

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

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Telephone Number:

Refer Reply To:

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PLR-121847-98

Date: AUGUST 07, 2007

Re:

Legend:

Taxpayer A

Taxpayer B

Family Trust

Child A

Child B

Child C

Policy

Date 1

Date 2

Assignment

Dear _____ :

This is in response to your letter, dated January 6, 2005, and prior correspondence requesting several rulings concerning the gift and estate tax consequences of a split-dollar life insurance arrangement.

Taxpayers A and B, husband and wife, have three adult children, Child A, Child B, and Child C. On Date 1, Child A, Child B, and Child C purchased a second-to-die life insurance policy (Policy) insuring the lives of Taxpayers A and B, and paid the first annual premium due on the policy. Child A, Child B, and Child C are designated as the owners of Policy with each child owning a one-third undivided interest in Policy.

On Date 2, prior to September 17, 2003, Child A, Child B and Child C entered into a split-dollar insurance arrangement (Agreement) with Family Trust, a revocable inter vivos trust previously established by Taxpayer A and Taxpayer B. Under Agreement, during the joint lives of Taxpayers A and B, Child A, Child B and Child C will

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pay that portion of the annual premium due, equal to the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. Family Trust will pay the balance of the annual premium. After the death of the first insured to die, Child A, Child B and Child C will pay the portion of the annual premium equal to the lesser of: (i) the applicable amount provided in the P.S. 58 tables set forth in Rev. Rul. 55-747, 1955-2 C.B. 228; or (ii) the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. Trust will pay the balance of any premium amount.

The Agreement further provides that if the Agreement is terminated during the lifetime of either Taxpayer A or Taxpayer B, Family Trust is to receive an amount equal to the cash surrender value of Policy, less the amount of the cash surrender value of the Policy at the end of the first policy year. If the Agreement is terminated by reason of the death of the survivor of Taxpayer A and Taxpayer B, Family Trust is to receive an amount equal to the cash surrender value of Policy immediately prior to the death of the surviving insured, less the amount of the cash surrender value of the Policy at the end of the first policy year.

To secure the Trust's right to repayment, the Child A, Child B and Child C executed Assignment, pursuant to which they assigned to Family Trust their interest in the Policy and the Policy cash surrender value sufficient to return to Trust the amounts due under Agreement, as described above. Assignment provides that Child A, Child B and Child C are retaining all other policy rights including the right to designate beneficiaries, assign rights in the policy and surrender the policy.

It is represented that after the death of the first of Taxpayer A and Taxpayer B to die, the Family Trust will be divided into separate trusts and rights under Agreement and Assignment will pass to and be held by a survivor's trust established under the terms of Family Trust, with respect to which the surviving Taxpayer will hold a power of revocation, exercisable alone. The Policy proceeds payable to Family Trust under Agreement and Assignment will be paid to this trust.

It is represented that the arrangement has not be modified in any manner since Date 2.

You have requested the following rulings:

1. The payment by the Trust of the portion of the premium for which it will be responsible under the Agreement will not result in a gift to Child A, Child B, or Child C under section 2511 of the Internal Revenue Code.

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2. The proceeds of the policy payable to Child A, Child B, and Child C will not be includible in the gross estate of the second to die of Taxpayer A and Taxpayer B under section 2042.

Ruling Request 1:

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Section 2512(b) provides that, where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift. Under section 25.2511-1(b)(1), the transfer of property by a corporation to an individual constitutes a gift from the shareholders of the corporation to the individual.

Rev. Rul. 64-328, 1964-2 C.B. 11, considers a situation where an employer and employee enter into a "split-dollar" life insurance arrangement, in which the employer pays the portion of the premiums equal to the increases in the cash surrender value and the employee pays the balance of the premiums, if any. On the employee's death, the employer is entitled to receive an amount equal to the policy's cash surrender value or, at a minimum, an amount equal to the employer's premium payments. The designated beneficiary is entitled to receive the remainder of the proceeds. The ruling concludes that the substance of the transaction is that the employer provides the funds representing the investment element in the contract. The earnings on these funds would ordinarily inure to the employer. However, the earnings on the investment element in the contract are used to provide all, or a portion, of the cost of the employee's insurance protection at either no cost to the employee or a cost less than the employee would pay absent the arrangement. Thus, the employee receives an economic benefit that is includible in gross income. The value of the economic benefit received by the employee that is included in income is an amount equal to the cost of one-year term life insurance protection to which the employee is entitled from year to year less the portion of the cost of insurance protection provided by the employee (if any). The ruling also concludes that the same income tax result follows if the transaction is cast in some other form that results in a similar benefit to the employee.

Rev. Rul. 64-328 further provides that the cost of life insurance protection as shown in the table contained in Rev. Rul. 55-747, 1955-2 C.B. 228 (P.S. 58 Rates) may be used to compute the value of the one-year term life insurance protection provided to the employee. Rev. Rul. 66-110, 1966-1 C.B. 12, amplified Rev. Rul. 64-328, and held that the insurer's published premium rates for one-year term insurance may be used to measure the value of the current life insurance protection if those rates are available to

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all standard risks and are lower than the P.S. 58 rates. Rev. Rul. 67-154, 1967-1 C.B. 11, amplified Rev. Rul. 66-110 by holding that an insurer's published term rates must be available for initial issue insurance (as distinguished from rates for dividend options) in order to be substituted for the P.S. 58 rates set forth in Rev. Rul. 55-747.

Rev. Rul. 76-490, 1976-2 C.B. 300, considers a situation where an employer makes premium payments on a group term life insurance policy that the insured employee irrevocably assigned to an irrevocable trust. The ruling concludes that for gift tax purposes, each premium payment made by the employer is deemed an indirect transfer by the employee to the assignee of the policy (the irrevocable trust) that is subject to gift tax under section 2501. Under the facts in the ruling the employer made all premium payments on the policy.

In Situation 2 of Rev. Rul. 78-420, 1978-2 C.B. 67, a corporation enters into a split-dollar life insurance arrangement with an employee's spouse pursuant to which the corporation agrees to pay that part of the annual premiums on a policy insuring the employee's life to the extent of the annual increase in the cash surrender value. The spouse, who owns the policy and has the right to select the beneficiary, pays the balance of the premiums. The corporation is entitled to receive, out of the proceeds of the policy upon the death of the employee, an amount equal to the cash surrender value of the policy or at least an amount equal to the funds it has provided for premium payments. The ruling concludes that the arrangement is subject to the rules of Rev. Rul. 64-328, and therefore, the employee must include in gross income the value of the life insurance protection provided by the corporation, less the portion of the premium paid by the spouse. Further, in accordance with Rev. Rul. 76-490, the value of the life insurance protection that is included in the employee's gross income is deemed to be transferred from the employee to the spouse for purposes of section 2511 and is subject to federal gift tax under section 2501.

Notice 2001-10, 2001-1 C.B. 459, revoked Rev. Rul. 55-747 and provided that, subject to a transitional rule in Part IV. B.1, the Treasury Department and the Internal Revenue Service would no longer treat or accept the P.S. 58 rates set forth therein as a proper measure of the value of current life insurance protection for Federal tax purposes.

Notice 2002-8, 2002-1 C.B. 398, revoked Notice 2001-10. Part III.1 of Notice 2002-8 provides that, pending the consideration of comments and publication of further guidance, Rev. Rul. 55-747 remains revoked, as provided in and with the transitional relief described in Part IV.B.1 of Notice 2001-10.

Notice 2002-8, Part III.2, provides that in the case of split-dollar life insurance arrangements entered into before the effective date of future guidance, taxpayers can

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use the premium rates in Table 2001 to determine the value of current life insurance protection on a single life that is provided under a split-dollar life insurance arrangement. Notice 2002-8 also provides that taxpayers should make appropriate adjustments to the Table 2001 rates if the life insurance protection covers more than one life.

Notice 2002-8, Part III.3, provides that for arrangements entered into before the effective date of future guidance (and before January 29, 2002), taxpayers may, to the extent provided by Rev. Rul. 66-110, as amplified by Rev. Rul. 67-154, continue to determine the value of current life insurance protection by using the insurer's lower published premium rates that are available to all standard risks for initial issue one-year term insurance.

Notice 2002-8, Part IV.2, provides generally that, for split-dollar life insurance arrangements entered into before the date of publication of final regulations, in cases where the value of current life insurance protection is treated as an economic benefit provided by a sponsor to a benefited person under a split-dollar life insurance arrangement, the Service will not treat the arrangement as having been terminated (and thus will not assert that there has been a transfer of property to the benefited person by reason of termination of the arrangement) for so long as the parties to the arrangement continue to treat and report the value of the life insurance protection as an economic benefit provided to the benefited person.

Final regulations regarding the income, employment and gift taxation of split dollar life insurance arrangements were promulgated in T.D. 9092, 68 F.R. 54336 (September 17, 2003), 2003-2 C.B. 1055. These regulations apply to any split-dollar life insurance arrangement (as defined in the regulations) entered into after September 17, 2003. The regulations also provide that if an arrangement is entered into on or before September 17, 2003, and is materially modified after September 17, 2003, the arrangement is treated as a new arrangement entered into on the date of the modification. Section 1.61-22(j).

Rev. Rul. 2003-105, 2003-2 C.B. 696, declared as obsolete Rev. Rul. 79-50, 1979-1 C.B. 139, Rev. Rul. 78-420, Rev. Rul. 66-110 (except as provided in Part III.3 of Notice 2002-8), and Rev. Rul. 64-328. However, Rev. Rul. 2003-105 also provides that in the case of any split-dollar life insurance arrangement entered into on or before September 17, 2003, taxpayers may continue to rely on these revenue rulings to the extent described in Notice 2002-8, but only if the arrangement is not materially modified after September 17, 2003.

In the instant case, Agreement was executed in 1998, and has not been modified. Accordingly, the rules promulgated in T.D. 9092 do not apply with respect to

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Agreement. Under Agreement, as described above, in consideration for a payment of a portion of the premium on Policy, the cash value of Policy will be payable to the Taxpayers' revocable trust on termination of the Agreement. We conclude that the payment of the Policy premiums each year by Family Trust pursuant to the terms of the Agreement, does not result in a gift by the Taxpayers under section 2511, provided that the amounts paid by Child A, Child B and Child C for the life insurance benefit that each received under Agreement was at least equal to the amount prescribed under Rev. Rul. 64-328, Rev. Rul. 66-110 as amplified by Rev. Rul. 67-154, and Notice 2002-8.

Ruling Request 2

Section 2042(2) provides that the value of a decedent's 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 his death any incidents of ownership exercisable either alone or in conjunction with any other person. An incident of ownership includes a reversionary interest arising by the express terms of the instrument or by operation of law only if the value of such reversionary interest exceeds 5 percent of the value of the policy immediately before the death of the decedent.

Section 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, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes 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.

In the instant case, Taxpayers will neither directly, or indirectly through Family Trust, possess any incidents of ownership in the Policy under the terms of the Agreement, as described above. See, Rev. Rul. 79-129, 1979-1 C.B. 306. Accordingly, the portion of the proceeds of Policy payable to Child A, Child B and Child C will not be includible in the gross estate of the last to die of Taxpayer A and Taxpayer B. The portion of the proceeds of Policy payable to the survivor's trust established under the terms of Family Trust will be includible in the gross estate of the last to die of Taxpayer A and Taxpayer B.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the foregoing transactions under any other provisions of the Code or regulations. Specifically, we are expressing no opinion regarding any gift tax consequences if Child A, Child B, or Child C borrows against the cash surrender value of Policy or the cash surrender value is utilized to pay any portion of the Policy

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premium. We also express no opinion concerning the federal gift tax consequences as between Taxpayer A and B regarding the premium payments on the second-to-die policy.

Under a power of attorney on file with this office, we are sending a copy of this letter to Trustee's authorized representative.

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,

George Masnik
Branch Chief, Branch 4,
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes