The Flexible Irrevocable Trust

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Abstract: *This article suggests methods to build flexibility into an irrevocable trust. It also discusses ways to terminate an existing trust, and in effect amend it, where the trust was drafted without such flexibility. By drafting the trust to deal with changes in the grantor's marital circumstances, granting the trustee the power to alter the nondispositive provisions of the trust to deal with changes in the tax law, giving the trustee broad power to make distributions and loans, allowing the trustee to terminate the trust and distribute the insurance policy to the grantor's spouse or other beneficiaries, and granting a limited power of appointment to a beneficiary, considerable flexibility can be attained. Where an inflexible insurance trust already exists, with proper planning the insurance policy can be transferred to a new trust without triggering the three-year rule or the transfer for value rule.*

Introduction

The irrevocable life insurance trust has become a standard in the repertoire of the estate planner. A trust is considered a person under the Internal Revenue Code[1] (hereinafter the "Code"). Since it never dies, it is not subject to federal estate tax.[2] Upon receipt of insurance proceeds, it is generally not subject to income tax.[3] As discussed below, insurance proceeds received by a properly drafted irrevocable trust that owns the policy are excluded from the taxable estate of the insured (and his or her spouse). For these reasons, the irrevocable insurance trust has become a powerful estate planning device.[4] Yet many people are wary of them, thinking that irrevocability means inflexibility. This article seeks to demonstrate the flexibility available in the irrevocable trust.

In a typical scenario, a wealthy individual is encouraged by his or her financial advisers to create a trust which will purchase, own, and become nominal beneficiary of a life insurance policy. Policy premiums are paid by the trust from gifts made by the grantor to the trust, subject to powers of withdrawal given to trust beneficiaries (the so-called *Crummey* powers).[5] Gifts of up to $10,000[6] per year per donee ($20,000 for joint gifts[7] with the grantor's spouse) may be contributed and excluded from federal gift tax through the granting of such *Crummey* powers. If the grantor-insured is married, the insurance proceeds typically remain in trust after his or her death, providing for the surviving spouse until the latter's death, at which time the trust corpus is distributed according to the dispository provisions of the trust. In most instances, the insurance policy or proceeds comprise the entire corpus of the trust.

The problem: At the time the trust is created, the grantor is usually in good health and presumably many years from death, which will trigger the dispositive provisions of the trust. Future changes in the grantor's and beneficiaries' life circumstances — and therefore in the grantor's wishes regarding the allocation and distribution of trust assets — cannot be known at the outset. Yet the trust must be irrevocable for the insurance proceeds to remain out of the grantor's taxable estate.[8] Thus, the grantor is "boxed in" to a plan which, years later, may not serve his or her best interests or be in accord with his or her dispository intent at that time. Nor can future changes in tax laws, which might impair the effectiveness of the trust's original strategy, be predicted. For example, a future limitation by Congress upon the number of donees eligible for annual exclusion gifts could have severe gift tax consequences.[9]

Simply establishing a new insurance trust to replace the "inflexible trust" and purchasing a new insurance policy may not be an option. Aside from the financial drawback of incurring new policy acquisition costs and higher premiums, the grantor's health may have deteriorated since the time of initial purchase to the point where the purchase of a new policy is cost prohibitive.

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Irrevocability, however, need not mean inflexibility. This article discusses what can be done to structure a flexible, dynamic irrevocable insurance trust and how, if a constrictive insurance trust already exists, the insurance policy can be disgorged and placed in a new irrevocable insurance trust without adverse tax consequences.

Flexibility

Much of what cannot be known in advance may be provided for without compromising a trust's irrevocable status:

Protection Against Changes in Marital Circumstances. The trust may provide that the insured's spouse ceases to be a beneficiary or trustee in the event of divorce. Such a provision was permitted in an IRS Technical Advice Memorandum.[10] In that ruling, the act of divorcing one's spouse was held to be an act of independent significance which would not constitute an incident of ownership.[11] The trust may also limit the term "spouse" to only the person to whom the grantor is married at the date of execution of the instrument. Thus, if the original spouse dies, no subsequent spouse (or potential ex-spouse) will be a beneficiary.

Change of Trustee. The trust may provide that a beneficiary or the beneficiaries together may replace a trustee with an independent (nongrantor) trustee or a corporate trustee. If a beneficiary is to be a trustee, a provision must be included limiting the beneficiary's powers to distribute assets to himself or herself subject to an ascertainable standard relating to education, health, maintenance, and support[12] and another prohibiting the beneficiary from exercising the power in favor of anyone to whom he or she has an obligation to support.[13] The trust might also provide that a beneficiary could become a trustee or cotrustee upon the occurrence of an event, such as the death of a prior trustee or attainment of a certain age. The trustee may also be given the power to name a cotrustee.

If a grantor of an irrevocable trust retains discretionary power as trustee to distribute trust assets, the trust property is includible in his or her estate under Code Sections 2036(a) and 2038(a). If the grantor possesses an unrestricted power to remove the trustee and appoint anyone (including himself or herself) successor trustee, the grantor is considered as having the powers of the trustee.[14] In a 1979 Revenue Ruling, the IRS stated that the grantor's retention of the power to remove a corporate trustee and substitute another corporate trustee is equivalent to the retention of discretionary power over trust assets.[15]

Important recent developments in the law, however, now give the grantor broad power to remove and replace a trustee without incurring adverse estate tax consequences. In the case of *Estate of Wall*,[16] it was held that the grantor's reservation of the right to replace the corporate trustee with another corporate trustee did not constitute a retained power causing inclusion of the trust assets in the grantor's estate. In the *Estate of Vak*,[17] the court held that where the grantor reserved the right to remove and replace the trustees with successor individual trustees who were not related or subordinate to him, the grantor had not retained dominion and control over the transferred property.

In a recent Revenue Ruling,[18] the IRS, conceding defeat, revoked the 1979 Revenue Ruling. It also held, with respect to the (grantor) decedent, as follows: "...even if the decedent had possessed the power to remove the trustee and appoint an individual or corporate successor trustee that was not related or subordinate to the decedent (within the meaning of Section 672(c)), the decedent would not have retained a trustee's discretionary control over trust income."[19] This important new ruling further enhances flexibility with respect to irrevocable trusts.

Limitations on Power Holder. The grantor may be given the right to remove a Crummey power holder or exclude a designated beneficiary from exercising such a withdrawal power. This protects against a situation where a beneficiary becomes financially irresponsible.[20]

Guaranteeing Sufficient Number of Donees. It is important to ensure that there are always a sufficient number of persons holding *Crummey* withdrawal powers to qualify transfers to a trust for the annual gift tax exclusion.[21] This may be accomplished by naming alternate power holders in the event one or more power holders dies. Such alternate power holders must also have a beneficial interest in the trust or the IRS may not recognize his or her power.[22]

Giving Trustee the Power to Change Nondispositive Provisions of the Trust. The trustee may be given the power to reduce the amount of each donee's *Crummey* withdrawal power. This may be useful if federal legislation alters the *Crummey* powers. The trustee would be able to limit the aggregate amount of withdrawal granted under the trust so that it does not exceed the amount that could be transferred to the trust tax free.[23] The trustee could also be given the power to change the administrative provisions of the trust, such as powers of management, investment, custody of assets, and the power to allocate receipts between principal and income.[24]

Granting Broad Power to Trustee. A nonbeneficiary trustee may be given the power to distribute the property to the beneficiaries based upon their "best interests." Trust assets may be distributed, for example, to buy a vacation home, if the trustee determines it is in the best interest of a beneficiary.

Loans. The trustee may be given the power to lend funds to any person, including the grantor or his or her estate, for adequate consideration.

