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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-106130-01
Date: April 11, 2001

Re:

LEGEND:

Trust =

Husband =

Spouse =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

F =

G =

H =

Dear :

This is in response to your letter dated January 19, 2001 requesting rulings concerning the application of the federal estate tax to Trust.

The facts and representations submitted are summarized as follows: On Date 1, in 1990, Husband created Trust, an irrevocable life insurance trust, for the benefit of Husband and Spouse's three children, F, G, and H. Husband transferred cash to Trust and the trustees applied for second-to-die term policies on the lives of Husband and

Spouse. Trust holds two life insurance policies, each insuring the joint lives of Husband and Spouse. Trust has owned the two second-to-die policies at all times since they were purchased and the policies are the only assets held by Trust. F, G, and H are the trustees of Trust.

Under Article Fifth of Trust, the trustee is vested with all right, title and interest in any insurance policies that are transferred to Trust, and is authorized and empowered to exercise and enjoy, for the purposes of Trust and as absolute owner of the insurance policies, all the options, benefits, rights and privileges under the insurance policies. Trust also provides that Husband relinquishes all rights and powers in the insurance policies which are not assignable and will, at the request of the trustee, execute all other instruments reasonably required to effectuate this relinquishment.

Under Article Third of Trust, during Husband's life, immediately following any contribution to Trust, Spouse has the right, for 60 days, to demand and withdraw the full amount of the contribution, except that the total withdrawals by Spouse in any calendar year cannot exceed five thousand dollars. If Spouse withdraws an amount less than five thousand dollars, F, G, and H have the right to withdraw a proportionate share of any contribution to Trust that Spouse has not withdrawn.

Article Fourth provides that during Husband's life, the trustee may, but is not required to, use net income and principal of Trust to pay premiums on the policies of life insurance on the lives of Husband and Spouse. After paying any insurance premiums, the trustee may pay to or apply for the benefit of Spouse, F, G, and H so much of the net income and principal of Trust as the trustee deems appropriate. However, the trustee may not distribute or apply Trust income or principal to discharge a legal support obligation of Husband.

Under Article Sixth, if Spouse survives Husband, the trustee is to pay all of the net income of Trust to Spouse, at convenient intervals, but at least quarter-annually, for Spouse's lifetime. The trustee is authorized to distribute principal of Trust, even to the exhaustion thereof, in the sole discretion of the trustee, if the net income together with income from other sources known to the trustee available to Spouse, F, G, and H is insufficient. Net income is insufficient if it is less than the amount needed to: (a) provide for proper health, support, education and maintenance; (b) meeting any emergency such as medical, dental, surgical care, or hospitalization; or (c) maintaining or permitting a standard of living approximately the same as was enjoyed during Husband's lifetime.

If the proceeds of any life insurance policies on Husband's life are includible in Husband's gross estate, Spouse will have the power to demand distribution of all such proceeds and the income therefrom, at all times, alone and in all events.

Upon Spouse's death, if Spouse survives Husband, the trustee is to divide the remaining Trust property in equal shares, one such share for each of the then living children of Husband and Spouse. If any of F, G, and H have predeceased Husband or Spouse, as the case may be, the share of the deceased child is to be divided further

into separate equal shares for such child's issue. If a deceased child's issue is under the age of thirty-five (35), such issue's share is to be held in further trust.

Upon the death or resignation of a co-trustee, the remaining co-trustees are to continue to serve. Trust contains no provision for the appointment of additional trustees. There is also no express prohibition against Spouse serving as a trustee.

Husband died on Date 2, in 1996, survived by Spouse.

It is represented that the scrivener of Trust incorrectly drafted the trust instrument as one that was intended to be funded with single-life insurance policies rather than policies on joint lives. It is also represented that upon creating Trust, Husband did not intend that Spouse would have any beneficial interests in Trust that would cause inclusion of life insurance proceeds in Spouse's gross estate.

On Date 3, also in 1996, Spouse executed a disclaimer of her right to satisfy the \$5,000 annual withdrawal power with a pro-rata portion of the life insurance policies held by Trust if other assets were unavailable to satisfy Spouse's demand right.

On Date 4, the trustee of Trust filed a petition with the appropriate Probate Court seeking the reformation of Trust. On Date 5, in 1996, the court entered its Order reforming Trust as follows:

1. Spouse's right to withdraw the first five thousand dollars contributed to Trust annually was eliminated;
2. Spouse's right to receive income and principal from Trust, both before and after the death of Husband was eliminated.

It is represented that the reformation is binding upon and enforceable against Spouse under State law. It is also represented that Spouse has never received a distribution of income or principal from Trust. It is also represented that Spouse has made contributions to Trust since the death of Husband, and continues to make such contributions, to cover the cost of the premium payments on the life insurance policies.

You have requested a ruling that upon the death of Spouse, no part of the assets of Trust, including the proceeds of the life insurance policies on the joint lives of Husband and Spouse, will be includible in Spouse's gross estate under §§ 2036, 2038, and 2042.

Section 2001 imposes a tax on the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of the decedent's death.

Section 2035(a) provides that if 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 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 transferred 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 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death, (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

Section 2042(1) provides that the value of the gross estate shall include the value of all property to the extent of the amount receivable by the executor as insurance under policies on the life of the decedent. Section 2042(2), provides that the gross estate includes the proceeds of any life insurance policies insuring the decedent's life receivable by beneficiaries other than the decedent's executor with respect to which the decedent possessed incidents of ownership at the time of his death.

Section 20.2042-1(b) of the Estate Tax Regulations provides as follows, regarding the application of § 2042(1):

Section 2042 requires the inclusion in the gross estate of the proceeds of insurance on the decedent's life receivable by the executor or administrator, or payable to the decedent's estate. It makes no difference whether or not the estate is specifically named as the beneficiary under the terms of the policy. Thus, if under the terms of an insurance policy the proceeds are receivable by another beneficiary but are subject to an obligation, legally binding upon the other beneficiary, to pay taxes, debts, or other charges

enforceable against the estate, then the amount of such proceeds required for the payment in full (to the extent of the beneficiary's obligation) of such taxes, debts, or other charges is includible in the gross estate.

Regarding the application of § 2042(2), § 20.2042-1(c)(2) provides that the term "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 surrender value of the policy.

Section 20.2042-1(c)(4) provides that a decedent is considered to have an incident of ownership in an insurance policy on his 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 and manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust.

Under § 2514(b), the exercise or release of a general power of appointment created after October 21, 1942, is deemed to be a transfer of property by the individual possessing the power. Section 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. This rule applies with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of: (1) \$5,000, or (2) 5 percent of the aggregate value of the assets out of which, the exercise of lapsed powers could be satisfied.

In the present case, Husband established Trust on Date 1 and made all the transfers to Trust up to the date of his death. Spouse has made no direct or indirect contributions to Trust by reason of the lapse of Spouse's withdrawal right since, Spouse could not withdraw more than \$5,000 in any calendar year. Spouse, has however, made transfers since the death of Husband, to Trust for the payment of premiums on the life insurance policies held by Trust. In 1996, as a result of Spouse's disclaimer and the trust modification, Spouse's interest in Trust was extinguished. The court order modifying the trust is controlling for tax purposes for periods after the date of the order. See Rev. Rul. 73-142, 1973-1 C.B. 405. Although Spouse continues to make transfers to Trust for the payment of premiums, Spouse retains no interest in Trust. Thus, Spouse's interest in Trust has been extinguished and more than three years have elapsed since Spouse's interests were extinguished. Accordingly, assuming that Spouse will not serve as a trustee of Trust, we conclude that the Trust property will not be includible in the gross estate of Spouse under §§ 2035, 2036 and 2038. See Rev. Rul. 73-142, *supra*.

Further, the policy proceeds are not payable to Spouse's estate, nor are the proceeds subject to any legally binding obligation to be used to pay taxes, debts, or other charges enforceable against the Spouse's estate. In addition, Spouse does not currently possess any incidents of ownership in the insurance policies held by Trust. Accordingly, we conclude that, assuming Spouse does not become trustee of Trust, upon Spouse's death, no part of the life insurance proceeds payable with respect to the policies on the joint lives of Husband and Spouse, will be includible in Spouse's gross estate under §§ 2042(1) or (2).

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code. We are specifically expressing no opinion regarding the gift tax consequences with respect to the reformation of the Trust on Date 5.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested 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 Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes

cc: