

actions of the decedent. An example of a power exercisable only as a result of potentially costly related action, and thus not an incident of ownership for purposes of section 2042(2) of the Code, is the power to cancel a group-term policy by termination of employment. That power of cancellation is considered a collateral consequence of the power that every employee has to terminate employment. See, Rev. Rul. 72-307, 1972-1 C.B. 307; see also, Rev. Rul. 82-5, 1982-1 C.B. 131. Similarly, a power to convert a group-term policy that is exercisable only by the voluntary termination of employment is a collateral consequence of a potentially costly action. That is, as is the case in Rev. Rul. 72-307, the power to convert is a collateral consequence of the power that every employee has to terminate employment.

Although termination of employment may occur either at the complete discretion of the employer or by the decedent's voluntary action, for purposes of section 2042(2) of the Code, the Service will not distinguish between conversion rights exercisable upon voluntary termination of employment and such rights exercisable upon involuntary termination.

Accordingly, the insurance proceeds payable to *A* under the group insurance policy are not includible in *D*'s gross estate because *D*'s retained conversion privilege is not an incident of ownership for purposes of section 2042(2) of the Code. The Service acquiesces in the result in the decision in *Estate of Smead v. Commissioner*, 78 T.C. 43 (1982), which held that a retained conversion privilege exercisable only on termination of employment was not an incident of ownership. See page 2, this Bulletin.

HOLDING

If a decedent transferred all the incidents of ownership in a noncontributory group-term life insurance policy on the decedent's life, but retained the right to convert the policy to an individual policy should the decedent's employment be terminated, the proceeds are not includible in the decedent's gross estate under section 2042(2) of the Code.

EFFECT ON OTHER REVENUE RULINGS

The holding of *Situation 2* of Rev. Rul. 69-54, 1969-1 C.B. 221, is modified to hold that a conversion privilege exercisable only in the event of the termination of employment is not an incident of ownership for purposes of section 2042(2) of the Code.

26 CFR 20.2042-1: Proceeds of life insurance.

Life insurance policy in trust; decedent as trustee; incidents of ownership. A decedent, to whom powers over an insurance policy were transferred in trust, did not have incidents of ownership in the policy if the decedent's powers could not be exercised for the decedent's benefit, and the decedent did not transfer the policy or any consideration for purchasing or maintaining the policy to the trust. Rev. Rul. 76-261 revoked.

Rev. Rul. 84-179

ISSUE

For purposes of section 2042(2) of the Internal Revenue Code, does an insured decedent possess incidents of ownership in an insurance policy if the decedent transferred all incidents of ownership to another person who, in an unrelated transaction, transferred all incidents of ownership to another person who, in an unrelated transaction, transferred the policy in trust and, at death, the decedent was a trustee with discretionary powers which, although broad, could not be exercised for *D*'s personal benefit?

FACTS

In 1960, *D*, the decedent, purchased an insurance policy on *D*'s life and transferred all incidents of ownership to *D*'s spouse. The spouse designated their adult child as the policy beneficiary.

The spouse died in 1978 and, by will, established a residuary trust for the benefit of the child. *D* was designated as trustee. The insurance policy on *D*'s life was included in the spouse's residuary estate and was

transferred to the testamentary trust. The drafting of the spouse's will to provide for the residuary trust and the appointment of *D* as trustee were unrelated to *D*'s transfer of the policy to the spouse.

As trustee, *D* 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 terms of the will did not preclude *D* from exercising these rights, although *D* could not do so for *D*'s own benefit. *D* paid the premiums on the policy out of other trust property.

D was still serving as trustee when *D* died in 1984.

LAW AND ANALYSIS

Section 2042(2) of the Code provides 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 date of death any of the incidents of ownership in the policies, exercisable either alone or in conjunction with any other person.

Section 20.2042-1(c)(2) of the Estate Tax Regulations provides that the meaning of the term "incidents of ownership" is not confined to ownership of the policy in the technical legal sense. The term includes the power to change the beneficiary, to surrender or cancel the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc.

Section 20.2042-1(c)(4) of the regulations provides that a decedent is considered to have an incident of ownership in a policy held in trust if under the terms of the policy the decedent (either alone or in conjunction with another person) 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.

The legislative history of section 2042 indicates that Congress intended section 2042 to parallel the statutory scheme governing those powers that would cause other types of property to be included in a decedent's gross estate under other Code sections, particularly sections 2036 and 2038. S. Rep. No. 1622, 83rd Cong., 2d Sess. 124 (1954). See *Estate of Skifter v. Commissioner*, 468 F. 2d 699 (2d Cir. 1972).

Sections 2036(a)(2) and 2038(a)(1) concern lifetime transfers made by the decedent. Under these sections, it is the decedent's power to affect the beneficial interests in, or enjoyment of, the transferred property that required inclusion of the property in the gross estate. Section 2036 is directed at those powers retained by the decedent in connection with the transfer. See, for example, *United States v. O'Malley*, 383 U.S. 627 (1966), 1966-2 C.B. 526. Section 2038(a)(1) is directed at situations where the transferor-decedent sets the machinery in motion that purposefully allows fiduciary powers over the property interest to subsequently return to the transferor-decedent, such as by an incomplete transfer. See *Estate of Reed v. United States*, Civil No. 74-543 (M.D. Fla., May 7, 1975); *Estate of Skifter v. Commissioner*, above cited, at 703-05.

In accordance with the legislative history of section 2042(2), a decedent will not be deemed to have incidents of ownership over an insurance policy on decedent's life where decedent's powers are held in a fiduciary capacity, and are not exercisable for decedent's personal benefit, where the decedent did not transfer the policy or any of the consideration for purchasing or maintaining the policy to the trust from personal assets, and the devolution of the powers on decedent was not part of a prearranged plan involving the participation of decedent. This position is consistent with decisions by several courts of appeal. See *Estate of Skifter*; *Estate of Fruehauf v. Commissioner*, 427 F. 2d 80 (6th Cir. 1970); *Hunter v. United States*, 624 F. 2d 833 (8th Cir. 1980). But see *Terriberry v. United States*, 517 F.2d 286 (5th Cir. 1975), *cert. denied*, 424 U.S. 977

(1976); *Rose v. United States*, 511 F. 2d 259 (5th Cir. 1975), which are to the contrary. Section 20.2042-1(c)(4) will be read in accordance with the position adopted herein.

The decedent will be deemed to have incidents of ownership over an insurance policy on the decedent's life where decedent's powers are held in a fiduciary capacity and the decedent has transferred the policy or any of the consideration for purchasing and maintaining the policy to the trust. Also, where the decedent's powers could have been exercised for decedent's benefit, they will constitute incidents of ownership in the policy, without regard to how those powers were acquired and without consideration of whether the decedent transferred to property to the trust. *Estate of Fruehauf*; *Estate of Skifter*, above cited at 703. Thus, if the decedent reacquires powers over insurance policies in an individual capacity, the powers will constitute incidents of ownership even though the decedent is a transferee.

In the present situation, *D* completely relinquished all interest in the insurance policy on *D*'s life. The powers over the policy devolved on *D* as a fiduciary, through an independent transaction, and were not exercisable for *D*'s own benefit. Also, *D* did not transfer property to the trust. Thus, *D* did not possess incidents of ownership over the policy for purposes of section 2042(2) of the Code.

HOLDING

An insured decedent who transferred all incidents of ownership in a policy to another person, who in an unrelated transaction transferred powers over the policy in trust to the decedent, will not be considered to possess incidents of ownership in the policy for purposes of section 2042(2) of the Code, provided that the decedent did not furnish consideration for maintaining the policy and could not exercise the powers for personal benefit. The result is the same where the decedent, as trustee, purchased the policy with trust assets, did not contribute assets to the trust or maintain the policy with personal assets, and could not exercise the powers for personal benefit.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-261, 1976-2 C.B. 276, is revoked.

Part IV.—Taxable Estate

Section 2055.—Transfers For Public, Charitable and Religious Uses

26 CFR 20.2055-2: *Transfers not exclusively for charitable purposes.*

Charitable bequest; remainder interest; mortmain statute. A bequest of a remainder interest in a farm qualifies for an estate tax charitable deduction under section 2055 of the Code even though the applicable state mortmain statute requires the charitable recipient to dispose of the farm within ten years after its acquisition.

Rev. Rul. 84-97

ISSUE

Does the bequest of a remainder interest in a farm qualify for an estate tax charitable deduction under section 2055 of the Internal Revenue Code if the applicable state mortmain statute requires the charitable recipient to dispose of the farm within ten years of acquisition?

FACTS

D, a resident of State X, died in 1982. Under *D*'s will, executed in 1980, *D*'s farm was bequeathed to *A*, *D*'s spouse, for life. The remainder interest in the farm was bequeathed to charitable organization *Y*, an organization described in section 2055 of the Code. State X has a mortmain statute that provides that a charitable organization may not retain a bequest of real estate for more than ten years. Under this statute, if *D*'s farm is held by *Y* for ten years after the death of *A*, the farm will revert to other beneficiaries of *D*'s estate. Thus, *Y* must sell the farm within ten years or be divested of all right, title, and interest therein. The State X statute has no comparable provisions concerning inter vivos transfers.

LAW AND ANALYSIS

Section 2055(a) of the Code provides, in part, that in determining the