Bail-out. The trustee may be given the power to terminate the trust and distribute the policy to the grantor's spouse or other beneficiaries, such as adult children. However, the trustee should not be given the power to distribute to the grantor, because the existence of such a power, even if never exercised, risks inclusion of the insurance proceeds in the grantor's estate.[25] To avoid a successful IRS argument that broad discretionary trustee powers make the *Crummey* powers illusory, the trust should contain language which provides that the trustee's termination right cannot eliminate a beneficiary's withdrawal right.[26]

Powers of Appointment (to Spouse or Other Beneficiary)

Limited Power of Appointment

A power of appointment is the power to direct the disposition of property that belongs to someone other than the power holder.[27] The grantor of an insurance trust may convey such a power to any trust beneficiary, who may then direct the use of — or "appoint" — property remaining in trust after the grantor's death. Such a power is considered a general power of appointment when the donee (i.e., the person given the power) may convey an interest in the property to whomever he or she pleases, including himself or herself.[28] A power is considered a limited (or "special") power of appointment when the donee is authorized to appoint interests in the property only to specified objects or classes of objects, other than the donee, the donee's estate, or creditors of the donee or his or her estate. An "object" of a power is the person, corporation, or charity to whom or to which the property may be appointed.[29] A general power of appointment causes the subject property to be included in the estate of the power holder, while a limited power does not.[30] In neither case, however, is the irrevocability of the trust — and thus the exclusion of its corpus from the grantor's estate — jeopardized by granting powers of appointment to trust beneficiaries.

Limited Powers of Appointment Add Trust Flexibility

The limited power of appointment is a powerful tool in building flexibility into an irrevocable insurance trust, giving a nontrustee the ability to override the typical *per stirpes* distribution on the death of the insured (or upon the death of the survivor of the insured and his or her spouse) and to redirect the distribution of trust assets in the event of changed circumstances to specific parties. It allows the deferral of decision until the most appropriate time for making the decision.

A few examples will illustrate how limited powers increase irrevocable trust flexibility. Assume that by the time of the death of the insured, or the insured's spouse, one child turns out to be financially secure and does not need a full share of the trust corpus. The power holder would have the right to allocate a lesser share— or even no share — to that child or to his or her descendants. Even where it is desired that such child receive his or her full share, it may not be to that child's advantage to receive his or her share outright. Instead, it might be desirable from an estate tax planning standpoint to leave that child's share to a lifetime trust for his or her benefit, so that the property would not be included in that child's estate. Thus, the limited power can be a powerful tool in planning to take advantage of the $1 million per grantor exemption from tax on generation-skipping transfers (GST).[31]

In planning for trusts not sheltered by the GST exemption, powers may be structured to cause general powers of appointment to be attributed to nonskip persons, causing their interests to be included in their estates, on the assumption that regular estate tax rates are preferable to the generation-skipping tax. Such powers may be technically general for GST purposes, but still afford the power holder limited discretion. For example, the authority in the successor generation to appoint could be limited to creditors of the power holder's estate, supplemented with a limited power to appoint to certain classes of beneficiaries, descendants or charities.[32]

Rather than growing wealthy, a child may have gotten into serious financial difficulties. If that child receives his or her share outright, the entire share may be attached by the child's creditors. In such a case, the power holder may establish an "asset protection trust" and leave such assets for that child's benefit, so that the trust assets are protected from creditors.[33]

Such a power given to the surviving spouse of the grantor might enable that spouse to favor one child over another in the distribution of trust assets, thus providing the children with an incentive to treat the surviving parent appropriately during his or her old age. On the other hand, the existence of such a power runs the risk that one child or other descendant may exercise undue influence over an elderly — and perhaps mentally diminished — power holder.

Avoiding a General Power of Appointment

The drafter of the trust must nevertheless be careful in granting a power of appointment to avoid creating a "general" power of appointment. A general power results in inclusion of the property subject to the power in the estate of the power holder at his or her death.[34] An addi-

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tional concern is that the exercise, lapse, or release of such general power during a power holder's life is treated as a gift.[35] Powers need not be completely unrestricted to be considered general. For example, the power to appoint to one's self, one's creditors, one's estate, or the creditors of one's estate constitutes a general power of appointment.[36]

A beneficiary may, however, be given the power to appoint trust assets to himself or herself or to his or her descendants, subject to an ascertainable standard, without having the assets included in the beneficiary's estate. Under the regulations, this limited power could include "health," "maintenance," "education," "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in the accustomed manner of living," "education including college and professional education," and "medical, dental, hospital and nursing, and the expenses of invalidism."[37]

This power need not require the holder to consider the wealth of a beneficiary or require the beneficiary to exhaust his or her financial resources before property may be appointed by the holder of the power to himself or herself or another beneficiary.[38] Thus, in a first-to-die policy where the wife is the trustee-beneficiary, she may be able to appoint the policy to herself pursuant to an ascertainable standard and thereby disgorge all the assets of the trust.

In addition to amounts permissible for self-appointment subject to an ascertainable standard, the power holder may also be given the right to withdraw an amount equal to the greater of $5,000 or 5 percent of the trust corpus annually, without being treated as the holder of a general power.[39] But if the power holder dies, the amount subject to the power, in excess of that $5,000 or 5 percent, is includable in his or her estate.[40]

The requirement for joint exercise of a power may prevent a power from being considered general. A power is treated as exercisable jointly if it may be exercised only in conjunction with the grantor (which would likely result in inclusion of the property in the grantor's estate under Code Section 2036 or 2038) or in conjunction with a person having both a substantial and adverse interest (i.e., adverse to the interest of the power holder) in the property subject to the power.[41]

Correcting an Inflexible Trust

The first section of this article noted provisions which may be incorporated into a trust at the time of its creation to provide the greatest possible flexibility, while still protecting the trust's irrevocable status in order to keep the insurance proceeds out of the grantor's taxable estate. If the trust already exists, however, and the instrument has not been drafted with the desired flexibility, or with the desired dispositive provisions, the grantor may wish to transfer the policy to a trust that does have such flexibility or contains such provisions. Two important obstacles, however, confront such a transfer: the three-year includibility rule of Code Section 2035(d)(2) and the transfer-for-value rule of Code Section 101(a)(2).

Code Section 2035 provides, in pertinent part, that the proceeds of life insurance policies transferred by gift from the insured are includible in the insured's estate if he or she dies within three years of the date of transfer.[42] Thus, if an insured purchases a policy from an existing trust and then gifts it to a new insurance trust, the gift of the policy by the grantor to the new trust risks the application of Code Section 2035.

Code Section 101(a)(2), the transfer-for-value rule, is an exception to the general rule that the proceeds of life insurance are not taxed as income to the beneficiary. The transfer-for-value rule provides that in the case of a transfer of the policy for valuable consideration, the proceeds of the policy, less the total premiums paid by the transferee, will be included in the income of the beneficiary of the policy.

A proposed solution to these two obstacles is for the insured to purchase the insurance policy from the existing insurance trust and then sell it to a new insurance trust, which is drafted as a "grantor" trust for federal income tax purposes pursuant to Section 671.

Under Section 671, the grantor is treated as the owner of certain trusts for federal income tax purposes. Although the many techniques available to draft a trust so that it is treated as a grantor trust[43] are beyond the scope of this article, among the methods commonly employed is giving a grantor the power to reacquire trust corpus and substitute assets of equal value for assets owned by the trust.[44] The IRS, however, has recently refused to rule on grantor trust status by virtue of such a power, explaining that the area is under study.[45]

Section 2035

With respect to the application of Section 2035 to this proposed solution, if the policy is sold to a new insurance trust for "adequate and full consideration" by the insured after purchasing it from the existing trust, there should be no Section 2035 problem. Section 2035(b)(1) provides an exception to the three-year rule for "any bona fide sale for an adequate and full consideration." As to what constitutes "adequate and full consideration," in a 1994 Private Letter Ruling, the Service ruled that where a life insurance policy that has not been fully paid up is transferred from one insurance trust to another for an amount equal to the "interpolated terminal reserve value"[46] plus the value of the unexpired portion of the most recent premiums, Section 2035 does not apply. This means the proceeds of such policy are not includible in an insured's estate, regardless of when he or she dies. Where the policy is fully paid up, adequate consideration will be its replacement cost.[47] It should be noted that the interpolated terminal reserve value in many cases, especially in early policy years, will exceed the cash value of the policy. If the insured is in such poor health, however, that death is imminent, adequate and full consideration is the face amount of the policy.[48]

