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Date:
March 19, 2014

Legend

AB =

BA =

Individual A =

Individual B =

Date 1 =

Number W =

Number X =

Number Y =

Number Z =

Dear

This is in response to your request for a ruling dated August 13, 2013 that the purchase of life insurance contracts is not subject to the transfer for valuable consideration rule under § 101(a)(2) of the Internal Revenue Code.

Facts

The BA Trusts were created under a trust agreement of Date 1. Individual A and his spouse, Individual B, are represented to be the grantors of the BA trusts for federal income tax purposes; it is represented that the BA Trusts are treated as grantor trusts for federal income tax purposes. Each of the Number W BA Trusts has a Number X ownership interest in Number Y (second to die) life insurance contracts on the joint lives of Individual A and Individual B and Number Z life insurance contracts on Individual B's life (collectively the "life insurance contracts"). After the death of the survivor of Individual A and Individual B, or upon the death of Individual B with respect to the life insurance contract on Individual B's life, the death proceeds will be paid to each of the BA Trusts and administered for the benefit of the respective beneficiaries of the trusts.

Individual A is the sole grantor of the AB Trust, which is represented to be a grantor trust for federal income tax purposes owned by Individual A.

It is proposed that the AB Trust, which otherwise has substantial assets, purchase the interests in the life insurance contracts owned by each of the BA Trusts. To the best knowledge of the taxpayers involved, the life insurance contracts being transferred between the grantor trusts qualify as life insurance contracts under § 7702.

Law and Analysis

Section 101(a)(1) provides that, except as otherwise provided in §§ 101(a)(2), 101(d), 101(f) and 101(j), 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) provides, however, that if a life insurance contract or any interest therein is transferred for 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 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 part of the proceeds of a life insurance contract.

An exception to the rule of § 101(a)(2) is provided in § 101(a)(2)(A) when the basis of the life insurance contract in the hands of the transferee is determined in whole or in part by reference to the basis of the insurance contract in the hands of the transferor. In such a case, the rule of § 101(a)(2) will not effect the application of the general rule of § 101(a)(1) which allows death benefit proceeds to be received by the beneficiaries without the amounts being included in the beneficiaries' gross income.

A "grantor trust" is generally disregarded for federal income tax purposes. Rev. Rul. 85-13, 1985-1 C.B. 184, provides that if a grantor is treated as the owner of a trust, the grantor is considered to be the owner of the trust's assets for federal income tax purposes. Under Rev. Rul. 85-13, a transaction cannot be recognized as a sale or exchange for federal tax purposes if the same person is treated as owning the purported consideration both before and after the transaction.

Rev. Rul. 2007-13, 2007-1 C.B. 685, addresses two different factual situations in which a life insurance contract is transferred between trusts. In Situation 1, a trust (TR1) acquired a life insurance contract in exchange for cash from a separate trust (TR2). TR1 and TR2 were both grantor trusts, which were treated as wholly owned by the same grantor under subpart E of part I of subchapter J of the Internal Revenue Code of 1986. Grantor was the insured under the policy subject to the transfer. Rev. Rul. 2007-13 holds that in Situation 1 the grantor is treated for federal income tax purposes as the owner of the contract for applying the transfer for value limitations of § 101(a)(2). Therefore, the transfer of the life insurance contract between the two grantor trusts that are treated as owned by the same grantor is not a transfer for valuable consideration under § 101(a)(2).

Section 1041(b) provides that in the case of any transfer of property described in § 1041(a): (1) for purposes of Subtitle A of the Code, the property shall be treated as acquired by the transferee by gift, and (2) the basis of the transferee in the property shall be the adjusted basis of the transferor.

The movement of the life insurance contracts from the BA Trusts to the AB Trust has two aspects. The first aspect is that, pursuant to the rationale of Rev. Rul. 85-13, Individual A, as a grantor of the BA Trusts, proposes to transfer the life insurance contracts to the AB Trust of which Individual A is the grantor. Thus, this aspect of the transaction cannot be recognized as a sale or exchange for income tax purposes because Individual A is treated for income tax purposes as owning the purported consideration both before and after the transaction. The second aspect of the transaction is that Individual B's interest in the BA Trusts (in which she is a grantor) is being moved to the AB trust in which Individual B's husband, Individual A, is the grantor. This action has the result, under § 1041(a), as being treated as a gift to her husband, Individual A, who pursuant § 1041(b) receives a carryover basis in the life insurance contracts from his wife, Individual B.

Conclusion

Based on the facts provided and the representations made, we rule that the AB Trust's proposed purchase of the life insurance contracts from the BA Trusts is not a transfer for valuable consideration within the meaning of §101(a)(2).

The ruling contained in this letter is based upon information and representations submitted by the taxpayers and accompanied by penalties of perjury statement executed by the taxpayer. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences if any aspect of the proposed transaction under any other provision of the Code or regulations, which may apply thereto. No opinion is expressed or implied concerning the qualification of the life insurance contracts proposed to be purchased by the AB Trust from the BA Trusts under § 7702 or the propriety of any valuation of the life insurance contracts, or on the status of either the AB Trust or the BA Trusts. We express no opinion as to the treatment of the transaction for estate or gift tax purposes.

This ruling is directed only to the taxpayers 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 federal tax return to which it is relevant.

In accordance with the Power of Attorney on file in this office, the original ruling letter is being sent to taxpayer with copies of this letter being sent to the taxpayer's authorized representatives.

Sincerely,

JOHN E. GLOVER
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)