion of the annual premiums on each policy equal to the lesser of: (1) the applicable amount provided in the P.S. 58 tables set forth in Rev. Rul. 55-747, 1955-2 C.B. 228; or (2) current published one-year term rates available to all standard risks of the insurance company issuing the insurance policy. A and B will pay the remaining portion of the annual premiums.

Prior to the death of the survivor of A and B, the Agreement may be terminated by written notice of the Trustees, upon the personal bankruptcy of A and B, surrender of all the policies, or payment to A and B at any time of an amount described as A and B's Investment, including any paid-up additional insurance purchased by any insurance policy advance. Further, A and B may terminate the Agreement if Trust does not pay the current cost of insurance.

Under the Agreement, upon the death of the survivor of A and B, the Agreement terminates and the portion of the proceeds of each policy equal to the greater of

premiums paid by A and B, or cash surrender value of the policies prior to termination is to be distributed one-half to A's estate and one-half to B's estate. The Trust is the designated beneficiary of the balance of the insurance proceeds.

To secure A and B's and their respective estates' interest in the policies and their proceeds, the Trustee executed a Collateral Assignment pursuant to which the Trustees assigned Policy 1 and Policy 2 to A and B. However, under the terms of the Collateral Assignment, the Trustees specifically retain all rights of ownership in the Policies subject to the right of A and B, or the estate of the survivor to receive the amount due, as described above, on termination of the Agreement. The rights expressly retained by the Trustees include, but are not limited to: the right to designate and change beneficiaries; the right to elect optional modes of settlement; the right to surrender cancel or assign the policies or obtain policy loans. A and B are prohibited from borrowing against the cash surrender value during the collateral assignment.

It is further represented that Agreement has not been modified in any manner since Date 3.

You have asked that we rule as follows:

1. The payment by A and B of the premiums pursuant to the Agreement will not result in a gift or a deemed gift to the Trust by A and B under §§ 2501 and 2511 of the Internal Revenue Code and will not cause a transfer under § 2652.

2. The insurance proceeds payable to the Trust will not be includible under § 2042 in the gross estate of either A or B.

ISSUE 1

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 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.

Section 25.2511-2(b) of the Gift Tax Regulations 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 for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its

disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

Section 2601 imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Section 2652(a) provides, in general, that "transferor" means (A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and (B) in the case of any property subject to the tax imposed by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 26.2652-1(a) of the Generation-Skipping Transfer Tax Regulations provides, in part, that an individual with respect to whom property was most recently subject to Federal estate or gift tax is the transferor of that property for purposes of chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor.

Rev. Rul. 64-328, 1964-2 C.B. 11, considers 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, if any, of the premiums. From the proceeds payable upon the employee's death, the employer receives an amount equal to the greater of the cash surrender value or at least an amount equal to the funds it has provided, with the beneficiary receiving the balance. The ruling holds that the employee must include in income annually the annual value of the benefit the employee receives under the arrangement, which is an amount equal to the 1-year term cost of the declining life insurance protection to which the employee is entitled from year to year, less the portion, if any, the employee provides. Rev. Rul. 64-328 also 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. The ruling further states 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. 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.

In Notice 2001-10, 2001-1 C.B. 459, the Service revoked Rev. Rul. 55-747 and provided in Table 2001, an interim substitute for the P.S. 58 rates that taxpayers may rely upon pending further guidance. Taxpayers, however, may use the P.S. 58 rates for taxable years ending on or before December 31, 2001. Part IV.B.1 of Notice 2001-10.

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. Notwithstanding such revocation, for a split-dollar life insurance arrangement entered into before January 28, 2002, in which a contractual arrangement between an employer and employee provides that the P.S. 58 rates will be used to determine the value of current life insurance protection provided to the employee, the employee and the employer may continue to use the P.S. 58 rates set forth in Rev. Rul. 55-747 to determine the value of current life insurance protection.

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) of the Income Tax Regulations.

Rev. Rul. 2003-105, 2003-2 C.B. 696, declared as obsolete certain revenue rulings, including 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.

The taxation of the split-dollar life insurance arrangement between A and B and the Trust is not subject to §§ 1.61-22(d) through (g) and §§ 1.7872-15 because it was entered into on or before September 17, 2003 and has not been materially modified after that date. Instead, the taxation of the arrangement is determined under prior law. *See* Rev. Rul. 2003-105.

In the present case, under the terms of the Agreement, Trust will pay the portion of the premium equal to the cost of current life insurance protection. A and B will pay the balance of the premium, and A and B (or their respective estates) will be entitled to receive one-half of any policy cash surrender value (plus any paid up additional insurance) on termination of the Agreement before the death of the survivor, or if the Agreement terminates on the death of the last to die of A and B, one-half of the greater of the cash value or premiums paid. We conclude that the payment of the premiums by A and B, pursuant to the terms of the Agreement, will not result in a gift by the A and B under section 2511, provided that the amounts paid by the Trust for the life insurance benefit that the Trust receives under the Agreement is at least equal to the amount prescribed under Rev. Rul. 64-328, Rev. Rul. 66-110, and Notice 2002-8. In addition, we conclude that A and B are not transferors under section 2652(a) with respect to the premium payments made by A and B.

We also conclude that, if some or all of the cash surrender value is used (either directly, or indirectly through loans) to fund the Trust's obligation to pay premiums, A and B will be treated as making a gift at that time and section 2652(a) will apply. We express no opinion concerning the federal gift tax consequences between A and B of the second-to-die policies.

Ruling Request 2

Section 2042(1) provides that the value of a decedent's gross estate shall include the proceeds of insurance policies 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 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, 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.

In the present case, neither A nor B will hold any incidents of ownership in Policies 1 and 2. As noted above, all incidents of ownership in the policies are vested in the Trustees of Trust. Accordingly, we conclude that the proceeds of the policy payable to the Trust will not be included in the gross estate of either A and B under section 2042(2). The estate of the first to die of A and B will include under section 2031 and section 2042(1) an amount reflecting the amount the estate is entitled to receive on the termination of the Agreement. The portion of the proceeds payable to the estate of the survivor of A and B will be includible under section 2042(1). See, e.g., Rev. Rul. 79-129, 1979-1 C.B. 306.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the foregoing transactions under any provisions of the Code (including any provisions of subtitle A) or regulations.

Under a power of attorney on file with this office, we are sending a copy of this letter to Trustee's 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
Branch Chief, Branch 4,
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purpose s