Transfer-for-Value Rule

There are important statutory exceptions to the transfer-for-value rule. There is a full exclusion from income for a beneficiary when (1) the transfer of the policy is made to the insured,[49] (2) when the transfer is made 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,[50] or (3) if a policy has a basis in the hands of a transferee determined in whole or in part by the basis of such policy in the hands of the transferor.[51] A taxpayer's basis in an insurance policy is equal to the amount of premiums paid, reduced by dividends received, and further reduced by the cost of insurance protection provided through the date of transfer.[52]

Thus, if the insured purchases the policy from the existing trust, there is no transfer-for-value problem with respect to that portion of the transaction because the sale is to the insured. With respect to the ensuing sale of the policy by the insured to the new grantor trust, it can be argued that a sale to the new trust should be treated as a sale to the insured, and that the transfer-for-value problem should therefore be avoided under that exception to the rule. There is support for the position that a grantor and his or her grantor trust should be treated as the same person.[53]

Further, Code Section 671 and a 1985 Revenue Ruling[54] support the position that the transferee's basis on the sale by the insured to the new trust is the same as the transferor's basis. The sale to the new insurance trust, structured as a grantor trust, is treated as a sale by the insured to himself or herself for income tax purposes. Therefore, the basis of the policy to the transferee should be determined in whole or in part by the basis of such policy in the hands of the transferor, and the transfer-for-value problem should be avoided under the "same basis" exception to the rule. If a transferor gifts the property, the basis to the transferee is generally the same as the transferor's basis,[55] but the Section 2035 problem remains.

An insured contemplating such a transaction will not be able to obtain an advance ruling from the Service. The IRS declines to rule on the grantor trust status of a life insurance trust.[56] The IRS also refuses to rule on the transfer-for-value issue with respect to a transfer of a life insurance policy, due to a bar on rulings of a primarily factual nature.[57] It is conceivable the Service might argue that the 1985 Revenue Ruling discussed above does not apply in the context of Section 101, because the language of that section does not mention trusts when specifying exempt transferees under the transfer-for-value rule. The Service might also argue that the step transaction doctrine[58] would treat the subsequent sale by the insured to the new insurance trust as a gratuitous transfer where the insured funds the new insurance trust. This latter argument might be avoided, however, by simply having someone other than the insured fund the new trust, or by having the new trust borrow the funds needed to purchase the policy.

Other Planning Alternatives

Could a newly established insurance trust drafted as a grantor trust purchase the policy from the existing insurance trust directly? There would be no Section 2035 problem because the insured would never have held incidents of ownership in the policy.[59] With respect to the transfer-for-value issue, if the new insurance trust is treated as the insured, there would be no transfer-for-value problem because the transfer would be to the insured.[60] If both the existing trust and the new trust are grantor trusts, the new trust could buy the policy directly, because the existing trust should be treated as the insured, as discussed above. Thus, upon a sale to the new trust, the sale should be disregarded for income tax purposes, with the basis of the policy to the new trust determined by the basis of the policy to the existing trust.

Another planning alternative, where the three-year rule is not a great concern due to the health and/or youth of the insured, is for the insured to purchase the policy and then gift it to a new insurance trust, rather than selling it to the new trust, thereby removing the above-discussed uncertainty regarding the transfer-for-value rule. Further, the impact of Section 2035 may be lessened, even if the insured gifts the policy to a new trust, if the new trust pays premiums from sources other than funds contributed by the grantor, such as a beneficiary. The Tax Court has held that if someone other than the grantor pays part of the premiums during the three-year period, a proportionate share of the insurance proceeds may be excluded from the insured's gross estate.[61]

Conclusion

While an irrevocable insurance trust appears by its nature to be an inflexible instrument, it can be structured to be surprisingly flexible. By drafting the trust to anticipate future changes in the law or family circumstances, allowing replacement of the trustee, giving the grantor the power to exclude a particular originally named *Crummey* power holder, providing for alternate power holders, giving the trustee the power to change the nondispositive provisions of the trust, providing for a broad "best interest" standard of distribution, giving the trustee the power to make loans, including a "bail-out" provision, and judiciously using limited powers of appointment, the trust may be able to effectively deal with future changes within the confines of the trust instrument.

