Internal Revenue Service

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:4 – PLR-117309-98
Date:
September 09, 2008

Re:

Legend

Settlor =

Spouse =
Trust A =

Trust B =

Date =
Agreement =

Dear :

This is in response to your June 11, 2008 letter and prior correspondence on behalf of Settlor concerning the gift and estate consequences of a split-dollar arrangement.

The facts, as submitted, indicate that Settlor created two irrevocable trusts on Date, Trust A and Trust B.

Under the terms of Trust A, during the lifetime of Settlor and after the death of Settlor if survived by Spouse, the trustee has discretion to distribute trust income and principal to Spouse and the descendants of Settlor as the trustee considers desirable

for their support, health, education and best interests; provided, however that, if a beneficiary (including Spouse) is acting as trustee, such beneficiary may only distribute principal to herself or himself for support, health or education. After the death of Settlor, Spouse is granted a lifetime and testamentary special power of appointment over the assets in Trust A. Trust A will terminate on the death of the survivor of Settlor and Spouse. Upon termination, if Settlor survives Spouse, or Spouse survives Settlor and does not exercise her testamentary power of appointment, the principal is to be divided into as many equal shares as there are then living children of Settlor and Spouse and deceased children of Settlor and Spouse who have left issue then surviving. Any share established for a child of Settlor and Spouse is to be distributed outright and any share established for the issue of a deceased child is to be distributed per stirpes. However, any share passing to a descendant under age 25 is to continue in trust for such descendant or is to be distributed to a custodian for the benefit of such descendant.

Under the terms of Trust A, when a contribution is made, Spouse, and in certain circumstances, the other trust beneficiaries have a specified right of withdrawal. The terms of the Trust A expressly preclude Settlor from acting as trustee and the Settlor has retained no powers or authority over either the trust, the trust property, or the administration of the trust. Spouse is the initial trustee of Trust A. Under the terms of Trust A, Settlor is prohibited from serving as trustee and Settlor can not remove, replace or appoint any successor trustee.

As indicated above, Settlor also created Trust B on Date. Under the terms of Trust B, the trustee is to distribute all the trust income to Spouse during her life. The trustee also has discretion to distribute trust principal to Spouse as the trustee considers desirable for Spouse's support, health, education and best interests; provided, however that if a beneficiary (including Spouse) is acting as trustee, such beneficiary may only distribute principal to herself or himself for support, health or education. Upon the death of Spouse, the trust will terminate and the trust property will be distributed in a manner similar to that provided for in Trust A. Settlor is prohibited from serving as trustee of Trust B and can not remove, replace or appoint any successor trustee.

The trustees of Trust A and Trust B have purchased a single-life insurance policy on the life of the Settlor and have entered into an agreement, Agreement, to share ownership of the policy. Under the agreement, Trust A will pay annually the portion of the required premium equal to the "Computed Term Cost" of the policy, defined as the amount at risk (the excess of the policy Death Benefit over the aggregate value of the "Policy Account") multiplied by the lesser of (i) the lowest published premium rate charged by the insurer for individual 1-year term life insurance available to all standard risks or (ii) the "PS. 58 rate" prescribed by the Internal Revenue Service, in either case based on the insured's age for the policy year. Trust B will pay the balance of the required premium.

Under the terms of the Agreement, on Setlor's death, Trust B is to receive the portion of the policy death benefit equal to the value of Trust B's share of the "Policy Account" (discussed below) determined immediately prior to the insured's death, subject to the insurer's claim with respect to any outstanding Trust B loan. Trust A is to receive the balance of the death benefit subject to the insurer's claim with respect to any Trust A outstanding loan.

In addition, the Agreement may be terminated during the lifetime of the insured by mutual agreement of the trustees of Trust A and Trust B. If the Agreement is terminated in this manner, Trust B has the option to require that Trust A surrender its interest in the policy and thus, to cause Trust B to become the sole owner of the policy. Trust A will receive Trust A's share of the Policy Account minus Trust A's loan balance. If Trust B does not exercise this option, then Trust A has a similar option to become the sole owner of the policy. If neither Trust A or Trust B exercise the option, then the Policy's cash surrender value is to be divided between Trust A and Trust B in proportion to each trust's respective share of the Policy Account, reduced by each Trust's respective share of all policy loans.

In general, the Policy Account is the aggregate credit balance in all investment accounts associated with the policy without reduction for outstanding loan balances and any potential surrender charges. Each Trust's share of the Policy Account is equal to the sum of certain credits set forth in the agreement, less the sum of certain debits set forth in the agreement. The credits listed in the agreement include the premiums paid by the respective Trust, plus the Trust's share of earnings credited to the Policy Account. The debits listed in the agreement include the Trust's share of all "allocated costs" charged against the Policy Account, the Trust's share of other costs apportioned against the Policy Account and any withdrawals made by the respective Trust. The term "allocated costs" includes the "Computed Term Cost" of the policy; that is, the portion of the premium to be paid by Trust A.

Under certain circumstances, both Trust A and Trust B are each entitled to borrow from the Trust's respective share in the Policy Account. All costs of such loan will be allocated to the Policy Account share of the Trust that borrows the funds. These costs are to be apportioned against each Trust's share of the Policy Account on a monthly basis. All policy costs that benefit both Trust A and Trust B are apportioned between the respective shares of each Trust in the Policy Account.

Under the Agreement, the trustee of each trust has the right to independently: (1) designate the beneficiary of the trust's respective share of the death benefits; (2) select settlement options relating to respective proceeds; (3) assign its respective interest in the policy and the agreement; (4) make withdrawals from its respective interest in the policy; and (5) obtain from the insurance company a loan against its respective interest in the policy. The ownership agreement requires the mutual consent of Trust A and

Trust B to exercise all other ownership rights under the policy. A third party administrator, also party to the ownership agreement, administers the agreement.

The following rulings have been requested:

1. The allocation of policy costs and benefits between Trust A and Trust B, pursuant to the Agreement, will not result in any imputed transfers between Trust A and Trust B that would constitute indirect gifts by the trust beneficiaries for federal gift tax purposes.

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

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 Trust A and Trust B is not subject to §§ 1.61-22(d) through (g) and §§ 1.7872-15 because Agreement 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 instant case, the Agreement was executed on Date, and has not been modified. Accordingly, the rules promulgated in T.D. 9092 do not apply with respect to Agreement. Under Agreement, as described above, we conclude that the payment of the premiums each year by Trust A and Trust B pursuant to the terms of the Agreement, does not result in a transfer between Trust A and Trust B that would result in a gift subject to gift tax, by the trust beneficiaries under section 2511, provided that the

amounts paid by Trust A for the life insurance benefit that the trust received under Agreement was at least equal to the amount prescribed under Rev. Rul. 64-328, Rev. Rul. 66-110 as amplified by Rev. Rul. 67-154, and Notice 2002-8.

Ruling Request 2

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.

In the instant case, Settlor, neither directly or indirectly, possesses any incidents of ownership in the Policy under the terms of the Agreement, as described above, or under the terms of Trust A or Trust B. See Rev. Rul. 79-129, 1979-1 C.B. 306. Accordingly, the portion of the proceeds of Policy payable to Trust A and Trust B will not be includible in the gross estate of Settlor.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the foregoing transactions under any other provisions of the Code or regulations. Specifically, we are expressing no opinion regarding any gift tax consequences if Trust B borrows against the cash surrender value of Policy or the cash surrender value is utilized to pay any portion of the premium. Additionally, we express no opinion regarding whether Trust B qualifies under section 2523(f) of the Code, or the application of section 2519.

Under a power of attorney on file with this office, we are sending a copy of this letter to Settlor.

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 purposes

cc: