The Often Overlooked Income Tax Rules of Life Insurance Policies
Donald O. Jansen, Esq., and Lawrence Brody, Esq.

Life insurance is a unique product that provides needed liquidity during the lifetime and at the death of the insured. It is useful in business and estate planning and can be a wealth creation or wealth transfer vehicle. The taxation of life insurance proceeds is complex and subject to certain exemptions. It is important to be familiar with the particular life insurance rules in order to avoid unexpected income tax consequences. This discussion summarizes some of the unique income tax attributes associated with life insurance policies and the tax planning strategies that involve life insurance.

INTRODUCTION
Generally, death proceeds and cash value build-up in the life insurance policy are free from federal income taxes. But this is not always the case. There are several exceptions to the income-tax-free receipt of death proceeds, including the following:

1. Transfers of the policy during the insured’s lifetime for value
2. The receipt of the death proceeds of some employer-owned life insurance

The otherwise tax-free build-up of life insurance value may be subject to income tax if:

1. the cash value is accessed and the policy is a modified endowment contract;
2. the policy is surrendered, lapses, or sold; or
3. there are significant dividends or policy withdrawals or policy loans.

This discussion relies on certain guidance and definitions presented in the Internal Revenue Code and Regulations. Where applicable, this discussion aggregates some of the more relevant definitions found in the Code and Regulations and presents that information on Exhibit 1.

TAXATION OF LIFE INSURANCE DEATH BENEFITS
Assuming that a policy meets the applicable definition of “life insurance,” the general rule is that any proceeds paid by “reason of the death of the insured” are not included in the beneficiary’s taxable income.\(^1\)

This rule applies to the entire death proceeds, but it does not apply to interest paid by the insurance carrier on the proceeds after the insured’s death. Any such interest is includible in the beneficiary’s taxable income. In the case of proceeds paid in installments, a portion of each payment represents nontaxable proceeds and the balance is taxable income to the beneficiary. The manner of the allocation depends on the type of installment payment involved.

There are several exceptions to the general rule that death proceeds are excluded from taxable income. The most notable exception among these is the so-called “transfer for value” rule of Internal Revenue Code Section 101(a)(2). This rule is triggered when the policy (or even an interest in the policy) has been transferred during the insured’s lifetime (other than as a pledge or assignment as security) for a “valuable consideration” (whether or not in a sale transaction).
Another exception is the employer-owned life insurance rule. This exception potentially includes death proceeds received by employers on the lives of certain employees in the employer’s income.

The transfer for value rule and the employer owned insurance rule are summarized next.

Transfer for Value Rule
When there has been a transfer of the policy for value during the insured’s lifetime, the proceeds paid by reason of the insured’s death will be includable in the beneficiary’s taxable income. This is true to the extent that the proceeds exceed the sum of (1) the consideration paid for the transfer and (2) the premiums paid by the buyer subsequent to the transfer.

Exemptions to the Transfer For Value Rule
There are, however, helpful exceptions to the transfer for value rule (which in some ways have become the rule). The transfer for value rule does not apply (i.e., the proceeds are not taxed) when a policy is transferred for a valuable consideration to the following parties:

1. The insured
2. A partner of the insured
3. A partnership in which the insured is a partner (including an LLC taxed as a partnership in which the insured is a member)
4. A corporation in which the insured is a shareholder or officer (the proper party exception).

There are other instances where the transfer for value rule does not apply.

First, the transfer for value rule does not apply if the transferee’s basis in the policy is determined in whole or in part by reference to the transferor’s basis in the policy. This is known as the carryover basis exception.

Second, if a policy is acquired by gift, the transfer for value rule generally does not apply. This is because the transferee’s basis will be the same as the transferor’s basis under Section 1014. The same rule would apply if a policy is contributed to a partnership or a corporation, so long as the contribution was income-tax-free.

Third, transfers between spouses (or former spouses, if the transfer is incident to a divorce) that occurred after July 18, 1984, are treated as gifts.

Finally, under Revenue Ruling 2007-13, a transfer for value (a sale) of a policy by the insured grantor (or even by another grantor trust created by the insured) to a grantor trust from the insured’s point of view will be treated as an exempt transfer to the insured for this purpose. This transfer would also qualify for another exception to the transfer for value rule. This is because the sale would be ignored for income tax purposes and the transfer would therefore qualify as a carryover basis transaction, under Revenue Ruling 85-13.

When a policy is transferred by gift, the income-tax-free death proceeds are limited to the sum of:

1. the amount that would have been excludible by the party making the transfer had no transfer taken place plus
2. any premiums and other amounts paid after the transfer by the transferee.

In either case, however, where the transfer is made to one of the “proper party” individuals or entities described in Section 101(a)(2)(B), the entire amount of the proceeds will be excludible from the transferee’s gross income.

There are also complex rules for determining which, if any, exception applies in a series of transfers of a policy.

Last Transfer Rule
What if the last transfer prior to the insured’s death was by gift, but there were other transfers prior to that for value?

As noted above, the answer is that the taint remains, unless the final transfer is to one of the safe harbor exempt parties, which would remove it. For example, where the last owner’s basis is determined in whole or in part by reference to the prior owner’s basis, the income tax exclusion is limited to the sum of:

1. the amount that the transferor could have excluded had no transfer taken place and
2. any premiums or other amounts paid by the final transferee.

The effect of a series of transfers for a valuable consideration of a life insurance policy or an interest therein is addressed in Regulation 1.101-1(b)(3)(ii). This regulation indicates that if the final transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer, then the final transferee can exclude the entire amount of the life insurance policy proceeds paid by reason of death of the insured from gross income under Section 101(a)(1).
If the last transfer is for valuable consideration, then only the actual consideration paid by that transferee (plus premiums or other amounts paid after the transfer) is excludible.

If the last transfer is a gift (or part sale and part gift, with more gift than sale), where the donee’s basis is determined at least in part by reference to the donor’s basis (which, as noted above, is not always the case in a part sale/part gift situation), then the final transferee will be able to exclude the entire amount of the proceeds.

If the last transfer is to one of the five “proper parties,” then that exempt transferee will be able to exclude the entire amount of the proceeds from gross income.

Can the last transferor rule be avoided by “washing” an otherwise tainted transaction through a brief ownership by the insured? In other words, can the transfer for value tax trap be avoided by having the insured buy the policy and then make an immediate gift to the intended eventual owner?

In Private Letter Ruling (PLR) 8906034, a life insurance policy was owned by a corporation on the life of an individual who owned 75 percent of the firm’s stock. Four percent of the stock of that corporation was owned by the insured’s son who worked in the business. And, the balance of the stock was owned equally by the five other children of the insured. None of the other children worked in the family business.

The insurance was briefly transferred to the insured who paid the corporation an amount equal to the policy’s value on the date of the transfer. The insured then made a gift of the policy to his son—at the same time the son promised to keep the insurance in force and use the policy proceeds to buy his father’s stock when he died and to pay his father’s estate liabilities if there were a shortfall between the purchase price and the amount of the insurance proceeds received.

The Service held that this final transfer was a transfer for value. The Service noted that, because the transfer was by gift, the transferee must determine basis by reference to the transferor’s basis.

There are potential problems even in a seemingly clear “safe” situation, such as the one described above. The Service could argue that the two transactions are in reality one—that is, the step transaction doctrine should be used to collapse the parts into a single transfer from the corporation to the co-shareholder son. Also, note that the tax-free receipt of proceeds holding in the PLR was conditioned on the fact that the transfer from father to son was a gift.

But what if the Service argued that the real motivation for the father’s transfer was not merely love and affection, but rather to assure estate liquidity by creating a market for the father’s stock, or was in exchange for the son’s promise to pay premiums and to buy back the stock?

Those promises would be “consideration,” as discussed below.

Perhaps in some situations the Service will claim that there was a quid pro quo, that each shareholder made a promise to buy the policy on his or her own life and then give it away in return for the other’s promise to do the same.

Transfer for Value Issues

Two issues that must be resolved in every transfer for value case are:

1. Has there been a “transfer” of a policy or an interest in a policy and, if so,
2. Was there “valuable consideration” for that transfer?

Obviously, these questions can’t be answered without definitions of the word “transfer” and the phrase “valuable consideration.”

In PLR 9852041, the taxpayer and his brother were joint owners of life insurance policies. For administrative convenience and to allow the brothers to make decisions regarding their respective investments in the policies separately, they wanted to change the current joint ownership of the policies. The insurance companies would issue two separate policies, one owned by the taxpayer and the other owned by his brother, to replace each of the present policies.

Each of the new separate policies would insure the same life as one of the policies and would provide one-half of the death benefit, cash value, and
indebtedness. Each brother would pay equally, using his own funds, a nominal administrative fee to the insurance companies for the proposed policy split. The Service held that, in this situation, there was no transfer for transfer for value purposes.

Note that if a transaction is deemed not to otherwise involve a transfer for income tax purposes, the requisite transfer for purposes of the transfer for value rule may not be present.

For instance, in PLR 200228019, there was a grantor trust-to-grantor trust transfer of life insurance. The second trust purchased the policy owned by the first trust for its gift tax value. So, clearly, there was no consideration. But since both trusts were grantor trusts from the point of view of the same grantor, it was as if there were no policy transfer—it was disregarded for income tax purposes.

Note that under the broad scope of the definition found in the regulations, a transfer for value occurs if, in exchange for any kind of valuable consideration, a life insurance policy is transferred, or the beneficiary of all or any portion of the proceeds is named or changed. For instance, consideration for this purpose could be found in an employee's promise to continue working for the business in exchange for the transfer or change.

In PLR 9701026, shareholders wanted to have their corporation transfer existing split dollar coverage to a trusteed cross purchase plan to fund a buy-sell arrangement. The Service held that (1) the absolute transfer of a right to receive at least a portion of the policy proceeds (split-dollar financing was used) provided the requisite transfer and (2) the corporation's release from the obligation to pay premiums was sufficient valuable consideration to trigger the rule.

The rule applies even if there is no legal assignment of the policy, even though the policy has no cash surrender value at the time of the transfer, and even if the policy is term insurance (so that it never had and never will have any cash value).

Let's assume the transfer may be for a valuable consideration and none of the exemptions provided for in Section 101(a)(2) to the transfer for value rule apply. Nonetheless, if the consideration paid for the transfer plus any amounts paid subsequent to the transfer by the transferee exceed the proceeds of the policy, the entire amount of the proceeds will be excludible from gross income.

It is not necessary that the consideration given to support a transfer be in the form of cash or other property with an ascertainable value. No purchase price need be paid nor need money change hands—reciprocal promises and quid pro quos are treated as consideration. The “valuable consideration” requirement is met by any consideration sufficient to support an enforceable contract right.

For example, in Monroe v. Patterson, and PLR 7734048, the mutuality of shareholders' agreements to purchase the others' stock in the event of death was held to be enough consideration to invoke the rule.

Borrowing Down the Policy

If the policy is subject to a loan at the time of the gift or other transfer, the loan raises another issue. This can be a common problem. This is because policy owners often contemplate “borrowing down” the cash value of the policy before making a gift. This may be done prior to transferring an existing policy to an irrevocable life insurance trust in order to reduce its transfer tax value, especially when the policy is older and has substantial cash value.

If, as part of the transfer, the transferor is released from liability on the loan, he or she has received a valuable consideration in the form of discharged indebtedness.

Note that if the transferor had an adjusted basis in the contract at least equal to or greater than the amount of the loan, then the transferee would determine his or her basis at least in part by a carryover of the transferor's basis.

If the transferor's basis exceeds the amount of the loan, then the transferee's basis will be determined, at least in part, by reference to the transferor's basis and the exception of Section 101(a)(2)(A) will apply.

On the other hand, if the loan exceeds the transferor's basis, then the transferee may not carryover all or any portion of the transferor's basis, which would take the transaction out of the “transferor's basis” safe harbor exception. The solution would be to (1) pay off at least a portion of the loan prior to the transfer or (2) otherwise structure the loan so that it would not exceed the transferor's basis at the time of transfer.

If, however, the loan exceeds the transferor's basis, the transferee's basis will equal the amount of the loan (plus any other consideration paid), the transfer will be treated as a taxable transaction, and, a transfer for value will have occurred (assuming the transferee is not otherwise exempt—for instance, a grantor trust from the insured's point of view). Note that withdrawals from universal life policies (even if taxable because they exceed basis) are not loans and, therefore, they do not create this issue.

Employer-Owned Insurance

Effective for life insurance contracts issued after August 17, 2006, Congress enacted Section 101(j)
to counter the practice of some employers of purchasing insurance policies on the lives of a large segment of their employees, in many cases without notice to the employees. These arrangements were derogatorily referred to as “janitor insurance” or “dead peasant insurance.”

The statute includes in the employer’s income the policy death proceeds on policies owned by employers on the lives of their employees in excess of premium payments, except for a restricted class of employees. In the case of the restricted class, the income is excluded only if the insured was notified of, and consented to, the purchase.14

If the employer purchases an insurance policy on the life of a person who is an employee at the time of issue, the general rule is that the death proceeds will be included in the employer’s income, to the extent they exceed the amount of premiums and other amounts paid on such contract.15

There are two exceptions to the general rule that death proceeds in excess of premiums and other amounts paid are included in the employer’s gross income. If either exception applies, the death proceeds may be excluded from employer income under Section 101(a). Neither exception applies unless the notice and consent requirements, discussed below, are met before the policy is issued.

The first exception to death proceeds being included in the employer’s income relates to the death of any insured who either (1) was an employee at the date of his or her death or (2) was an employee at any time during the 12-month period before his or her death.16

The second exception applies only if the insured at the time the contract was issued is (1) a director, (2) a highly compensated employee within the meaning of Section 414(q), or (3) a highly compensated individual.

Insurance proceeds received because of the death of the insured employee are not subject to Section 101(j) (i.e., they are not taxable to the employer) if the proceeds are payable to any of the following:
- A family member17 of the insured
- Any individual who is the designated beneficiary of the insured under the contract other than the employer
- A trust established for the benefit of any such member of the family or designated beneficiary
- The estate of the insured, or the amount is used to purchase an equity (or capital or profits) interest in the employer from such family member, designated beneficiary, trust or the estate of the insured

This exception applies to any insurance owned by the employer to finance a stock redemption or business purchase agreement.

For any exception to apply, before the issuance of the contract, the employee must:

1. be notified in writing that the employer intends to insure his or her life and the maximum face amount for which the employee could be insured at the time the contract was issued,
2. provide written consent to being insured under the contract and to such coverage possibly continuing after the employee terminates employment, and
3. be informed in writing that the employer will be a beneficiary of any proceeds payable upon the death of the employee.18

An inadvertent failure to satisfy the notice and consent requirements may be corrected under the following circumstances:

1. The employer made a good faith effort to satisfy those requirements, such as maintaining a formal system for providing notice and securing consents from new employees.
2. The failure was inadvertent.
3. The failure was discovered and corrected no later than the due date of the tax return for the taxable year of the employer in which the policy was issued.19

In general, every employer owning one or more employer-owned life insurance or company-owned life insurance (EOLI/COLI) contracts issued after the date of enactment must file Form 8925 annually. This form shows the following information for each year such contracts are owned:

1. The number of employees
2. The number of employees insured under EOLI/COLI contracts
3. The total amount of life insurance in force under EOLI/COLI contracts
4. The name, address, taxpayer identification number and type of business of the employer, and
5. The employer has a valid consent for each insured employee (or, if all such consents are not obtained, the number of insured employees for whom such consent was not obtained)
The employer is also required to keep such records to show that the requirements of Section 101(j) are met.\textsuperscript{20}

The new EOLI/COLI rules apply to insurance contracts issued after August 17, 2006.\textsuperscript{21} A grandfathered insurance policy which is subject to a tax-free exchange under Section 1035 after August 17, 2006, will remain grandfathered from the statute. However, if the new policy obtained in the exchange itself contains material changes, such as increase of death benefit, grandfather status will be lost.\textsuperscript{22}

**OTHER CAUSES FOR TAXABLE DEATH PROCEEDS**

Other less common exceptions to the general rule that insurance death proceeds are not taxable income include the following:

1. The payment of proceeds from a qualified retirement (where part or all of the proceeds can be treated as taxable income depending on whether the employee/insured either paid the cost of the insurance or was taxable on that cost)\textsuperscript{23}

2. The payment of proceeds to someone who did not have an “insurable interest” in the life of the insured when the policy was issued, as determined by applicable state law

3. Post-final regulation economic benefit regime split-dollar arrangements, if the economic benefit isn’t contributed or reported as income by the owner

Finally, in some cases, policyholders will be able to receive a portion of the death proceeds of their policies “in advance of death” without income tax. Section 101(g) permits terminally ill persons to receive an accelerated death benefit provided under the policy, if certain conditions are satisfied, which will be treated as paid “by reason of the death” of the insured (even though the insured is still living) and thus, not subject to income tax.

A similar rule applies to chronically ill insureds for amounts paid for qualified long-term care. Amounts received by a terminally ill insured from a viatical settlement will likewise be treated as an amount paid by reason of death of the insured; a similar rule applies to chronically ill persons, for amounts paid by them for qualified long-term care.

**CASH VALUE GROWTH OF LIFE INSURANCE CONTRACTS**

The inside build-up of the cash value of a life insurance contract is not subject to income taxation before distributions in the form of surrenders, withdrawals, or dividends.\textsuperscript{24} Of course, if the cash value is held in the contract until the death of the insured, the entire death proceeds, including the cash value immediately before death, will be excluded from gross income under Section 101(a).

Cash value increases are not taxed to the policy owner under the constructive receipt rules. This is because access would be subject to substantial restrictions and limitations involving a surrender or partial surrender of the policy.\textsuperscript{25}

**Failure to Meet Definition of Life Insurance Contract Exception**

The general rule that the cash value growth is not taxed does not apply to any life insurance policy under applicable law that does not meet the alternative tests for a life insurance contract under Section 7702(a).\textsuperscript{26} Also, any life insurance policy that fails the diversification requirements for variable contracts is excepted from the general rule.\textsuperscript{27}

When a life insurance contract is disqualified, the income on the contract for any taxable year shall be treated as ordinary income received or accrued by the policyholder during such year.\textsuperscript{28}

If, during any taxable year, a life insurance contract ceases to meet one of the alternative tests under Section 7702(a), the income on the contract for all prior years will be treated as received or accrued by the policyholder during the taxable year in which such cessation occurs.\textsuperscript{29}

Once a policy fails to meet the test, it will remain disqualified even though it may meet the test requirements in a future year.

**Dividends, Withdraws, Surrenders, and Sales of Policy Exception**

Except with regard to modified endowment contracts, as a general rule, dividends, withdraws, and proceeds from the surrender or sale of a policy that are not received as an annuity are considered a return of basis (the investment in the contract).\textsuperscript{30}

In other words, such distributions reduce basis first with the excess being included in gross income.
The Contract Basis

Investment in the contract or basis as of any date is (1) the aggregate amount of premiums or other consideration paid for the contract before such date less (2) the aggregate amount received under the contract before such date to the extent that such amount was excludable from gross income.

The starting point to determine basis is the aggregate premiums paid by the taxpayer. Premium payments for the following benefits are not includable as part of the premium to determine investment in the contract: disability income, double indemnity provisions, disability waiver premiums. Interest payments on policy loans are likewise not included in determining investment in the contract.

For insurance policies with long-term care riders, charges against cash value will reduce basis. However, the charge will not be includable in gross income.

If there has been a transfer of the insurance policy for valuable consideration, then the new owner's investment in the contract would be the amount of consideration paid at the time of transfer plus any subsequent premiums paid, reduced by any dividends, withdrawals, or funds received from the policy to the extent those items were not included in gross income.

In some situations, the transferee will maintain the basis of the transferor despite the payment of consideration. These situations include the following:

1. Transfer from one corporation to another corporation in a tax-free reorganization
2. Transfer of a policy partially as a gift and partially for consideration when the transferor's basis exceeds the consideration paid
3. Transfer of policies between spouses or between former spouses incident to a divorce
4. Tax-free exchange of the policies under Section 1035

Dividends

With regard to participating insurance policies, dividends benefiting or directly paid to the policyholder will reduce the investment in the contract. If the dividend distribution plus all previous non-taxable distribution withdrawals exceed the investment in the contract, the excess would be ordinary income.

Dividends received in cash will reduce basis. Presumably, dividends left with the insurance carrier without restriction to accumulate interest would reduce basis under constructive receipt. Interest earned on the retained dividends does not reduce basis but is currently taxable to the policyholder under constructive receipt rules.

Withdrawals

As a general rule, with regard to a policy that is not a modified endowment contract, cash distributions from withdrawals or partial surrenders will not be included in the policy owner's gross income if they do not exceed the investment in the contract.

Withdrawals first come from basis and only then from income build-up within the policy.

There is an exception for withdrawals from the policy within the first 15 years after issuance of the policy if there is a reduction in the death benefit under the contract. In such a case, the order is reversed so that income comes out first and basis second up to a recapture ceiling.

If the withdrawal occurs during the first five years, there are two recapture ceilings depending on the type of policy involved. These are described in Exhibit 1.
Transfer for Variable Consideration. There is no definition of the term "transfer for valuable consideration" in the Code. The income tax regulations provide that a transfer occurs whenever any absolute transfer for value of a right to receive all or any part of the proceeds of a life insurance policy takes place. The term "transfer for valuable consideration" is defined for purposes of Section 101(a)(2), as any absolute transfer for value of a right to receive all or part of the proceeds of a life insurance policy.\(^1\) This includes the creation for value of an enforceable right to receive all or part of the proceeds of a policy, but excludes any pledge or assignment of a policy as collateral security.\(^2\) The creation by separate contract or agreement of a right to receive all or a portion of the policy proceeds would be considered a transfer for this purpose.

Employer. The Internal Revenue Code defines an “employer” as a person engaged in a trade or business under which such person (or related person) is directly or indirectly a beneficiary under the contract. A “related person” includes any person who bears a relationship to the employer which is specified in Sections 267(b) or 707(b)(1) or is engaged in trades or businesses with such employer which are under common control (within the meaning of subsection (a) or (b) of Section 52).\(^3\)

Insured. An “insured” under EOLI/COLI is an employee with respect to the trade or business of the employer or related person on the date the life insurance contract is issued. Employee includes an officer, director, and highly compensated employee.\(^4\)

Highly Compensated Individual. Pursuant to Section 105(h)(5), highly compensated employee is one of five highest paid officers, a shareholder owning more than 10 percent of the value of employer’s stock or among the highest paid 35 percent of all employees, excluding certain employees who are not participants.

EOLI Reporting. The Service issued Form 8925 “Report of Employer Owned Life Insurance Contracts” January 2008. This form is used to report the number of employees covered by EOLI contracts and the total amount of EOLI in force on those employees at the end of the tax year.

Income on the Contract. With respect to any taxable year of a policyholder, the taxable “income on the contract” includes the sum of (1) the increase in the net surrender value of the contract during the taxable year and (2) the cost of life insurance protection provided under the contract during the taxable year reduced by premiums paid during the taxable year.\(^5\)

Net Surrender Value. The “net surrender value” of the contract will be determined with regard to surrender charges but without regard to any policy loan. The “cost of insurance protection” during the taxable year is based upon the lesser of (1) the uniform premium tables (computed on the basis of five-year age brackets) to be prescribed by regulations or (2) the mortality charge, if any, stated in the contract.\(^6\)

Recapture Ceilings. Recapture ceilings in years one through five of a contract:

- In the case of a traditional contract qualifying under the cash value accumulation test, the recapture ceiling is the excess of the cash surrender value of the contract, immediately before the reduction, over the net single premium immediately after the reduction.
- In the case of a universal life contract qualifying under the guideline premium/cash value corridor test, the recapture ceiling is the greater of the excess of (1) the aggregate premiums paid under the contract, immediately before the reduction, over (2) the guideline premium limitation for the contract, taking into account the reduction in benefits or the excess of the cash surrender value of the contract, immediately before the reduction, over the cash value corridor, determined immediately after the reduction.

Material Change. A “material change” includes any increase in the death benefit under the contract or any increase in, or addition of, a qualified additional benefit under the contract.\(^7\) Material change shall not include (1) any increase that is attributable to the payment of premiums necessary to fund the lowest level of the death benefit and qualified additional benefits payable in the first seven contract years or to crediting of interest or other earnings (including policyholder dividends) in respect of such premium and (2) to the extent provided in regulations not yet issued, any cost of living increase based on an established broad-based index if such increase is funded ratably over the remaining period during which premiums are required to be paid under the contract.\(^8\)

Notes:
1. Regulation 1.101-1(b)(4).
2. Regulation 1.101-2(b)(4).
4. Within the meaning of Sections 414(q)), 101(j)(3)(A)(ii) and (5)(A).
5. Section 7702(g)(1)(B)(A).
6. Section 7702(g)(1)(D).
7. Section 7702A(c)(3)(B).

www.willamette.com  INSIGHTS • AUTUMN 2013  49
If the withdrawal occurs after the fifth year and before the 16th year, the recapture ceiling is the excess surrender value of the contract, immediately before the reduction, over the cash value corridor, determined immediately after the reduction.

The distribution rules of Section 7702(f)(7) also apply to any distribution that reduces the cash surrender value of the contract which is made within two years before reduction in death benefits under the contract. Except for modified endowment contracts, loans are not subject to this special 15-year rule. This is because loans against the cash value of insurance policies are not treated as distributions and do not reduce the death benefits.

**Redemptions, Surrenders, or Maturities**

Any amount received under a contract upon its complete surrender, redemption, or maturity shall be included in gross income but only to the extent it exceeds the investment in the contract. Such amount is taxed as ordinary income and not as capital gain. Proceeds received from surrender of paid up additions also reduce basis first.

There is an exception when a policyholder elects prior to the maturity or surrender date to postpone receipt of the proceeds under a settlement option and to receive a payment in another format (e.g., an annuity or deposit of proceeds with payment of interest only). In such a case, income will be taxed to the beneficiary upon receipt rather than at the date of surrender.

There is another exception that relates to certain annuity options elected after maturity or surrender. The surrender proceeds in excess of the investment in the contract would normally be included in the gross income of the policyholder if he or she is entitled to a lump sum distribution after the policy has matured or been surrendered.

However, income is not recognized if, prior to receipt of the lump sum and within 60 days after the surrender or maturity, the policyholder exercises an option or irrevocably agrees with the insurance carrier to take the payments in the form of an annuity. In such a case, future distributions would be taxed to the policyholder under the annuity rules of Section 72.

Does Section 1234A change the results of the gain from the surrender of a policy from ordinary income to capital gain?

That Section states in part that “gain or loss attributable to the cancellation, lapse, expiration or other termination of . . . a right or obligation . . . with respect to property which is . . . a capital asset in the hands of the taxpayer . . . shall be treated as gain or loss from the sale of a capital asset.”

The Service’s position is that, although the insurance policy may itself be a capital asset, the internal buildup of cash value is ordinary income to which Section 1234A does not apply.

**Sale of Life Insurance Contract**

If a policy is sold, the seller will realize ordinary income (not capital gain) on the amount of sale proceeds in excess of the investment in the contract up to the amount of the inside build-up. The internal build-up in excess of the cost basis represents accumulation of interest income rather than appreciation of capital and is therefore ordinary income.

Technical Advice Memorandum (TAM) 200452033 ruled that the ordinary income accrual to cash value of an insurance policy is not a capital asset. If the insurance policy is subject to a nonrecourse loan, then the sale price is the value of the property received by the seller plus the amount of the loan.

As noted earlier, there is an exception for policies sold to a viatical settlement provider pursuant to Section 101(g)(2)(A). What if a life settlement policy not eligible for viatical treatment is sold?

In Revenue Ruling 2009-13, Situations 2 and 3, the Service ruled that the excess sales proceeds over the greater of basis and cash value is capital gain.

Is the investment in the contract reduced by mortality charges which would result in more ordinary income?

For an elderly insured such reduction could almost eliminate basis.

Section 72 does not reduce basis by mortality charges when determining the taxability of withdrawals and distributions from a life insurance policy. Section 72 covers amounts received under the insurance contract and does not address the basis of a life insurance policy when the policy is sold or transferred. Many practitioners thought that the basis for distribution and withdrawal under Section 72 also applies to sales or transfers of insurance policies. The Service disagrees.

When a policy is sold, the Service looks to Section 1001 to determine the gain or loss on the sale of property. The basis for determining gain or loss is the cost of acquiring such property adjusted “for expenditures, receipts, losses or other items, properly chargeable to the capital account.”

The Service has ruled that, with regard to the sale of a policy by the insured, the basis or investment in the contract is reduced by the cost-of-insurance (mortality) charges over the term of the policy. In so ruling, the Service’s position is that insurance
premiums pay for two items—the investment in the cash value and the insurance protection. For the basis in the cash value investment in the policy, the cost-of-insurance protection premium is ignored.

Strangely, in a situation where the owner of the policy bought the policy solely with a view to profit (such as a life settlement purchase), when the owner for profit later sells the policy, such owner’s basis is not reduced by cost-of-insurance protection and his basis is consideration paid plus subsequent premiums. Therefore, the reduction in basis for mortality charges appears to apply only to policies owned by the insured or someone who purchased the policy for protection against any loss upon the insured’s death.

The Service’s position is controversial. The revenue ruling cited three court cases. The facts of those cases involve sales or surrenders of insurance policies where the premiums exceeded the sales proceeds or cash surrender value. Therefore, the courts determined that basis to measure a loss is based on premiums reduced by cost of insurance protection.

However, in Forbes Lithograph Manufacturing v. White, the court allowed the taxpayer to recognize a loss when the surrender proceeds for the insurance policy were less than the premiums paid.

There are no court decisions involving basis in a sale of a policy for gain. In Lucas v. Alexander, the U.S. Supreme Court determined that the realized gain on the surrender proceeds of an insurance policy was the amount in excess of the total premiums paid. Technically, the Supreme Court did not consider the cost basis in the policy but merely the realized gain which was exempt from income taxation because it preceded the federal income tax.

Therefore, it is not clear whether the Service’s position is correct that the cost of insurance policy is always reduced by the mortality charges. There are two alternative arguments. One is that the premium is basis without any reduction for mortality charge. The other position is that the full premium is the measure of basis for determining gain, but the premium less mortality charge is used to determine loss.

Let’s consider this analogy: the basis in your home is not reduced by the fair rental value of your use of the home. Why should the basis in your life insurance policy be reduced by the costs of insurance coverage you receive?

The Service’s answer is that the policy is two items of property:
1. An investment in cash value
2. Death coverage

Some of the investment is taken to continue the death coverage.

**Modified Endowment Contract Exception**

A modified endowment contract (MEC) means any contract that meets the requirements of Section 7702 that is entered into on or after June 21, 1988, and fails to meet the seven-pay test. The seven-pay test is defined in Exhibit 2. A new contract received in exchange for an MEC is also an MEC.

The MEC rules were adopted by Congress to discourage the sale of insurance policies as tax shelter investment vehicles (rather than for family, creditor and business investment purposes) through the payment of large single premiums for policies with the minimum amount of pure insurance coverage under the definition of life insurance contract.

These policies could generate significant internal income. That income could be accessed without income taxation by the owner through withdrawals or loans at minimum interest rates.

**Material Changes**

If there is a material change in the benefits under (or in other terms of) the life insurance contract that was not reflected in any previous determination, such contract will be treated as a new contract entered into on the day on which such material change takes effect and the seven-pay test will be applied again. A “material change” is defined in Exhibit 1.

In applying the seven-pay test (i.e., to determine if a policy is classified as an MEC) to a policy after a material change, appropriate adjustments are made to the cash surrender value. However, if the cash surrender value is artificially repressed, then the fair market value of the contract will be used instead.

A series of material changes is not intended to circumvent the limitations in Section 7702A.

**Taxation of Distributions from MEC**

The tax consequences of distributions from an MEC are the exact opposite of the distributions from a non-MEC. Distributions will be deemed to come from the income build-up in the cash value of the policy first, and distribution of investment in the contract second. Furthermore, any loans against the policy or assignment or pledge of the policy will be treated as a distribution.

In other words, distributions from an MEC are taxed in the same manner as distributions from a tax-deferred annuity.
A contract fails to meet the seven-pay test if the accumulated amount paid under the contract at any time during the first seven contract years exceeds the sum of the net level premiums that would have been paid on or before such time if the contract provided for paid-up future benefits after the payment of seven level annual premiums. “Amount paid” means the premiums paid under the contract reduced by any amount received in a distribution not includable in gross income.

The seven-pay test will be determined at the time the contract is issued by applying the cash value accumulation test of Section 7702(b)(2) subject to the computational rules of Section 7702(e) except that the death benefit provided for the first contract year shall be deemed to be provided until the maturity date without regard to any scheduled reduction after the first seven contract years. Charges for qualified additional benefits are taken into account to determine if the seven-pay test is met.

If there is a reduction in death benefits under the contract within the first seven contract years, the seven-pay test will be applied as if the contract had originally been issued at the reduced benefit level. Any reduction in benefits attributable to nonpayment of premiums due under the contract shall not be taken into account if the benefits are reinstated within 90 days after reduction in such benefits. If the contract is a second-to-die policy, and there is a reduction in death benefit below the lowest level of death benefit provided under the contract during the first seven contract years, the seven-pay test will be applied as if the contract had originally been issued at the reduced benefit level.

The seven-pay premium for each of the first seven contract years after the change is to be reduced by the product of (1) the cash surrender value of the contract as of the date that the material change takes effect (determined without regard to any increase in the cash surrender value that is attributable to the amount of premium payment that is not necessary), and (2) a fraction the numerator of which equals the seven-pay premium for the future benefits under the contract, and the denominator of which equals the net single premium for such benefits computed using the same assumptions used in determining the seven-pay-pay premium.

Notes:
1. Section 7702A(b).
2. Section 7702A(e)(1)(A).
3. Section 7702A(c)(1).
5. Section 7702A(c)(2)(B).
6. Section 7702A(c)(6).
To determine the amount includable in gross income, all MECs issued by the same insurance company to the same policyholder during any calendar year will be treated as one MEC.\textsuperscript{58}

An MEC loan will be treated as a distribution even though the policy owner is a person other than an individual.\textsuperscript{69}

With regard to a participating policy, dividends received in cash or used to pay the principal or interest on a policy loan are distributions taxable to the extent of income build-up in the cash value.

On the other hand, a dividend under an MEC retained by the insurer to purchase additional paid-up insurance or a qualified additional benefit or to pay a premium is not a taxable distribution.\textsuperscript{69} As noted earlier, presumably, dividends used to purchase riders that are not integral to the policy—for example, waiver of premium upon disability, term insurance rider, disability income, and so forth—would be treated as distributions.

As noted above, a loan against an MEC is considered to be a taxable distribution to the extent of income build-up of the cash value.\textsuperscript{71} Amounts borrowed under the MEC and retained by the insurer as premiums under the contract are considered distributions. If the amount of loan is includable in gross income, then the policyholder’s investment in the contract is increased by the amount of the loan.\textsuperscript{72}

If a contract is classified as an MEC, distributions are affected during the contract year in which the MEC fails the seven-pay test and during any subsequent contract year.\textsuperscript{73} In addition, any distribution from an insurance contract that is made within two years before the failure to meet the seven-pay test will be treated as made in anticipation of such failure.\textsuperscript{74}

If a taxpayer includes an MEC distribution in his or her gross income, the tax will be increased by an amount equal to 10 percent of the distribution so included.\textsuperscript{75} The 10 percent additional penalty tax will not apply in the following situations:\textsuperscript{76}

- Distributions after taxpayer attains age 59½
- Distributions attributable to the taxpayer’s becoming disabled (within the meaning of Section 72(m)(7))
- Distributions that are a part of a series of equal periodic distributions made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and his beneficiary

**Effective Date**

Generally, the MEC rules apply to life insurance contracts entered into on or after June 21, 1988.\textsuperscript{77} As a general rule, life insurance contracts issued before June 21, 1988, are grandfathered from the MEC rules.

Grandfathering is lost, however, in the following situations:

- If the death benefit under the contract increases by more than $150,000.00 over the death benefit under the contract in effect on October 20, 1988. The seven-pay rules would apply as if this were a material change in testing whether this is an MEC.
- If, (1) on or after June 21, 1988, the death benefit under the contract is increased (or a qualified additional benefit is increased or added) and (2) before June 21, 1988, the owner of the contract did not have a unilateral right under the contract to obtain such increase or addition without providing additional evidence of insurability.\textsuperscript{78}
- If the contract is converted after June 20, 1988, from a term life insurance contract to a life insurance contract providing coverage other than term life insurance coverage without regard to any right of the owner of the contract to such conversion.\textsuperscript{79}

The Service has privately ruled that grandfather status will not apply to a new insurance contract issued in exchange for a grandfathered policy under Section 1035.\textsuperscript{80}

The grandfathering status is not lost if the policy as of June 21, 1988, required at least seven level annual premium payments and under which the policyholder continues to make level annual premium payments over the life of the contract (the typical whole life contract).\textsuperscript{81}

**Section 1035 Tax-Free Exchange of Life Insurance Contract**

Normally, the surrender of a life insurance contract with the purchase of a new life insurance contract with the surrender proceeds would result in the inclusion in the gross income of the policy owner that portion of the surrender proceeds in excess of his or her investment in the contract. However, if the requirements of Section 1035 are met, the old insurance policy can be exchanged for a new insurance policy without triggering income.

No gain or loss shall be recognized on the exchange of a contract of life insurance (which is not ordinarily payable in full during the life of the insured) for another contract of life insurance or for
an endowment, an annuity contract, or a qualified long-term care insurance contract.\textsuperscript{82}

However, the reverse is not true. There is no tax-free exchange of an endowment, an annuity contract, or a qualified long-term care contract for a life insurance policy.\textsuperscript{83} Many of the citations in this section apply to annuity exchanges. The rules, however, should be the same for life insurance policy exchanges.

The owner of the contract that is exchanged does not have to be the insured. However, presumably, the owner of both the surrendered and the new contracts have to be the same. Some argue that the exchange of a policy owned by the insured for a new policy owned by the insured’s irrevocable grantor life insurance trust is the same owner. This is based by analogy on the transfer for value ruling that the purchase of a policy by a grantor trust is equivalent to a purchase by the grantor insured.\textsuperscript{84}

However, this is risky since the trust is a separate legal entity and the Service may treat it as a separate owner for Section 1035 purposes. Proponents of this analogy seek to avoid the three-year rule of Section 1035 by having the trust own all incidents of ownership of the new policy at all times. The Service has not ruled on whether this technique would avoid the three-year rule.

The Same Insured Requirement

The regulations state that Section 1035 does not apply if the policies exchanged do not relate to the same insured.\textsuperscript{85} However, as long as the same insured is involved, exchanges involving multiple policies are tax-free.\textsuperscript{86}

The substitution of one insured for another under an option contained in a corporate-owned life insurance policy does not qualify as a tax-free exchange of insurance contracts under Section 1035. The exchange of a second-to-die policy after the death of the first insured to die for a new life insurance policy on the surviving insured’s life qualifies as a tax-free exchange.\textsuperscript{87}

In PLR 9542037, the Service determined that the following exchanges to acquire a second-to-die policy do not qualify for tax-free treatment:

1. Married owner exchanges life insurance contract insuring solely his own life for a second-to-die life insurance contract on the lives of both the owner and his spouse.
2. Married owner exchanges two life insurance contracts, one of which insures the life of the owner and one of which insures solely the life of his spouse, for a second-to-die life insurance contract that covers the lives of both spouses.

3. Married owners jointly exchange separate life insurance contracts each of which insures solely the life of one spouse for a jointly owned second-to-die life insurance contract that covers the lives of both spouses.
4. Trust exchanges life insurance contract on life of one spouse for a second-to-die life insurance contract on the lives of both spouses.
5. Trust exchanges two life insurance contracts, one of which insures the life of one spouse and one of which insures the life of the other spouse, for a second-to-die life insurance contract on the lives of both spouses.

Presumably, an exchange of a second-to-die policy for another second-to-die policy on the lives of the same insureds would qualify. The 1995 private letter ruling cast doubts on the tax-free nature of a division of a second-to-die policy into separate policies insuring a single life of the formerly joint insureds.

What Is an Appropriate Exchange?

The only safe approach for an exchange is for the policyholder to assign the existing life insurance contract to the insurance company which surrenders the old policy and issues a new policy purchased from the surrender proceeds.\textsuperscript{89} This is called the inside procedure.

Can there be a tax-free exchange if the surrender proceeds from the old policy are made available to the insured even if the insured immediately purchased the second policy with the proceeds (the outside procedure)?\textsuperscript{90}

There are no rulings on point that involve exchanges of life insurance contracts, but rulings on annuity exchanges would indicate a negative Service position. Exchange of one annuity for another annuity is not tax-free unless the inside procedure is followed by assigning the annuity contract to the new insurance carrier for surrender.\textsuperscript{90}

However, the Service made an exception for a nontransferable annuity from an Section 403(b) or a qualified plan. In such a case, the old insurance company may issue a check to the policyholder if the policyholder endorses the check to the new insurance company pursuant to an irrevocable pre-existing binding agreement.\textsuperscript{91}

In other words, the outside procedure may be used for annuity exchange only if there is a nontransferable annuity and there is a binding agreement.\textsuperscript{92} This would not apply to life insurance
since there is no similar nontransferable life insurance contract.

The Tax Court disagreed with the Service position with regard to the necessity for a pre-existing binding agreement. In Greene v. Commissioner, the Tax Court ruled that the exchange was tax-free when the taxpayer surrendered a Section 403(b) annuity for cash and then purchased a new annuity without such a pre-existing agreement.93

It is noteworthy that, since the exchange involved a nontransferable Section 403(b) annuity, this decision does not necessarily mean the Tax Court will support the outside procedure for a transferable annuity. The Service does not agree with the Greene case. The Service acquiesced in result only, and it later ruled in PLR 8741052 that a pre-existing binding agreement was necessary.

Exchange Involving Boot

If an exchange would otherwise be tax-free if it were not for the fact that other property or money is received in addition to the insurance contract, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of such money and fair market value of such other property.94 However, loss is not recognized even with the presence of boot.95

The assumption of liability (or a transfer subject to liability) is to be treated as other property or money.96 Consequently, if a policy subject to a loan is exchanged for a new policy without a loan, the extinguished loan will be considered boot. If the new life insurance contract is also subject to a loan, that loan will offset dollar for dollar the amount of the loan against the exchanged policy and will reduce boot.97

To avoid boot on exchange of a policy subject to a loan, one should pay off the loan before the exchange and create a new loan against the new policy after the exchange.

Partial exchanges of insurance contracts may involve boot or a non-tax-free exchange. The Service recently issued a revenue procedure that governs when a transfer of a portion of the cash surrender value of an existing annuity contract for a second annuity contract can be tax-free under Section 1035.98

The annuity transfer will be tax-free if no amount, other than an amount received as an annuity for a period of ten years or more or during one or more lives, is received under either the original annuity contract or the new contract during the 180 days beginning on the date of transfer (in the case of the new contract, the date the annuity contract is placed in-force).

If the transfer is within the 180 days, it will be characterized by the Service in a manner consistent with its substance, based on general tax principles and all the facts and circumstances—a distribution under Section 72(e) or boot under Section 1035. A subsequent transfer of all or a portion of either annuity contract outside the 180-day window pursuant to Section 1035 will not be affected by the previous transfer.

Do these rules apply to a partial transfer of life insurance contracts under Section 1035?

Some commentators think so. In a ruling predating the annuity revenue procedure, a loan against an endowment policy was paid off by a partial surrender of the same policy. Subsequently, the endowment policy was exchanged for another endowment policy. The Service treated the surrender of the old endowment policy as an exchange for a new endowment policy, with the extinguishment of the loan as boot.99

If there is an exchange involving cash boot, the basis of the new policy will be equal to the original policy’s basis, less the cash boot, plus the amount of gain recognized. If the boot is property other than cash, the basis of the new policy calculated above will be divided between the new policy and the property boot with the boot receiving basis equal to its fair market value.100

Impact of Tax-Free Exchange on Grandfathering Provisions

There are many statutes applicable to life insurance policies that contain grandfathering provisions for policies issued before the statute’s effective date. In most cases, a tax-free exchange loses grandfathering protection for the new policy received in the exchange—but occasionally not.

The loss of grandfathering status occurs if a tax-free exchange is completed after the grandfathered effective date in the following situations/types of contracts:

1. Definition of life insurance contract (Section 7702) for policies issued after December 31, 1983.101
2. Modified endowment contract (Section 7702A) issued after June 21, 1988.102
3. Denial of interest deduction for insurance contracts (Section 264(a)) issued after August 6, 1963, pursuant to systematic direct or indirect borrowing of all or part of cash value increases.103
4. Fifteen-year withdrawal exception to basis first rule for contracts (Section 7702(f)(7)) issued after December 31, 1983.104
5. Disallowance of employer general interest deduction allocable to unborrowed employer
owned policy cash value (Section 264(f)) for policies issued after June 8, 1997.  

6. It is unclear whether a tax-free exchange of a grandfathered split dollar policy after September 17, 2003, loses grandfathered status.

Some tax-free exchanges, however, do not lose grandfathered status:
1. EOLI/COLI rules (Section 101(j)) for policies issued after August 17, 2008, do not lose grandfathered status after a subsequent tax-free exchange unless the new policy contains material changes, such as an increase in death benefit.
2. Modification or restructuring of a policy pursuant to an insurance company's rehabilitation, conservatorship, insolvency or similar state proceedings (if certain conditions are met) does not lose grandfathering under Sections 72, 101(f), 264, 7702 or 7702A.

**Summary**

Life insurance is often referred to as the favored child of the Internal Revenue Code. This is because of the many income tax preferences granted to taxpayers who own or benefit from such insurance. The tax benefits include tax-free death proceeds, cash value build-up, and exchanges.

But, as this discussion demonstrates, there are many exceptions to these tax-free benefits which can result in income taxation of death benefits or cash value increases. The wary tax practitioner should be alert to these unexpected taxes which could have disastrous impact on business or estate plans that rely on the benefits being free from income taxes.

**Notes:**
1. Section 101(a)(1).
4. The carryover basis rules of Section 1014(b) apply to these gifts.
5. 2007-1 C.B. 684.
9. See Regulation 1.101-1(b).
10. See, e.g., Desks, Inc. v. Commissioner, 18 T.C. 674 (1952) and Lambeth v. Commissioner, 38 B.T.A. 351 (1938). See also Haverty Realty & Investment Co., 3 T.C. 161 (1944), for a discussion of the valuable consideration issue where the insurance transfer documents and corporate

minutes reflected the fact that the transfer was for a valuable consideration.
11. PLR 9701026.
14. Sections 101(j)(1) and (3)(A).
15. Ibid.
17. Within the meaning of Section 267(c)(4).
20. Section 6039(I).
21. Section 863(a) of the Pension Protection Act of 2006.
23. See Reg. Sec. 1.72-16(a).
24. Section 72(e). Section 7702(g).
26. Section 7702(g)(1)(A).
27. Section 817(h).
28. Section 7702(g)(1)(A).
29. Section 7702(g)(1)(C).
30. Section 72(e)(5)(A)(C).
31. Section 72(e)(6).
35. Section 72(e)(1)(B).
36. Section 72(e)(5)(A).
37. Regulation 1.72-2(b)(2).
42. Section 72(e)(5)(A).
43. Section 7702(f)(7).
44. Section 7702(f)(7)(B).
46. Blum v. Higgins, 150 F.2d 471 (2nd Cir. 1945).
47. Brown v. Commissioner, supra.
49. Section 72(h). Reg. Sec. 1.72-12.
53. PLR 8951056.
56. Sections 1012 and 1016.
59. Section 7202A(a)(1).
60. Section 7202A(a)(2).
61. Section 7202A(a)(3).
62. Section 7202A(c)(3).
63. Section 7202A(c)(4).
64. “Technical Explanation of the Job Creation and Worker Assistance Act of 2002” Staff of Joint Committee on Taxation, p. 45.
69. Section 72(e)(10)(A)(ii).
71. Section 72(e)(10).
72. HR Conf. Rep. No. 100-1104 at pp. 592/593.
73. Section 7702A(d).
74. Ibid.
75. Section 72(v)(1).
76. Section 72(v)(2).
77. TAMRA Section 5012(e)(1).
78. TAMRA Section 5012(e)(3)(A).
79. TAMRA Section 5012(e)(3)(B).
80. PLR 9044022.
81. TAMRA Section 5012(e)(2).
82. Section 1035(a)(1) and (b)(3).
83. Section 1035(a)(2)-(4). Reg. Sec. 1.1035-1(c).
85. Regulation 1.1035-1.
86. PLR 9708016 (two policies for one annuity). PLR 90177062 (two policies for two participating interests in group policy).
88. PLR 9248013. PLR 9330040. PLR 201304003.
91. PLR 8741052.
94. Section 1031(b).
95. Section 1031(c).
96. Regulation 1.1031(c).
97. PLR 604033. PLR 8806058. PLR. 8816015. Regulation 1.1031(b)-1(e).
99. PLR 9141025.
100. Section 1031(d).
101. PLR 8816015.
102. PLR 9044022 (subject to 7-pay test on issue of new contract). Grandfathering not lost in tax-free reorganization of mutual carrier into a stock life insurance carrier. PLR 985039.
103. PLR 8816015.
104. PLR 8816015.
105. PLR 200627021.

©2013 University of Miami School of Law. This article is a portion of outlines which were prepared by the authors for the 47th Annual Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law. It is reprinted with the permission of the Heckerling Institute and the University of Miami School of Law.

Donald Jansen is the senior tax counsel for The University of Texas System, Fellow American College of Trust and Estate Counsel, and the American College of Tax Counsel; Advisory Committee member Heckerling Institute on Estate Planning. He can be reached at (512) 499-4493, at djansen@utsystem.edu, or visit his web page at www.donaldjansen.com.

Lawrence Brody is a partner of Bryan Cave, LLP, St. Louis office. He can be reached at (314) 259-2652 or at lbrody@bryancave.com.