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Department of the Treasury
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RE:

Legend

Date 1 =
Settlor =
Trust =
Child 1 =
Child 2 =
Spouse =
Court =
Date 2 =
Year 1 =
State =
Statute =
Year 2 =

Dear :

This letter responds to a letter dated June 8, 2018, submitted on behalf of your authorized representative, requesting a ruling regarding the federal estate tax consequences of the purchase by Insurance Trustee of Trust of a life insurance policy on the life of Child 1.

The facts submitted and representations made are as follows. On Date 1, Settlor established an irrevocable trust, Trust, for the benefit of Child 1 and Child 1's descendants. The Trustee of Trust is Child 1. Settlor predeceased Child 1. It is represented that Child 1 has not made any contributions to Trust and does not intend to make any contributions to Trust.

Section 2.1 of Trust provides that the Trustee is expressly granted the power to own and acquire life insurance and to pay the premiums on existing life insurance on the life of any person in which the trust or its beneficiaries may have an insurable interest. The ownership of any and all policies of insurance applied for and purchased by the Trustee or transferred and assigned to the Trustee is irrevocably vested in the Trustee.

Under Section 2.4, the Trustee is vested with all rights, powers, options, elections, privileges and incidents of ownership in all insurance policies owned by Trust.

Section 2.5 provides that the Trustee shall have the power to use all or any part of the net income or corpus of Trust to pay all or any part of any premiums or other charges due on any insurance policies held in trust. Provided, however, notwithstanding any contrary provision in this paragraph, in the event the Trust owns any life insurance on the life of Settlor, premium payments shall only be made out of corpus, and not out of income (as determined for federal income tax purposes under Subpart E of Part I, Subchapter J, Chapter 1, Subtitle A of the Internal Revenue Code (Code)).

Under Article III, during Child 1's lifetime, the Trustee shall have the power to distribute net income and corpus of Trust as Trustee may determine to be appropriate to provide for the health, support, maintenance and education of Child 1 and Child 1's descendants. Any undistributed net income shall be accumulated and added to the corpus of Trust.

Section 6.1 provides that upon the death of Child 1, Child 1 shall have a testamentary special power of appointment over the remaining assets of Trust limited to the class consisting of Child 1's descendants. To the extent Child 1 does not exercise or ineffectively exercises Child 1's testamentary special power of appointment, then the Trustee shall apportion the property of Trust into separate equal trusts, one for the benefit of each of Child 1's then living children (Child's Trust) and one trust for the benefit of the descendants (Descendant's Trust), taken collectively, of each child of Child 1 who is then deceased leaving descendants then surviving. Moreover, Sections 6.2 and 6.3 grant a testamentary special power of appointment to the primary beneficiary of a Child's Trust or a Descendant's Trust.

Under Section 7.2, Child 1 shall have the power to appoint one or more persons, individual or corporate, to serve as Co-Trustee or sole Trustee of Trust or the separate trusts created hereunder and shall have the power to remove or replace any Co-Trustee or sole Trustee whether named in Trust or appointed pursuant to Article VII. If Child 1 should die, resign or be unable or unwilling to serve as Trustee for any reason, or fail to appoint a successor, then Settlor appoints Child 1's spouse, Spouse, as Trustee. If Spouse is unable to serve for any reason, then Settlor appoints Child 2. Upon the death of Child 1, if Child 1 has not appointed a trustee to succeed upon Child 1's death,

Settlor appoints each child of Child 1 as sole Trustee of any separate trust created for his or her benefit.

Section 7.12 provides that Settlor does not intend that the Trustee have any power over trust property that, if held by the Trustee in a fiduciary capacity, would result in inclusion of trust assets in the estate of the Trustee for federal estate tax purposes. To this end, the Settlor appoints the Co-Trustee or, if none, the next Successor Trustee named or appointed under Article VII who is qualified to serve as Trustee and who does not suffer the same disability, as Special Co-Trustee during any period in which a trust governed by this agreement provides for current distribution to beneficiaries to whom the primary Trustee owes a legal obligation of support or contains property over which the primary Trustee's powers would result in such inclusion.

Section 7.12(a) provides that a Special Co-Trustee shall be appointed if a trust governed under this agreement owns or otherwise possesses any incidents of ownership over any life insurance policies on the life of the primary Trustee within the meaning of § 2042.

