

**Internal Revenue Service**

Department of the Treasury  
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July 20, 2009

**LEGEND:**

Taxpayer =  
Trust 1 =  
Trust 2 =  
Policy 1 =  
  
Policy 2 =  
  
Partnership 1 =  
Partnership 2 =  
Partnership 3 =  
Partnership 4 =  
Corporation 1 =  
Corporation 2 =  
Insurance Company =  
Sister =  
State =  
Year 1 =  
Year 2 =  
a =  
b =  
c =

Dear :

This responds to your February 17, 2009 letter and other correspondence requesting a ruling under §§ 2042 and 2035 of the Internal Revenue Code with respect to a series of proposed transactions involving life insurance held in partnerships and trusts.

The facts submitted are as follows:

Partnership 1 is a State limited partnership. Corporation 1, which is wholly owned by Taxpayer, owns a a% general partnership interest in Partnership 1. Corporation 2, which is wholly owned by Trust 1, owns a b% limited partnership interest in Partnership 1. Taxpayer owns the remaining c% limited partnership interest in Partnership 1.

Corporation 2 also owns limited partnership interests in Partnerships 2, 3, and 4. The general partners of Partnerships 2, 3, and 4 are separate limited liability companies or corporations, each of which is solely owned by Taxpayer or Taxpayer's parents.

Partnership 1 owns Policy 1, a whole life insurance policy on the life of Taxpayer. The beneficiaries of Policy 1 are Partnerships 1-4. It is represented that Partnership 1, as the owner of Policy 1, intends to designate Taxpayer's children as the beneficiaries of Policy 1. Partnership 1 owns no other assets. It is represented that Taxpayer has contributed funds to Partnership 1 to pay premiums on Policy 1.

Trust 1 was formed by Taxpayer's parents in Year 2. Taxpayer and Taxpayer's sister, Sister, are the co-trustees of Trust 1. Trust 1 provides, in relevant part, that Taxpayer is the sole current beneficiary. The trustees have a discretionary power to distribute income to Taxpayer, while Taxpayer is living. Upon Taxpayer's death, the assets of Trust 1 pass to a trust for the benefit of Taxpayer's descendants. Taxpayer has no power of appointment to change the disposition of Trust 1.

Trust 2 was formed by Taxpayer in Year 1. The beneficiaries of Trust 2 are Taxpayer's wife and children. Trust 2 provides that the trustee has discretionary authority to distribute income and principal to a beneficiary in such amounts as the trustee considers appropriate to provide for the beneficiary's education, support, maintenance, and health, after taking into account the beneficiary's other income or resources.

Trust 2 is the owner and beneficiary of Policy 2, a whole life insurance policy on the life of Taxpayer. Taxpayer has made gifts to Trust 2 to fund the premiums of Policy 2.

Taxpayer proposes to undertake the following series of transactions:

- a) Partnership 1 will remove itself and Partnerships 2, 3, and 4 as the beneficiaries of Policy 1 and designate Taxpayer's children as the beneficiaries.

- b) Corporation 1, Corporation 2, and Taxpayer will make capital contributions to Partnership 1 in an amount sufficient to allow Partnership 1 to make distributions to Taxpayer in an amount equal to Taxpayer's contributions to Partnership 1 used to make premium payments.
- c) Trust 1 will purchase Taxpayer's limited partnership interest in Partnership 1.
- d) Trust 1 will purchase Taxpayer's shares in Corporation 1.
- e) Corporation 2 will distribute the Partnership 1 limited partnership interest that it owns to Trust 1.
- f) Trust 2 will contribute Policy 2 to Partnership 1 in exchange for a limited partnership interest in Partnership 1.
- g) Trust 1 will contribute cash to Partnership 1 in an amount projected to fully pay the premiums on Policy 1 and Policy 2 for the remainder of Taxpayer's life.
- h) Taxpayer will release to Sister any power to make any significant decisions with regard to Policy 1. Taxpayer represents that after this release, Taxpayer will not have the power to change the beneficiary of Policy 1, surrender or cancel the policy, assign the policy, revoke an assignment of the policy, pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy. Only the principal of Partnership 1's cash assets will be used to pay the premiums on Policies 1 and 2. The amount of assets necessary to pay such premiums will be based on projections provided by Insurance Company. In the event that the projections are incorrect, such that the amount of assets set aside is insufficient to pay the premiums on Policies 1 and 2, the trustees of Trust 1 will contribute additional assets to Partnership 1 to be set aside for payment of the premiums.
- i) Upon receipt of a favorable private letter ruling, Partnership 1 will designate itself as the sole beneficiary of Policy 1.

Following the proposed transactions, Trust 1 and Trust 2 will own 100% of Partnership 1. The two policies will be owned by Partnership 1. The beneficiaries of each policy will be Partnership 1.

You have requested the following rulings:

1. The proceeds of Policy 1 and Policy 2 received by Partnership 1 upon Taxpayer's death will not be includible in Taxpayer's gross estate under § 2042(2).

2. The proceeds of Policy 1 and Policy 2 received by Partnership 1 upon Taxpayer's death will not be includible in Taxpayer's gross estate under § 2035.

## LAW AND ANALYSIS

### Ruling 1

Section 2042(2) of the Internal Revenue Code 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 policy (or other instrument) or by operation of law only if the value of such reversionary interest exceeds 5% of the value of the policy immediately before the death of the decedent.

