

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

Number: **201328030**

Release Date: 7/12/2013

CC:PSI:B04:
POSTF-145962-12

[Third Party Communication:
Date of Communication: <Month> DD, YYYY]

UILC: 2042.00-00

date: March 18, 2013

to: Lawrence Mack
Branch Chief
(Procedure & Administration)

from: James F. Hogan

Branch Chief, Branch 4
(Passthroughs & Special Industries)

subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Decedent	=
Former Spouse	=
State	=
Year	=
Date 1	=
Date 2	=
Date 3	=
State Court	=
Agreement	=
<u>X</u>	=

ISSUE

Whether, at death, the Decedent possessed an incident of ownership in the policies insuring his life, such that the insurance proceeds are includible in his gross estate under § 2042 of the Internal Revenue Code.

CONCLUSIONS

The insurance proceeds are not includible in the decedent's gross estate because, at death, he held only a right to receive the policies' dividends, which by itself is not an incident of ownership for purposes of § 2042.

FACTS

Decedent and Former Spouse were married on Date 1. In Year, Former Spouse instituted an action for divorce in State Court. On Date 2, Decedent and Former Spouse executed a property settlement agreement (Agreement) with respect to all marital and separate property.

Under the Agreement, Decedent was to maintain life insurance policies having an aggregate death benefit of \$x for the sole benefit of Former Spouse. Decedent was to pay all premiums, dues and assessments on the policies. Decedent could not borrow against or pledge the policies. Dividends from the policies belonged exclusively to Decedent.

Decedent and Former Spouse were divorced within three months of executing the Agreement. The State Court judgment of divorce incorporated the Agreement and ordered that the property of Decedent and Former Spouse be distributed as set forth in the Agreement.

Decedent died on Date 3, and the insurance company paid the proceeds of the insurance policies to Former Spouse. On the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return filed for Decedent's estate, Decedent's executor included the policies' proceeds in Decedent's gross estate.

LAW AND ANALYSIS

Under section 2042(2), the value of the gross estate includes the value of all property to the extent of the amount receivable by all beneficiaries (other than the decedent's estate) as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership.

Section 20.2042-1(c)(2) of the Estate Tax Regulations provides that the term “incidents of ownership” is not limited in its meaning to ownership of the policies in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy.

Section 20.2042-1(c)(4) provides, in part, that a decedent is considered to have an “incident of ownership” in an insurance policy on his life held in trust if, under the terms of the policy, the decedent has the power 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 § 2042 indicates that Congress intended § 2042 to parallel the statutory scheme governing those powers that would cause other property to be included in a decedent's gross estate under §§ 2036, 2037, 2038, and 2041. S. REP. NO. 83-1622, at 124 (1954). In general, the term “incidents of ownership” pertains to the right of the insured or his estate to the economic benefits of the insurance policy. See Skifter v. Comm’r, 468 F.2d 699, 701 (2d Cir. 1972). Incidents of ownership include powers to: change the beneficiary, surrender and cancel the policy, pledge the policy as security for a loan, and dispose of the policy and its proceeds for one’s own benefit. See Treas. Reg. § 20.2042-1(c)(2); Chase Nat’l Bank v. United States, 278 U.S. 327, 335 (1929).

The Tax Court considered the question of whether “dividends paid on an insurance policy” is an economic benefit that would cause the value of the insurance proceeds to be includible in a decedent’s gross estate in Estate of Bowers v. Commissioner, 23 T.C. 911 (1955). In Estate of Bowers, the decedent agreed to carry life insurance on his life payable to his former wife as part of a settlement agreement in a divorce. The court held that the right to dividends, which may be applied against a current premium, is nothing more than a reduction in the amount of premiums paid rather than a right to the income of the policy. Id. at 917. See Estate of Jordahl v. Comm’r, 65 T.C. 92, 99 (1975) (stating that “it is well established that, since dividends ‘are nothing more than a reduction in the amount of premiums paid,’ the right to dividends is not an incident of ownership.”) (citations omitted). Cf. Schwager v. Comm’r, 64 T.C. 781, 792 (1975) (finding that while certain powers may be retained which will not constitute incidents of ownership, such as the right to receive policy dividends, the ability to bar the change of beneficiary to a part of the policy does constitute a substantial incident of ownership).

In this case, pursuant to the settlement agreement arising from his divorce, Decedent agreed to maintain life insurance policies for the sole benefit of Former Spouse. Although the dividends from the policies “belonged” to Decedent in a technical legal sense, the mere right to the dividends, by itself, is not an incident of ownership that

would cause the value of the insurance proceeds to be included in Decedent's gross estate under § 2042(2).

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Please call _____ if you have any further questions.