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## TRANSFERRING LIFE INSURANCE POLICIES BY GIFT

— by Neil E. Harl\*

In order to avoid inclusion of the proceeds of life insurance policies in the gross estate for federal estate tax purposes,<sup>1</sup> policies are often transferred by gift during life.<sup>2</sup> If transferred more than three years before death, the proceeds are ordinarily not included in the gross estate.<sup>3</sup> However, assignment of a life insurance policy without retaining incidents of ownership constitutes a gift for federal gift tax purposes.<sup>4</sup> Payment of life insurance premiums on a policy owned by another is a gift of the premium amount.

### Valuing policies

For a life insurance policy paid up at the time of the transfer, the gift is the value that would be charged for a single premium policy of the same amount on the life of a person of the age of the insured.<sup>5</sup> If the particular kind of policy is not presently available, the value may be established by the replacement cost of comparable policies. For a policy that is not paid up, the amount of the gift is based upon the interpolated terminal reserve accumulated at the time of the gift plus a proportionate part of the last premium paid before the gift.<sup>6</sup>

For each policy of life insurance given to a donee during a calendar year, the donor should obtain a statement by the insurance company on Form 712, Life Insurance Statement, and file it with the Internal Revenue Service Officer with whom the gift tax return is filed.

### Gift of a present or future interest

Whether a transfer of a life insurance policy qualifies for the \$10,000 federal gift tax annual exclusion depends upon the title vested in the donee. To obtain the exclusion, the gift must be a present rather than a future interest.

- If the donee's ownership is outright, the donor is normally entitled to the exclusion.<sup>7</sup>

- But if the transfer is to two or more owners jointly, the transfer may not qualify for the annual exclusion.<sup>8</sup> The reason is that none of the donees could immediately possess and enjoy the property inasmuch as each donee's rights are dependent upon the consent of the other or others.<sup>9</sup> The solution is to request that each policy be split so that each donee is the sole owner of a separate policy. In that event,

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the federal gift tax annual exclusion should be available to the donor.

### Gift at death of insured

Normally, death of the insured and payment of the policy proceeds to the policy beneficiary or beneficiaries does not result in a gift. However, if the policy owner is someone other than the insured and the beneficiary is a third party, a gift would occur at the death of the insured.<sup>10</sup>

Example: a \$100,000 whole life policy is taken out on the husband's life with the husband as owner and the wife as beneficiary. Later, as part of the implementation of an estate plan, the policy is transferred to the wife who then becomes both owner and beneficiary. A gift of approximately the cash value of the policy would occur from husband to wife.<sup>11</sup> Several years later, the wife designates their two children as beneficiaries of the policy. If the husband dies with the policy owned by the wife but with the children named as beneficiaries, the wife would be deemed to have made a gift of the policy proceeds to the child.<sup>12</sup> That has been the case even where the policy owner was considered by local law to survive the insured.<sup>13</sup> If policy ownership is transferred to the beneficiaries, be sure the policy is split with each owner receiving a separate policy in order to avoid the future interest problem.<sup>14</sup>

### FOOTNOTES

<sup>1</sup> I.R.C. § 2042.

<sup>2</sup> See generally 6 Harl, *Agricultural Law* § 46.06 (1993); Harl, *Agricultural Law Manual* § 5.02[4] (1993).

<sup>3</sup> See I.R.C. §§ 2035(a), 2042.

<sup>4</sup> Treas. Reg. § 25.2511-1(h)(8).

<sup>5</sup> See Treas. Reg. § 25.2512-6(a).

<sup>6</sup> Treas. Reg. § 25.2512-6(a).

<sup>7</sup> *Beal v. Comm'r*, 2 T.C.M. 285 (1943).

<sup>8</sup> *Nashville Trust Co. v. Comm'r*, 2 T.C.M. 992 (1943).

<sup>9</sup> *Id.*

<sup>10</sup> See Rev. Rul. 81-166, 1981-1 C.B. 477.

<sup>11</sup> See n. 5 *supra*.

<sup>12</sup> *Id.*

<sup>13</sup> *Est. of Goldstone v. Comm'r*, 78 T.C. 1143 (1982).

<sup>14</sup> See n. 8 *supra*.