Section 7.12(c) provides that a Special Co-Trustee shall be appointed if a trust governed under this agreement provides for current distributions to beneficiaries to whom the primary Trustee has a legal obligation of support. The Special Co-Trustee shall have the sole power to determine the amount and timing of any discretionary distribution to a beneficiary to whom the primary Trustee has a legal obligation of support. The primary Trustee's powers at such times shall be limited to management of trust assets and distributions to beneficiaries to whom the primary Trustee owes no legal support obligation.

In Year 1, Trustee proposed to purchase a life insurance policy on the joint lives of Child 1 and Spouse. However, Section 6.1 of Trust provides Child 1 with a testamentary special power of appointment over all assets contained in Trust. As a result, if Trust owned a life insurance policy on the life of Child 1, there is a risk that the life insurance death benefit proceeds will be included in Child 1's gross estate for federal estate tax purposes upon Child 1's death.

Accordingly, Child 1, in the capacity of Trustee of Trust, petitioned Court to modify the terms of Trust to remove Child 1's testamentary special power of appointment over any life insurance policy on Child 1's life or the proceeds of such policy; to add an Insurance Trustee, who will have sole authority over any insurance policies on the life of Child 1 purchased by Trust; and to modify Trust to require that premium payments on life insurance policies on Child 1 must be paid out of Trust corpus. On Date 2, in Year 1, a Final Judgment of Modification was issued by Court approving the modification of Trust.

Pursuant to the Final Judgment of Modification, Trust is modified as follows:

Section 2.5, as modified, provides that if Trust owns any life insurance on the life of Settlor, a beneficiary, or a trustee, premium payments shall only be made out of corpus, and not out of income (as determined for federal income tax purposes under Subpart E of Part I, Subchapter J, Chapter 1, Subtitle A of the Internal Revenue Code (Code)). Sections 6.1, 6.2 and 6.3, as modified, provide that a holder of a testamentary special power of appointment under the terms of Trust, Child's Trust or Descendant's Trust is excluded from exercising the power over any life insurance policy on such beneficiary's life or proceeds of such policy on such beneficiary's life.

Section 7.12(a) of Trust, as modified, is deleted and replaced with the following:

Notwithstanding the foregoing procedure, [Child 2] is appointed as Insurance Trustee (hereinafter referred to as "Insurance Trustee") if a trust governed by this Agreement intends to purchase, purchases, owns or otherwise possesses any incidents of ownership over any life insurance policies on the life of the primary Trustee within the meaning of § 2042 of the Internal Revenue Code. [Child 1] shall have the power to: (i) change the Insurance Trustee succession herein, (ii) appoint one or more persons, individual or corporate, excluding [Child 1], to serve as Insurance Trustee or Co-Trustees of this trust or any trust created hereunder, and (iii) remove such persons appointed, whether now serving or appointed to serve in the future. Provided, however, [Child 1] shall not have the power to appoint a person related to or subordinate to [Child 1], within the meaning of § 672(c) of the Internal Revenue Code, as successor Insurance Trustee. The Insurance Trustee shall have the power to maintain the policies in which the applicable trust has an ownership interest and pay the trust's proportionate share of the premiums thereon. If for any reason there are not sufficient funds to pay the premiums and maintain the policies in force, the Insurance Trustee shall have authority to accept paid-up insurance for the policies. Additionally, if necessary for the health, support or maintenance of the beneficiary of that trust, the Insurance Trustee shall have complete authority to surrender the said policies, or borrow on them, and to utilize the proceeds for the benefit of that trust beneficiary. The Insurance Trustee shall not be liable to any beneficiary by virtue of its decision in exercising its discretion and in carrying out these instructions. If [Child 2] should die, resign or be unable or unwilling to exercise the power described in this subparagraph, unless [Child 1] has otherwise named a successor Insurance Trustee, then a majority of the beneficiaries then entitled or permitted to receive income from each separate trust hereunder, per stirpes and not per capita, who are at

least twenty-one (21) years of age, shall have the authority to appoint a successor Insurance Trustee, other than Settlor.

Statute provides, in pertinent part, that on the petition of a trustee or a beneficiary, a court may order that the terms of the trust be modified if because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust; modification of administrative, non-dispositive terms of the trust is necessary or appropriate to prevent waste or avoid impairment of the trust's administration; the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions; or the order is not inconsistent with the material purpose of the trust and all beneficiaries of the trust have consented or are deemed to have consented to the order.

