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Private Letter Ruling 7734048

May 26, 1977

This is in reply to your letter of . . . wherein you request a ruling on behalf of your clients, . . . , as to whether their exchange of insurance policies will constitute a transfer for value under section 101(a)(2) of the Internal Revenue Code.

Briefly stated, the pertinent facts submitted are as follows:

On . . . took out an insurance policy on his life retaining ownership of the policy and named . . . as the beneficiary. On the same day . . . took out an insurance policy on his life retaining ownership of the policy and named . . . as the beneficiary. . . . and . . . are the sole shareholders of . . . , each owning . . . percent of the stock. On . . . assigned the policy on his life to and . . . assigned the policy on his life to . . . thus creating cross insurance on each other's lives to help provide funds to buy out the other's interest in the corporation upon the death of the first to die. The parties were advised that the policies, being in their . . . year, have no cash surrender value or interpolated terminal reserve.

Section 101(a)(2) of the Internal Revenue Code provides that if a policy, or any interest in a policy, is transferred for a valuable consideration, the death proceeds will generally be exempt only to the extent of the consideration paid by the transferee and net premiums, if any, paid by the transferee after the transfer. The balance of the death proceeds is taxable as ordinary income. This is the so-called "transfer for value rule." However, if the sale or other transfer for value comes within any of the following exceptions to the transfer-for-value rule, the death proceeds will be wholly exempt despite the sale or other transfer for value.

- (1) If the sale or other transfer for value is to the insured himself. Sec. 101(a)(2)(B) of the Code.
- (2) If the sale or other transfer for value is 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 an officer or shareholder. Sec. 101(a)(2)(B) of the Code.
- (3) If the policy changes hands in a type of transfer that does not result in changing the tax basis of the individual assets transferred; for example, where a policy is transferred from one corporation to another in a tax-free reorganization or, where a policy is acquired in part by gift. Sec. 101(a)(2)(A) and Rev. Rul. 69 – 187, 1969-1 C.B. 45.

The transfer-for-value rule extends beyond outright sales of policies. The naming of a beneficiary in exchange for any kind of valuable consideration would constitute a transfer for value of an interest in the policy. Even the creation by separate contract of a right to receive all or part of the proceeds would constitute a transfer for value. A transfer for value can occur even though the policy transferred has no cash surrender value. See *JAMES F. WATERS, INC. v. COMMISSIONER*, 160 F. 2d 596.

In the case of *MONROE v. PATTERSON*, 197 F. Supp. 146 (N.D. Ala. 1961), two policies were purchased on the life of an officer-stockholder, one by the insured and the other by the corporation. Subsequently insured entered into an agreement with two key employees for the purchase of his stock at his death. The policies were transferred to a trustee for use in partially financing the agreement and the key employees took over the payment of premiums. Upon insured's death, the proceeds were applied to the purchase of his stock. The Court held, the employees were transferees for value even though they had paid no purchase price for the policies. Their agreement to make the premium payments and to purchase the stock constituted a valuable consideration. Consequently the employees were taxed on the difference between the premiums they had paid and the proceeds applied toward their purchase of the insured's stock.

Since the exceptions contained in Section 101(a)(2)(A) and (B) are not applicable in the instant case, the assignment by . . . and . . . of their insurance policies to each other resulted in a transfer for valuable consideration. Therefore, the death proceeds will be exempt only to the extent of the new premiums paid after the transfer. The balance of the proceeds will be taxed as ordinary income.