

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
April 10, 2002

Legend

- Taxpayer/Transferee Trust =
- Husband =
- Wife =
- Child A =
- Child B =
- Child C =
- Trustee =
- Trust 1 =
- Trust 2 =
- Partnership =
- General Partner =
- Date 1 =
- Date 2 =
- Date 3 =
- U =
- V =
- W =
- X =
- Y =
- State A =

Dear

This ruling responds to a letter dated November 30, 2001 and additional submissions, submitted on behalf of Transferee Trust (“Taxpayer”) by Trustee requesting a ruling concerning the income tax consequences of the proposed transfer of three life insurance policies from Trust 2 to Taxpayer.

FACTS

On Date 1, Husband created Trust 1, which is comprised of three separate trusts created

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for the benefit of Husband's children, Child A, Child B, and Child C. Subsequently, on Date 2 Husband created Trust 2 for the benefit of Husband's lineal descendants. Trustee serves as the trustee for Trust 1 and Trust 2. Under the trust instrument of Trust 2, the trust principal and income may be used by Trustee for the best interest of Husband's lineal descendants, and to pay premiums on policies insuring the life of any individual or on the joint lives of any individuals in which any beneficiary has an insurable interest. In January of 2000, Trust 2 purchased three variable life insurance policies (the "Policies") insuring the joint lives of Husband and Wife. The total face value of the Policies is \$U. Upon the death of the second to die of Husband and Wife, the trust estate of Trust 2 will be distributed to Husband's lineal descendants, per stirpes, subject to certain limitations in the trust instrument. Taxpayer represents that under section 677(a)(3), Husband, the grantor, is treated as owner of Trust 2.

On Date 3, Husband created Taxpayer. Trustee also serves as trustee for Taxpayer. Taxpayer differs from Trust 2 in that upon the death of the second to die of Husband and Wife, \$V will be distributed to certain relatives and friends of Husband and the balance of the trust estate will be distributed to Husband's lineal descendants per stirpes, subject to certain limitations in the trust instrument. Additionally, the trust instrument of Taxpayer empowers Trustee to restrict distributions to Husband's lineal descendants upon the failure on the part of the lineal descendant to enter into a pre-nuptial or post-nuptial agreement. Taxpayer represents that under section 677(a)(3), Husband, the grantor, is treated as owner of Taxpayer.

Taxpayer intends to purchase the Policies from Trust 2 for the value of Trust 2's interest in the Policies, as determined under section 25.2512-6(a) of the Gift Tax Regulations. Taxpayer will obtain from the issuing insurance companies the interpolated terminal reserve value of each policy as of the date of sale plus the proportionate part of the gross premium last paid before the date of sale, which covers the period extending beyond that the date of sale. Upon the transfer of the Policies to Taxpayer, Taxpayer will become the beneficiary of the Policies. Husband will make annual gifts to Taxpayer, which will be utilized in part to pay the premiums on the Policies.

Taxpayer, Trust 1, Husband and Wife are limited partners in the Partnership. Taxpayer, Husband and Wife each hold a W% interest in the Partnership, and Trust 1 holds an X% interest. General Partner is the general partner of the Partnership and owns a Y% interest. The Partnership is an investment partnership established under State A law. The Partnership has not elected to be treated as an association taxable as a corporation under section 301.7701-3(b) of the Income Tax Regulations, and has filed Form 1065 for all years in which it has been in existence.

LAW AND ANALYSIS

Section 101(a)(1) provides that except as otherwise provided in section 101(a)(2), 101(d) and 101(f), gross income does not include an amount received under a life insurance contract, if such amounts are paid by reason of death of the insured.

Section 101(a)(2) provides, however, that if a life insurance contract or any interest therein is transferred for valuable consideration, the exclusion from gross income provided by section 101(a)(1) is limited to an amount equal to the sum of the actual value of the consideration

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and the premiums and other amounts subsequently paid by the transferee.

The term “transfer for a valuable consideration” is defined for purposes of section 101(a)(2) and section 1.101-1(b)(4) of the regulations, as any absolute transfer for value of a right to receive all or part of the proceeds of a life insurance policy.

An exception to the rule of section 101(a)(2) is provided in section 101(a)(2)(B) when the life insurance contract is transferred to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer. In these cases, the rule of section 101(a)(2) will not affect the application of section 101(a)(1) to amounts received by the beneficiaries.

Rev. Rul. 85-13, 1985-1 C.B. 184, concludes that if a grantor is treated as the owner of the entire trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes.

RULING

Taxpayer has requested a ruling that section 101(a)(1) of the Code will be applicable to the proceeds of the Policies which are paid upon the deaths of Husband and Wife. Taxpayer represents that both it and Trust 2 are grantor trusts owned by Husband. Under Rev. Rul. 85-13, a transaction cannot be recognized as a sale for federal income tax purposes if the same person is treated as owning the purported consideration both before and after the transaction. Husband is treated for federal income tax purposes as owning the assets of Trust 2 and Taxpayer. Therefore, the transfer of the Policies is disregarded for federal income tax purposes and will not affect the application of section 101(a)(1) to amount that the beneficiaries of the Policies will receive upon the death of Husband and Wife.

CONCLUSION

The transfer of the life insurance contracts from Trust 2 to Taxpayer is disregarded for federal income tax purposes, and will not affect the application of section 101(a)(1) to amounts that the beneficiaries receive upon the deaths of Husband and Wife.

CAVEATS

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the proposed transaction under any other provisions of the Code or regulations. No opinion is expressed or implied concerning whether the Policies are “life insurance contracts,” as defined in section 7702(a) of the Code. No opinion is expressed or implied regarding whether Husband should be treated as the owner of any portion of Taxpayer or Trust 2 under sections 671 through 679 of the Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is

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being sent to the taxpayer.

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.

A copy of this letter must be attached to any federal tax return to which it is relevant.

Sincerely yours,
Donald J. Drees, Jr.
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)