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 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 or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust.

Section 20.2042-1(c)(6) provides that, in the case of economic benefits of a life insurance policy on the decedent's life that are reserved to a corporation of which the decedent is the sole or controlling shareholder, the corporation's incidents of ownership will not be attributed to the decedent through stock ownership to the extent the proceeds of the policy are payable to the corporation. However, if any part of the proceeds of the policy are not payable to or for the benefit of the corporation, and thus are not taken into account in valuing the decedent's stock holdings in the corporation for purposes of § 2031, any incidents of ownership held by the corporation as to that part of the proceeds will be attributed to the decedent through the stock ownership where the decedent is the sole or controlling shareholder.

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 which was part of the residuary estate, 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, based on the legislative history underlying § 2042(2), that the section generally applies to include life insurance in situations that parallel the inclusion of property under §§ 2036-2038. Those sections generally involve the transfer of property where rights or powers are retained incident to the transfer. Under the facts in Rev. Rul. 84-179, the decedent transferred the policy to his wife and subsequently, in an unrelated transaction, reacquired incidents of ownership over the policy in a fiduciary capacity. The ruling holds that under these circumstances, the decedent will not be considered to possess incidents of ownership in the 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. The ruling further provides that the result would be the same if the decedent acting as trustee purchased a policy as a trust asset. The ruling states, however, that if the decedent's powers over the policy could have been exercised for the decedent's benefit, they would constitute incidents of ownership in the policy without regard to how those powers were acquired and without consideration of whether or not the decedent was the source of the funds used to pay the premiums. See Estate of Fruehauf v. Commissioner, 427 F.2d 80 (6th Cir. 1970).

In Estate of Knipp v. Commissioner, 25 T.C. 153 (1955), acq. in result, 1959-1 C.B. 4, aff'd on another issue, 244 F.2d 436 (4th Cir. 1957), cert. denied, 355 U.S. 827, 78 S. Ct. 36, 2 L. Ed. 2d 40 (1957), a partnership in which the decedent was a 50% general partner, owned 10 insurance policies on the decedent partner's life at his death. The partnership paid the premiums on all of the policies, and the insurance proceeds were payable to the partnership. The court found that the partnership purchased the policies in the ordinary course of business and held that the decedent, in his individual capacity, had no incidents of ownership in the policies and, therefore, the policies were not includible in the decedent's gross estate under the predecessor to § 2042(2).

Rev. Rul. 83-147, 1983-2 C.B. 158, considers whether incidents of ownership in

an insurance policy owned by a general partnership would be attributed to the insured general partner. In the revenue ruling, a general partnership obtained a whole life insurance policy on the life of one of its partners. The partnership made the premium payments in partial satisfaction of the insured partner's distributive share of partnership income and the insured partner's child was designated as the beneficiary of the policy. When the partner died, the face amount of the policy was paid to the child. The revenue ruling distinguished Estate of Knipp, supra, on the basis that, in Knipp, the insurance proceeds were paid to the partnership and inclusion of the proceeds in the gross estate under § 2042 would have resulted in "unwarranted double taxation" of a substantial portion of the proceeds were included in the value of decedent's partnership interest. In contrast, in the revenue ruling, the proceeds are payable to a third party for a purpose unrelated to the general partnership business, and thus, would not be included in the value of the partnership interest included in the gross estate. Accordingly, the ruling concludes that under these circumstances, the incidents of ownership are treated as held by the insured general partner in conjunction with the other partners. The ruling further states that the Service did not agree with any implication that incidents of ownership should not be attributed to an insured partner when the proceeds are payable other than to or for the benefit of the partnership.

In this case, after the transactions, Taxpayer will release to Sister any power to make any significant decisions with regard to Policy 1. Taxpayer will not have the power to change the beneficiary of Policy 1, surrender or cancel the policy, assign the policy, revoke an assignment of the policy, pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy. Partnership 1 will pay all the premiums on Policies 1 and 2. Accordingly, based solely on the facts submitted and representations made, assuming the proposed transactions are carried out as represented, it is concluded that the proceeds of Policy 1 and Policy 2 received by Partnership 1 upon Taxpayer's death will not be included in Taxpayer's gross estate under § 2042.

### Ruling 2

Section 2035(a) provides that (1) if the decedent transferred an interest in 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 (2) the value of the property (or interest therein) would have been included in the gross estate under §§ 2036, 2037, 2038, or 2042 if the interest or power had been retained by the decedent on the date of death, then the value of the gross estate includes the value of any property (or interest therein) that would have been so included.

Section 2035(d) provides that § 2035(a) shall not apply to any bona fide sale for an adequate and full consideration in money or money's worth.

In this case, before and after the transactions, Taxpayer will not possess any incidents of ownership. Accordingly, based solely on the facts submitted and representations made, we conclude that the proceeds of Policy 1 and Policy 2 will not be includible under § 2035(a), if Taxpayer dies within three years of releasing his powers over Policy 1. The above conclusions assume that Taxpayer's powers are not reinstated.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning the income tax treatment of the proposed transactions under § 101.

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) of provides that it may not be used or cited as precedent.

Sincerely,

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

Enclosure:

Copy of letter for § 6110 purposes