

**Internal Revenue Service**

Number: **200514002**

Release Date: 4/8/2005

Index Number: 101.01-02

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:FIP:B04

PLR-121994-04

Date:

December 13, 2004

Legend

Taxpayer =

Trust 1 =

Trust 2 =

PTP =

SibTP =

Policy 1 =

Policy 2 =

State =

Corp =

Dear

This is in reply to the ruling request filed by your representative, dated April 13, 2004, and supplementary submissions. The ruling request concerns the transfer of two life insurance policies from Trust 1 to Trust 2.

### FACTS

Trust 1 is an irrevocable trust created by Taxpayer for the benefit of Taxpayer's descendants, SibTP,<sup>1</sup> and SibTP's descendants. PTP<sup>2</sup> is the trustee of Trust 1. The trust provides that, except as otherwise provided in the trust instrument, Trust 1 will be governed by the laws of State.

Under the provisions of Trust 1, the trustee may receive or acquire one or more insurance policies of any kind and pay the premiums on such policies. Trust 1's assets consist of two whole life insurance policies, Policy 1 and Policy 2. Trust 1 has entered into split-dollar life insurance agreements with Corp for each policy. Taxpayer represents that Taxpayer is an employee of Corp and that the split-dollar agreements are designed to assist Trust 1 in insuring Taxpayer's life. The two split-dollar agreements are in the form of collateral assignments, naming Trust 1 as the owner. Taxpayer further represents that Trust 1 is a grantor trust falling within the scope of Subpart E of Subchapter J of Chapter 1 of the Code.<sup>3</sup>

Trust 2 is an irrevocable trust created by Taxpayer for the benefit of Taxpayer's descendants. SibTP and STP are the trustees of Trust 2. Trust 2 provides that Taxpayer reserves the right at any time to reacquire property transferred to the trust by substituting property of an equivalent value. Such right shall be exercisable by Taxpayer in a non-fiduciary capacity and without the approval or consent of any person then serving in a fiduciary capacity under the trust. Notwithstanding the foregoing, the Taxpayer's power to acquire any property held in the trust by substituting property of equivalent value shall not extend to any stock in a "controlled corporation," as defined in § 2036(b).

Trust 2 has assets with significant net worth. These assets include shares of Corp and other property. Taxpayer represents that Corp is a "controlled corporation," as defined in § 2036(b) of the Code. Taxpayer further represents that Trust 2 is a grantor trust at least with respect to all of its assets other than the Corp stock.

It is contemplated that Trust 1 will transfer Policy 1 and Policy 2 to Trust 2 in exchange for consideration. Trust 2 will use assets other than Corp stock to fund the transfer. The proposed transaction will free Trust 1 from the having to service the loans resulting from the conversion of the two split-dollar arrangements. Trust 2 will use its cash flow to pay policy premiums, keeping the two policies in force.

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<sup>1</sup> SibTP is Taxpayer's sibling.

<sup>2</sup> PTP is Taxpayer's parent.

<sup>3</sup> Sections 671-79.

The consideration for the transfer of the policies will be the fair market value of the policies, as determined under § 25.2512-6(a) of the Gift Tax Regulations. If the amounts received for Policy 1 and Policy 2 suffice, Trust 1 will use those amounts to terminate the two split-dollar agreements by paying off the respective loan balances. Otherwise, it is anticipated that Trust 2 will use its significant cash flow to cover any shortfall owed to Corp under the split-dollar insurance agreements. The split-dollar insurance agreements will then be terminated.

#### REQUESTED RULING

1. The transfer of Policy 1 and Policy 2 from Trust 1 to Trust 2 will be disregarded for Federal income tax purposes.
2. The “transfer-for-value” rule of § 101(a)(2) will not apply to diminish the exclusion from gross income under §101(a)(1) for amounts received by the beneficiaries of Policy 1 and Policy 2.

#### LAW AND ANALYSIS

1. Section 1.671-3(a) of the Income Tax Regulations provides that when a grantor is treated under subpart E of part I of subchapter J (§ 671 and following) as the owner of any portion of a trust there are included in computing the grantor’s tax liability those items of income, deduction, and credit against tax attributable to that portion. See also § 1.671-3(a)(2).

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

Rev. Rul. 85-13 also concludes that a transaction is disregarded for federal income tax purposes if the same person is treated as owning the purported consideration both before and after the transaction.

Taxpayer has represented that Trust 2 is a grantor trust at least with respect to all of its assets other than the Corp stock. The Corp stock will not be used as consideration for the transfer of Policy 1 and Policy 2. Taxpayer has represented that all of Trust 1 is a grantor trust. Assuming these representations are correct, Taxpayer will be treated, for federal income tax purposes, as owning the purported consideration for the transfer of the insurance policies both before and after the proposed transaction. Under Rev. Rul. 85-13, the proposed transaction will therefore be disregarded for federal income tax purposes.

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

Section 101(a)(2) of the Code provides, generally, that if a life insurance contract, or any interest therein, is transferred for a valuable consideration, the exclusion from gross income provided by § 101(a)(1) is limited to an amount equal to the sum of the actual value of the consideration and the premiums and other amounts subsequently paid by the transferee.

The term "transfer for a valuable consideration" is defined, for purposes of § 101(a)(2) of the Code, in § 1.101-1(b)(4) of the Regulations as any absolute transfer for value of a right to receive all or a part of the proceeds of a life insurance policy.

We have concluded above that, based on the representations, the transfer of Policy 1 and Policy 2 from Trust 1 to Trust 2 is disregarded for federal income tax purposes. Therefore, it is not a "transfer for a valuable consideration," within the meaning of § 1.101-1(b)(4) of the regulations, and the "transfer-for-value" rule of § 101(a)(2) will not apply to diminish the exclusion from gross income under §101(a)(1) for amounts received by the beneficiaries of Policy 1 and Policy 2.

#### RULINGS

1. The proposed transfer of Policy 1 and Policy 2 from Trust 1 to Trust 2 will be disregarded for Federal income tax purposes.
2. The "transfer-for-value" rule of § 101(a)(2) will not apply to diminish the exclusion from gross income under §101(a)(1) for amounts received by the beneficiaries of Policy 1 and Policy 2.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including the gift tax consequences of the transaction.

No opinion is expressed or implied concerning any matter of State law.

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

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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.

Sincerely,

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Donald J. Drees, Jr.  
Acting Chief, Branch 4  
Office of Associate Chief Counsel  
(Financial Institutions & Products)