

**Internal Revenue Service**

Department of the Treasury  
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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
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Date: DECEMBER 13, 2005

**Legend:**

- Husband =
- Wife =
- Father =
- Date 1 =
- Date 2 =
- Trust =
  
- Q% =
- W% =

Dear ,

This is in response to your authorized representative's letter dated July 28, 2005, in which a ruling was requested regarding the federal estate tax consequences of the proposed purchase by Trustee of Trust A of a life insurance policy on the life of Wife.

According to the facts submitted, Husband created Trust, an irrevocable trust, on Date 1. Wife did not provide any of the funding for Trust.

Under the terms of Trust, during Husband's lifetime, the trustees are directed to pay such amounts of income and principal to Wife, and to Husband's issue, as the trustees in their absolute discretion shall determine.

On the death of Husband, Article Third (A) provides that the trustees are to set aside W% of the Trust corpus as a separate trust (Trust A) for the benefit of Wife. The Trustees are to pay Wife the entire net income and so much of the principal of Trust A as the trustees in their absolute discretion determine. Trust A is to terminate upon the death of Wife, and the balance of the Trust A corpus is to be paid to Husband's then living issue, per stirpes. The balance of the Trust corpus (after providing for the funding of Trust A) is to be paid to husband's then living issue, per stirpes, provided that any property payable to a child of Husband who had not attained the age of 29 is to be held in further trust for the benefit of the child.

Article Fifth (I) of the Trust agreement provides that if any person currently eligible to receive any principal or income from any trust created under the terms of Trust is acting as a trustee, then such trustee shall have no power whatsoever to make or participate in making decisions affecting in any way the disposition of the income or principal of such trust to himself or herself, including determining how much income or principal should be distributed and whether the trust should be terminated.

Husband died on Date 2. In accordance with the terms of Article Third (A), Trust A was established for the benefit of Wife. Wife and Father are currently serving as co-trustees of Trust A.

Wife proposes to resign as co-trustee of Trust A. Subsequent to Wife's resignation, Father, as trustee of Trust A, will apply for and purchase a policy of insurance on Wife's life. Trust A will be the owner and beneficiary of the policy. It is represented that the principal of Trust A will be used to pay the premiums on the policy and that the annual premiums will be less than Q% of the principal of Trust A. Wife will not pay any premiums with respect to the policy or otherwise contribute towards the maintenance of the policy. All the income of Trust A will continue to be paid to Wife.

A ruling is requested that Wife will not possess any incidents of ownership over the life insurance policy on her life owned by Trust A and that the proceeds of the policy will not be includible in Wife's gross estate under section 2042(2) of the Internal Revenue Code. You also request a ruling that the policy proceeds will not be includible under section 2035 of the Code, if Wife dies within three years of renouncing her rights as co-trustee of Trust A.

Section 2035(a) provides that if (1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2042(2) provides that the value of the 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 death any incidents of ownership exercisable either alone or in conjunction with any other person.

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 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 policy.

Under § 20.2042-1(c)(4), a decedent is considered to have an incident of ownership in an insurance policy on decedent's 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.

In Rev. Rul. 84-179, 1984-2 C.B. 195, the decedent purchased an insurance policy on his life and transferred all incidents of ownership to his spouse. His spouse designated their adult child as the policy beneficiary. Subsequently, the spouse died and her will established a residuary trust for the benefit of the child. The decedent was designated the trustee of this trust. The insurance policy on the decedent's life which was part of the residuary estate, passed to the testamentary trust. As trustee, the decedent had broad discretionary powers in the management of the trust property and the power to distribute or accumulate income. Under the terms of the policy, the owner could elect to have the proceeds made payable according to various plans, use the loan value to pay the premiums, borrow on the policy, assign or pledge the policy, and elect to receive annual dividends. The will precluded the decedent from exercising these powers for the decedent's own benefit. The decedent paid the premiums on the policy out of other trust property and was still serving as trustee when he died.

The ruling concludes, based on the legislative history underlying section 2042(2), that the section generally applies to include life insurance in situations that parallel the inclusion of property under sections 2036-2038. Those sections generally involve the transfer of property where rights or powers are retained incident to the transfer. Under the facts in Rev. Rul. 84-179, the decedent transferred the policy to his wife and subsequently, in an unrelated transaction, reacquired incidents of ownership over the policy in a fiduciary capacity. The ruling holds that under these circumstances, the decedent will not be considered to possess incidents of ownership in the policy for purposes of section 2042(2), provided the decedent did not furnish consideration for maintaining the policy and could not exercise the powers for the decedent's personal benefit. The ruling further provides that the result would be the same if the decedent acting as trustee purchased a policy as a trust asset. The ruling states, however, that if the decedent's powers over the policy could have been exercised for the decedent's benefit, they would constitute incidents of ownership in the policy without regard to how those powers were acquired and without consideration of whether or not the decedent was the source of the funds used to pay the premiums. See Estate of Fruehauf v. Commissioner, 427 F. 2d 80 (6<sup>th</sup> Cir. 1970).

In the present case, Wife will resign as co-trustee of Trust A prior to the acquisition by Trust A of the life insurance policy on Wife's life. Trust A will be the owner and beneficiary of the policy. Accordingly, because Wife is resigning as co-trustee prior to the acquisition of the policy, Wife will never possess, or have the power to exercise, any incidents of ownership in the policy to be acquired by Trust A, nor will she relinquish or transfer any incidents of ownership in the policy by resigning as co-trustee prior to the acquisition of the policy. Further, it is represented that only trust principal will be used to pay the premiums on the policy and the annual premiums will be less than Q% of the Trust A principal. All the income of Trust A will continue to be paid to Wife. In addition, Wife has not transferred, nor will she transfer any assets to Trust A, and she will not pay any premiums with respect to the policy to be held as an asset of Trust A.

Based on the foregoing, we conclude that the proceeds of the life insurance policy to be acquired by Trust A, as described above, will not be includible in Wife's gross estate under section 2042(2). Further, the policy proceeds will not be includible under section 2035(a), if Wife dies within three years of resigning as co-trustee of Trust A. The above conclusions assume that Wife is not reinstated as co-trustee and is not serving as co-trustee at the time of her death, or after being reinstated, subsequently resigns within three years of death. See Rev. Rul. 84-179.

The ruling contained in this letter is 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.

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.

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 yours,  
George Masnik  
Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy of letter for section 6110 purposes