In Year 2, subsequent to the Court's Final Judgment, Child 2, in the capacity of Insurance Trustee, purchased a second-to-die policy on the lives of Child 1 and Spouse.

Trustee requests a ruling that Child 1 will not possess any incidents of ownership over any life insurance policy on Child 1's life acquired by Trust, as amended, and that the proceeds of any policy on Child 1's life will not be includible in Child 1's gross estate under § 2042(2) of the Internal Revenue Code.

LAW AND ANALYSIS

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

Section 2042(2) provides, in pertinent part, that the value of the gross estate includes the value of all property to the extent of the amount receivable as insurance under policies on the life of the decedent by beneficiaries (other than the executor), with respect to which the decedent possessed at his death any of the 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 the term "incidents of ownership" is not limited in its meaning to ownership of the 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, in pertinent part, 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

in 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 was part of the residuary estate, and 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 that, based on the legislative history of § 2042(2), a decedent will not be considered to possess incidents of ownership in the insurance policy for purposes of § 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.

In the present case, prior to the modifications of Trust, Section 2.1 of Trust expressly granted the Trustee the power to own and acquire life insurance and to pay the premiums on existing life insurance on the life of any person in which the trust or its beneficiaries may have an insurable interest. The ownership of any and all policies of insurance applied for and purchased by the Trustee or transferred and assigned to the Trustee is irrevocably vested in the Trustee. Under Section 2.4, Child 1, as the Trustee, is vested with all rights, powers, options, elections, privileges and incidents of ownership in all insurance policies owned by Trust. Accordingly, prior to the modifications, Child 1 possessed all incidents of ownership in any life insurance policy on Child 1's life that the Trust may acquire.

The modifications to Trust relinquished Trustee's powers with respect to any life insurance policy on Child 1's life acquired by Trust and granted such powers to an Insurance Trustee. Under Section 7.12(a), as modified, Child 2 is appointed as Insurance Trustee with power to maintain and pay premiums on a life insurance policy on the life of Child 1. Child 2 shall have complete authority to surrender policies, borrow on them, or utilize the proceeds for the benefit of the beneficiary if necessary for the health, support or maintenance of the beneficiary. Accordingly, Trustee is precluded from exercising any power normally conferred on the owner of a policy.

Child 1 retains a beneficial interest in income and principal of Trust, subject to an ascertainable standard. However, under Section 2.5, as modified, premium payments will only be made out of corpus and not income. In addition, Child 1 has not made any contributions to Trust and further represents that Child 1 will not make any contributions to Trust.

Further, prior to the modifications of Trust, Child 1 possessed a testamentary special power of appointment over the Trust principal, which would include any proceeds from life insurance on the life of Child 1 that Trust may hold. This power gave Child 1 the power to change the beneficial ownership of the proceeds. However, the modifications to Trust restrict Child 1's testamentary special power of appointment. Under Section 6.1, as modified, Child 1 may not exercise Child 1's testamentary special power of appointment over any life insurance policies on the life of Child 1. Accordingly, Child 1 may not exercise Child 1's testamentary special power of appointment to change the beneficial interests in the proceeds of the life insurance policy on Child 1's life.

In this case, Child 1's powers, in the capacity as Trustee and beneficiary were eliminated prior to the acquisition of the life insurance policy on Child 1's life. Trust is the owner and beneficiary of the policy. Accordingly, when the Insurance Trustee purchased a life insurance policy on Child 1's life, Child 1 did not possess and did not have the power to exercise, any incidents of ownership in the policy acquired by Trust. Child 1 will not relinquish or transfer any incidents of ownership in the policy as a result of the modification prior to the acquisition of the policy.

Accordingly, based on the facts submitted and the representations made, we conclude that Child 1 does not and will not possess any incidents of ownership over any life insurance policy on Child 1's life acquired by Trust, as amended, and that the proceeds of any policy on Child 1's life will not be includible in Child 1's gross estate under § 2042(2). The above conclusions assume that Child 1 is not serving as Insurance Trustee at the time of Child 1's death, or Trust is modified such that Child 1 regains fiduciary powers over life insurance on Child 1's life.

We neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are 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.

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.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Sincerely,

Lorraine E. Gardner

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: