

Part I

Section 101.—Certain death benefits

26 CFR 1.101-1: Exclusion from gross income of proceeds of life insurance contracts payable by reason of death.
(Also § 671.)

Rev. Rul. 2007-13

ISSUE

Is the grantor who is treated for federal income tax purposes as the owner of a trust that owns a life insurance contract on the grantor's life treated as the owner of the contract for purposes of determining whether a transfer of the contract (a) is a transfer for a valuable consideration within the meaning of § 101(a)(2) of the Internal Revenue Code, and (b) if so, is a transfer to the insured within the meaning of § 101(a)(2)(B)?

FACTS

Situation 1. TR1 and TR2 are grantor trusts, both of which are treated as wholly owned by G under subpart E of Part I of subchapter J of the Internal Revenue Code. TR2 owns a life insurance contract upon the life of G. TR2 transfers the life insurance contract to TR1 in exchange for cash.

Situation 2. The facts are the same as in Situation 1, except that TR2 is not a grantor trust.

LAW AND ANALYSIS

Section 61 defines gross income as all income from whatever source derived, including gains derived from dealings in property.

Section 101(a)(1) 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 received by reason of the death of the insured.

Section 101(a)(2) 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) shall not exceed 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) in § 1.101-1(b)(4) of the Income Tax Regulations as any absolute transfer for value of a right to receive all or a part of the proceeds of a life insurance policy.

Section 101(a)(2)(B) provides that § 101(a)(2) does not apply to a transfer of a life insurance contract or any interest therein 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 Rev. Rul. 85-13, 1985-1 C.B. 184, a grantor acquired the corpus of a trust in exchange for the grantor's unsecured promissory note. The ruling concludes that the

grantor is considered to have borrowed the corpus of the trust and, as a result, is treated as the owner of the trust under § 675(3). Because the grantor is treated as the owner of the trust, the grantor is deemed the owner of the trust assets for federal income tax purposes. In addition, because the grantor is therefore considered to own the purported consideration both before and after the transaction, the exchange of a promissory note for the trust assets is not recognized as a sale for federal income tax purposes.

In Situation 1, because G is treated as the owner of both TR1 and TR2 for federal income tax purposes, G is treated as the owner of all the assets of both trusts, including both the life insurance contract and the cash received for it, both before and after the exchange. Accordingly, in Situation 1 there has been no transfer of the contract within the meaning of § 101(a)(2).

In Situation 2, because G is treated as the owner of all the assets of TR1 but not of TR2 for federal income tax purposes, G is treated as the owner of the cash (but not the life insurance contract) before the exchange, and as the owner of the life insurance contract (but not the cash) after the exchange. Accordingly, in Situation 2 there has been a transfer of the life insurance contract for a valuable consideration within the meaning of § 101(a)(2). Nevertheless, the transfer for value limitations of § 101(a)(2) do not apply, because the transfer to TR1 is treated as a transfer to G, the insured, within the meaning of § 101(a)(2)(B).

HOLDING

The grantor who is treated for federal income tax purposes as the owner of a trust that owns a life insurance contract on the grantor's life is treated as the owner of the contract for purposes of applying the transfer for value limitations of § 101(a)(2). Accordingly, in Situation 1, the transfer of a life insurance contract between two grantor trusts that are treated as wholly owned by the same grantor is not a transfer for a valuable consideration within the meaning of § 101(a)(2); in Situation 2, the transfer of a life insurance contract to a grantor trust that is treated as wholly owned by the insured is a transfer to the insured within the meaning of § 101(a)(2)(B) and is therefore excepted from the transfer for value limitations under § 101(a)(2).

DRAFTING INFORMATION

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