Where such provisions still do not address the problem, or where the insurance trust at issue was drafted without such flexibility or with undesirable dispository provisions, a purchase of the policy by the insured from the existing insurance trust and a sale of the policy to a new insurance trust with the desired provisions and which is structured as a grantor trust would appear to allow the insured to amend the inflexible insurance trust without negative tax consequences. Further, where the insured's health status indicates that survival for at least three years is probable, the insured can purchase the policy from the existing trust and gift it to the new insurance trust. Even where death within three years is a concern, if someone other than the grantor of the new trust pays the premiums during the three-year period, the negative tax consequences are minimized. J

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(1) IRC §7701(a)(1).
(2) IRC §2001(a) provides that "a tax is hereby imposed on the transfer of the taxable estate of every decedent...."
(3) IRC §101(a)(1).
(4) Stephen M. Margolin, *The Not-So Irrevocable Insurance Trust*, Taxes, Aug. 1973, at 477.
(5) Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968). This withdrawal power allows designated beneficiaries to withdraw contributions to the trust, thereby qualifying the contribution as a present rather than a future gift, eligible for the annual exclusion from gift tax. *See* Stephen M. Margolin, *Feeling Crummey? Try the Annual Exclusion*, Life Ass'n News, Nov. 1993, at 146.
(6) IRC §2503(b).
(7) IRC §2513.
(8) IRC §2038.
(9) Roy M. Adams, *Trust and Estate Planning After the Clinton Tax Bill*, 133 Trusts & Est. 8 (Jan. 1994).
(10) Tech. Adv. Mem. 88-19-001 (May 13, 1988).
(11) *See also* Landorf v. U.S., 408 F.2d 461 (Ct. Cl. 1969); Rev. Rul. 72-307, 1972-1 C.B. 307.
(12) IRC §2041(b)(1)(A); Treas. Reg. §20.2041-1(c)(2).
(13) *See* Treas. Reg. §20.2041-1(c).
(14) Treas. Reg. §20.2036-1(b)(3); 20.2038-1(a)(3).
(15) Rev. Rul. 79-353, 1979-2 C.B. 325.
(16) Estate of Wall, 101 T.C. 300 (1993).
(17) Estate of Vak, 973 F.2d 1409 (8th Cir. 1992).
(18) Rev. Rul. 95-58, 1995-36 I.R.B. 16.
(19) *Id.*
(20) *See* Priv. Ltr. Rul. 89-01-004 (Jan. 6, 1989). IRC §6110(j)(3) provides that a private letter ruling may not be used or cited as precedent; however, it does indicate the thinking of the IRS.
(21) Tech. Adv. Mem. 95-32-001 (Apr. 12, 1995) discusses notice requirements for satisfaction of IRC §2503(b).
(22) Estate of Cristofani v. Commissioner, 97 T.C. 74 (1991), acq. 1992-1; Tech. Adv. Mem. 87-27-003 (Mar. 16, 1987); Priv. Ltr. Rul. 90-45-002 (Jul. 27, 1990). *See also* Sanford J. Schlesinger and S. Timothy Ball, *Life Insurance: Taxation and Products*, 52 N.Y.U. Tax Inst. §9.05[3] at 9-31 (1994).
(23) Adams, *supra* note 10.
(24) Treas. Reg. §20.2041-1(b)(1).
(25) Estate of Paxton, 86 T.C. 785 (1986); Rev. Rul. 77-378, 1977-2 C.B. 347; Priv. Ltr. Rul. 87-52-064 (Sept. 30, 1987).
(26) *See* Priv. Ltr. Rul. 82-13-074 (Dec. 30, 1981).
(27) See discussion under Treas. Reg. §20.2041-1(b).
(28) IRC §2041(b)(1); Treas. Reg. §20.2041-1(c); IRC §2514; Treas. Reg. §25.2514-1(c).
(29) Estate of Chisholm, 26 T.C. 253 (1956).
(30) IRC §2041(a)(2).
(31) IRC §2631.
(32) William A. Peithmann, *A Look at the Principle Uses of Powers of Appointment*, 132 Trusts & Est. 38, 45 (Aug. 1993).
(33) Andrew D. Westhem and Donald J. Korn, Protecting What's Yours (1995).
(34) IRC §2041.
(35) Treas. Reg. §25.2514-3(a).
(36) IRC §§2041(b)(1); 2514(c).
(37) Treas. Reg. §20.2041-1(c)(2).
(38) *Id.*
(39) IRC §2514(e).
(40) Treas. Reg. §20.2041-3(d)(4).
(41) IRC §§2514(c)(3); 2041(b)(1)(C).
(42) Sanford J. Schlesinger and S. Timothy Ball, 52 N.Y.U. Tax Inst. §9.05[4], at 9-44 (1994). Commentators have noted that if a second-to-die policy is involved, and is owned by one spouse, the entire proceeds would be included in the decedent's estate if the decedent is the assignor spouse, and that spouse is second to die and dies within three years of the assignment. If the second spouse dies within three years of the transfer, rather than the assignor, the proceeds would not be included in her estate because the second spouse had no incident of ownership.
(43) *See* Howard M. Zaritsky 452 2nd Tax Mgmt. (BNA) Grantor Trusts: §§671-679, at A-44 – A-46.
(44) IRC §675(4)(c); Estate of Jalkut, 96 T.C. 675 (1991). *See also* Randall W. Roth, *The Intentional Use of Tax-Defective Trusts*, 26th U. Miami Est. Plan Inst., ch. 4 (1992), Howard M. Zaritsky & Stephan R. Leimberg, Tax Planning with Life In-

surance, ¶5.03[13][b], at S5-24-27; IRC §671.
(45) Priv. Ltr. Rul. 94-13-045 (Jan. 4, 1994). However, the IRS did rule that such a substitution policy is not an incident of ownership under IRC §2042.
(46) Treas. Reg. §25.2512-6(a).
(47) U.S. v. Ryerson, 312 U.S. 260 (1941); Diana S.C. Zeydel, *The Transfer For Value Rule: Developments and Clarifications*, 134 Trusts & Est. 75,77 (Apr. 1995).
(48) Rev. Rul. 80-80, 1980-4 C.B. 194.
(49) IRC §101(a)(2)(B); Treas. Reg. §1.101-1(b)(1); Priv. Ltr. Rul. 89-51-056 (Sept. 27, 1989).
(50) IRC §101(a)(2)(B); Treas. Reg. §1.101-1(b)(1).
(51) IRC §101(a)(2)(A); Treas. Reg. §1.101-1(b)(1).
(52) Treas. Reg. §1.72-6; Priv. Ltr. Rul. 94-43-020 (Jul. 22, 1994); Diana S.C. Zeydel, *supra* note 48.
(53) Rev. Rul. 85-13, 1985-1 C.B. 184; Priv. Ltr. Rul. 93-28-010 (Apr. 16, 1993); Swanson v. Commissioner 518 F.2d 59 (8th Cir. 1975) Gen. Couns. Mem. 37, 228.
(54) Rev. Rul. 85-13, 1985-1 C.B. 184. Under IRC §675, the grantor was considered the owner of the trust, so under IRC §671 he was also considered "the owner of the trust assets for federal income tax purposes."
(55) IRC §1015.
(56) Rev. Proc. 94-3, 1994-1 I.R.B. 79.
(57) Priv. Ltr. Rul. 95-11-009 (Dec. 13, 1994).
(58) The step transaction doctrine requires that a series of transactions be looked at as a whole, rather than its component steps. Thus, the IRS may ignore intermediate steps and may view only the beginning and end of a series of transactions to determine the tax treatment. CCH Stand Fed Tax Rep §601.05(1995).
(59) IRC §2042.
(60) IRC §101(a).
(61) Estate of Silverman, 61 T.C. 338 (1973); Estate of Friedberg, 63 T.C.M. (CCH) 3080 (1992).