Steve Leimberg's Estate Planning
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Subject: Lee Slavutin, Richard Harris & Martin Shenkman - Intergenerational Split Dollar - Recent Adverse Decisions in *Morrissette* and *Cahill*, Where Do We Go from Here?

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Lee Slavutin, **Richard Harris**, and **Martin Shenkman** provide members with detailed commentary on the Morrissette and Cahill opinions.[i]

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Here is their commentary:

EXECUTIVE SUMMARY:

Two recent Tax Court decisions affecting intergenerational split dollar (IGSD) arrangements have forced practitioners to rethink this strategy. In Morrissette in 2016, the Tax Court ruled favorably on the income and gift tax treatment of the initial premium transfer.[ii] The unanswered question after Morrissette, however, was the determination of the value of the donor/decedent's interest in the IGSD plan. Taxpayers have taken, based on independent appraisals, significant discounts in valuing the decedent's interest in IGSD plans.

The IRS has argued for the application of Sections 2036, 2038 and 2703 to negate the discount. In mid-June, the Tax Court refused to rule favorably on the taxpayer's request for summary judgement that Sections 2036, 2038 and 2703 were not applicable in this context.[iii] Practitioners might consider communicating with clients who have existing economic benefit ISGD plans.

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COMMENT:

Split-Dollar Overview and Background

A private split-dollar insurance arrangement is one in which two persons or trusts together purchase insurance on the life of a particular person. In the estate planning context, this typically, involves the insured and an irrevocable life insurance trust ("ILIT"). In the recent Cahill case, the taxpayer through his revocable trust entered into a split-dollar arrangement with an ILIT. Split-dollar plans, however are not limited to this approach. The two parties can agree to allocate policy costs and benefits between them and the beneficiaries of the insured in various manners. There are two types of split-dollar arrangements: (1) the economic benefit regime under Reg. Sec. 1.61-22; and (2) the loan regime under Reg. Sec. 1.7872-

15. The Cahill and Morrissette cases address only economic benefit split-dollar.

In a private economic benefit split-dollar arrangement, the ILIT typically pays only the term cost of the life insurance which is modest in the early years of the arrangement. Another party, such as a family member (often the insureds) or a family trust (e.g., an existing funded marital (QTIP) or dynasty trust) pays the remaining portion, which is typically the bulk of the insurance cost in the early years of the arrangement. This arrangement can substantially reduce the current gifts the donor/insured is required to make to the ILIT to purchase the insurance, but nevertheless can assure that the insurance proceeds are removed from the donor/insured's taxable estate. With an $11.18 million inflation-adjusted exemption most taxpayers will not need this reduction in current gifts, although for ultra-high net worth taxpayers who have used their exemption for other planning, this type of traditional split-dollar planning will remain important.

This traditional application of economic benefit split-dollar was sanctioned in the Morrissette case[iv] and is discussed below. Practitioners should not be deterred from this type of split-dollar planning by the recent developments which have focused on the estate tax implications of generational economic benefit split-dollar. It is only that application of IGSD to reduce estate tax values that has become more of a concern in light of the recent cases.

General Discussion of IGSD Cases

There are three cases in Tax Court dealing with IGSD plans (there may be others): [v]

1. Estate of Clara Morrissette.
2. Estate of Richard Cahill.
3. Estate of Marion Levine.

In 2016, the Tax Court ruled in Morrissette and Levine that the initial premium transfer was not a gift and the arrangement should be taxed for income and gift tax purposes as an economic benefit split-dollar arrangement under the Regulations.[vi] This was an important victory for the taxpayers. Only a very small fraction of the premium (the "economic benefit") was treated as a gift.[vii]

In 2018, in the Morrissette and Cahill cases, the taxpayers asked the Court to rule, in partial summary judgment motions, that Sections 2036, 2038 (in Cahill) and 2703 (in Cahill and Morrissette) do not apply to the valuation of the decedent's interest in the IGSD plan for estate tax purposes.[viii] In June 2018, the Tax Court denied the motions in both these cases. These are potentially significant victories for the IRS. In fact, some commentators have speculated that these cases, on the heels of the Powell FLP case,[ix] might begin to signal a shift in the Tax Court to a more pro-IRS, less taxpayer friendly, environment.

To understand the issues raised in the recent Tax Court decisions, it will be helpful to compare traditional split dollar with IGSD (see chart attached).

The features that distinguish the IGSD plans in the three Tax Court cases from traditional split dollar are as follows:

1. The premium donor is usually over age 80.
2. The insurance is funded with a single premium or premiums paid over a short period, e.g. 2-4 years.
3. The insured is a child of the donor.
4. The donor dies within 4 years or less after the split dollar plan is established and the estate values the donor's interest in the IGSD at a deep discount. The rationale for a significant discount is that the donor's estate is entitled to its repayment when the insured child dies many years in the future, and therefore the present value of that repayment is greatly reduced.

Cahill Facts and Discussion

What is the discounted value of the donor estate's interest in the IGSD plan? The Cahill case illustrates the issue clearly:

- The donor's revocable trust, the "Richard F. Cahill Survivor Trust" (referred to as the "Survivor Trust" in the case) contributed $10 million in premiums in one year to purchase $79.8 million of life insurance on the donor's son and daughter-in-law under the IGSD plan
- The policies were purchased in 2010.
- The donor died in 2011.

- At the date of the donor’s death the total cash value of the policies was $9.6 million.
- The donor’s estate was entitled to a repayment equal to the greater of cash value or premiums paid.
- The estate claimed that its repayment would occur many years in the future because the ILIT would never agree to terminate the split dollar plan before the death of the insured children.
- If we assume the children are in their 60’s and have a life expectancy of 25 years, the future repayment must be discounted to a present value over 25 years. The discount valuation methodology is beyond the scope of this article.[x]
- The estate claimed the discounted value of the future repayment was $183,700, which is 1.9% of the cash value. If the discount was calculated solely on the basis of time value of money, then the 98% discount is equivalent to a 17% discount interest rate compounded over 25 years.

It warrants noting that in Cahill the IRS did not dispute that the agreements involved were in fact split-dollar life insurance arrangements within the meaning of the Regulation.[xi]

<u>Cahill “Bad” Facts</u>

Some commentators have suggested that the Cahill case has “bad” facts and that perhaps differentiating other cases from the Cahill “bad facts” might provide a more favorable (or perhaps less harsh) result. However, whether the facts are in fact “bad” may require waiting to see the final analysis as the case proceeds to trial. Until a final judgment is rendered practitioners should be cautious:

- The economic benefit split-dollar arrangement was affected by taxpayer’s son, the primary beneficiary of the plan, in his capacity as trustee of the father’s revocable trust (Survivor Trust).
- At the time the plan was implemented the 90-year-old father could not manage his own affairs. This is similar to Powell and other cases which were classified as bad fact cases where the planning was done by the child/heir after the parent/benefactor was not competent.
- The Cahill plan was structured with an ILIT that had son’s cousin and business partner as the sole trustee. Thus, there was no

independence on either side of the transaction. This might be particularly relevant in Cahill because of the lack of economic substance to the transactions.

- There appeared to be limited non-tax purpose for the insurance component of the transaction. However, the estate may well endeavor to argue this point at trial to attempt to deflect the 2036, 2038 and 2703 challenges. The business purpose in Cahill contrasts with Morrissette, which had what some view as a more substantial non-tax purpose of protecting a family business, although based on the recent denial of summary judgement on 2703 it is not yet clear whether that business purpose will suffice to salvage the intended result. In Cahill, the son claimed the insurance was to facilitate succession of his business to his children which had nothing to do with G-1 and the purported business purpose did not seem to have any weight in the eyes of the Court.
- The IGSD plan could be terminated during the insured's lifetime by agreement between Survivor Trust and ILIT. This effectively had the son and primary beneficiary of the plan, and his cousin/business partner controlling the decision.
- The cash surrender value of policy at the father's death was substantial, $9,611,624. The valuation of the IGSD at approximately 98% discount from the CSV was significant.
- The life insurance policies guaranteed 3.0% on the invested portion of premiums. Also, the return on the policies over the long-term was apparently less than the cost of the loan so that there was a negative economic result from inception, and this was exacerbated by the fact that the loan was only for five years when life expectancy was dramatically more, only further corroborating the potential lack of sustainability of the transaction.
- The Cahill estate maintained it was not likely that the arrangement would be terminated. But this contention was contradicted by the negative arbitrage on the cost of the loan from Northern Trust and the return on the underlying policies, and on the disconnect between a five-year loan and a supposed long-term plan.
- The transaction may not have been economically viable for the long term:
    - Loan term was for five years.
    - Northern Trust did not have to renew the loan.

    - The loan interest rate may have exceeded the guaranteed rate of return on the policy cash value.
- The father guaranteed the loan.
- At death of insured, repay the greater of the: (1) loan and/or the (2) premiums paid, or (3) cash surrender value. The IRS position was that this, combined with the right to terminate the plan, is in part what warrants the inclusion of the cash value of the policy in the estate, if the restrictions in the IGSD arrangement can be disregarded under Section 2703.
- The ILIT did not provide consideration for the IGSD arrangement including the rights to death benefits under the three policies.
- If agreement is terminated and ILIT retains the policy, it must pay the Revocable Trust/Survivor Trust greater of cash surrender value or premium paid.
- If agreement is terminated and ILIT does not maintain the policy the policy is turned over to Northern Trust.

Sections 2036, 2038 and 2703 Overview

The IRS obviously believes that the taxpayer valuation was inappropriate and presented three different theories to invalidate the discount:

- Inclusion under Sections 2036
- Inclusion under Section 2038.
- Disregard the restrictions of the split dollar agreement under Section 2703.

The key issue in Cahill and Morrissette is what is included in the donor's estate, and more specifically, what is the value of the IGSD interests so included. In both cases the IRS asserted inclusion at a large value based on Code Sections 2036, 2038 and 2703. In both cases that taxpayers' motions for dismissal were denied. So, while practitioners will have to await the final conclusions of these cases, it appears that the IRS's arguments under the aforementioned sections have been bolstered by these dismissals.

In a traditional split dollar plans, the donor is transferring the premium payments in exchange for a repayment right that should meet the test for a bona fide "sale" for full consideration or a bona fide business arrangement.

The donor will be repaid the full cash value in an economic benefit arrangement or a loan with interest at a fair rate in a loan arrangement.

The following discussions will discuss the possible application of these three Code sections to IGSD plans in more detail.

IRC Section 2036

Code Sec. 2036 can apply to include in the value of the gross estate the value of:

- All property that the decedent had transferred during lifetime [The Cahill Court viewed the transfer of the premium payments from the Survivor's trust (the decedent's revocable trust) to the ILIT as constituting the property transferred],
- Over which the decedent retained for life the right, alone or in conjunction with another person, to designate the person or persons who shall possess or enjoy the property or the income therefrom. The Cahill Court viewed the right of the Survivor's Trust and the ILIT together to terminate the IGSD agreement as the right "in conjunction with another" to designate who would enjoy the property, i.e. the cash value resulting from the premiums paid.

To what extent do the facts in Cahill support such a position? Does the fact that the son orchestrated the plan, and that the son as trustee of the revocable trust and executor, could "in conjunction with" his cousin/business partner, as trustee of the ILIT, terminate the IGSD, sway the Court's view? Did it further influence the Court's view that the same son (and his descendants) were the primary beneficiaries of the trust? Would having independent trustees affect the conclusions? Did the weight of other circumstances also affect the Court's view? There is perhaps another perspective. Even though the ILIT trustee was a cousin and business partner of the son, he still had a fiduciary responsibility to act appropriately for the beneficiaries of the trust. If that fiduciary responsibility required he not terminate a IGSD agreement, then could he be assumed to do so? What quantum of independence might be necessary for that fiduciary responsibility to be relevant? Would the Cahill Court opt to disregard the fiduciary responsibility in all situations? Can it?

IRC Sections 2038

Code Section 2038(a)(1) provides that the value of the gross estate shall include the value of:

- All property which the decedent transferred during lifetime. The Cahill Court viewed the transfer of the premium payments from the Survivor's trust (the decedent's revocable trust) to the ILIT as constituting the property transferred.
- Where the decedent retained a power, exercisable by the decedent alone or in conjunction with any other person, to alter, amend, revoke or terminate the transferee's enjoyment of the transferred property, which the decedent did not relinquish before death, or which was relinquished but within the 3-year period ending on the date of death. The Cahill Court viewed the right of the Survivor's Trust and the ILIT together to terminate the IGSD agreement as the right "in conjunction with another" to terminate the IGSD plan as the right to alter, amend, etc.

Bona Fide Sale Exception

Code Sections 2036 and 2038 do not apply if the transfer was a bona fide sale for full consideration in money or money's worth. One line of defense taxpayers may pursue in Cahill is to argue that neither Section 2036 nor 2038 should not apply because the transfers were bona fide sales for full consideration. Some commentators have suggested that the facts in Morrissette may better support such a position then the facts in Cahill. However, until final decisions are issued (if that should in fact occur) it cannot be determined whether Cahill could so qualify, although some commentators have clearly speculated that this would be a difficult argument for the taxpayer to sustain.

"In Conjunction With"

Both Code Sections 2036 and 2038 summarized above include a requirement that the decedent could have pulled the 2036 or 2038 "strings" "alone or in conjunction with any other person."[xii] The court in Cahill focused on this requirement and noted that the decedent (really through his son as trustee of the revocable trust) had the right to terminate the split-dollar agreements in conjunction with the trustee of the MB Trust (the ILIT). That, in the Court's view, satisfied the 2036 and 2038 requirements

because the two trustees could have, in the court's view, merely terminated the split-dollar agreement and the Revocable Trust would have received the cash value of the policy. The estate's counter to this was that it would not make economic sense for the ILIT to allow termination of the split-dollar agreements since that would harm the beneficiaries of the ILIT. However, the son and his descendants were the beneficiaries. The estate argued that such a termination was so unlikely that the termination rights had no value as of decedent's date of death. On this basis, the estate contended that the value of decedent's interests in the split- dollar agreements was limited to the value of decedent's death benefit rights. The difference between the two was dramatic.

The Cahill court quoted the Powell FLP case on the requirement of "in conjunction with":[xiii] ("Decedent's ability to dissolve * * * [her limited partnership] with the cooperation of her sons constituted a 'right * * * in conjunction with * * * [others], to designate the persons who shall possess or enjoy the property [she transferred to the partnership] or the income therefrom', within the meaning of section 2036(a)(2)." The estate tax notice quoted in the Powell case included the following three paragraphs addressing "in conjunction with:"

> It is determined that the decedent retained at her death the possession, enjoyment, or right to the income from property she transferred to NHP * * * or the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income there from such that the property transferred to the partnership valued at $10,022,570 on the valuation date is includible in the gross estate under IRC §2036(a).
>
> Alternatively, it is determined that the decedent retained at her death a power to change the enjoyment of property transferred to NHP * * * through exercise of a power * * * by the decedent alone or in conjunction with any other person * * * to alter, amend, revoke, or terminate such that the property transferred to the partnership valued at $10,022,570 on the valuation date is includible in the gross estate under IRC §2038(a).
>
> Alternatively, it is determined that the decedent retained at her death a power to change the enjoyment of a 99% limited

> partnership interest in NHP * * * through exercise of a power * * * by the decedent alone or in conjunction with any other person * * * to alter, amend, revoke, or terminate such that the value of the 99% limited partnership interest is includible in her gross estate under IRC §2038(a) at its fair market value of $10,022,570. The fair market value of the 99% partnership interest is determined without regard to certain rights and restrictions identified in IRC §2703(a).

Might "in conjunction with" be the weapon the IRS has long sought?

In both Cahill and Powell a son or sons of the decedent orchestrated the planning to reduce estate tax and held the rights "in conjunction with." Would a court reach the same result if Cahill or another case demonstrated a non-tax purposes for the right involved? What if the other person to the "in conjunction with" were independent? Would that matter under the statute? The estate countered this argument by stating that the son on behalf of the decedent held the right to terminate the split-dollar agreement "in conjunction with" the trustee of the ILIT.

The Court stated that such an interpretation would render the phrase "in conjunction with" under 2036 and 2038 meaningless. But would it? If a decedent owns 30% of an interest in a property with unrelated persons, or persons acting under a fiduciary responsibility, what relevance is the phrase "in conjunction with?" The decedent in such instances would have no meaningful rights but the Cahill Court's view would suggest that such circumstances would also trigger the "in conjunction with."

The Regulations provide in part:

> …*With respect to such a power, it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e.g., the death of another person during the decedent's lifetime). The phrase, however, does not include a power over the transferred property itself which does not affect the enjoyment of the income received or earned*

during the decedent's life. (See, however, section 2038 for the inclusion of property in the gross estate on account of such a power.) Nor does the phrase apply to a power held solely by a person other than the decedent. But, for example, if the decedent reserved the unrestricted power to remove or discharge a trustee at any time and appoint himself as trustee, the decedent is considered as having the powers of the trustee.[xiv]

The Regulation confirms that even if the trustee of the ILIT were adverse to the decedent (i.e. the son acting on behalf of the father in Cahill) that the power held by the trustee of the ILIT would still be held "in conjunction with" the decedent. Further, the fact that the power must be exercisable in a fiduciary capacity seems also irrelevant to the 2036 issue.

IRC Section 2703

Code Section 2703(a) provides that the value of any property is determined without regard to:

1. Any option or agreement to acquire or use the property at a price that is less than fair market value of the property (without regard to such option or agreement); or
2. Any restriction on the right to sell or use the property.

Section 2703 defines the terms above, e.g. "agreement," quite broadly. It can include a right or restriction contained in any agreement, a right to acquire or use property if the price charged is under the fair market value for the acquisition or use of that property. It can also include a restriction on the right to sell or use property. A lease or license agreement could serve as a restriction on the equipment leased or intangibles licensed. The restriction can be incorporated into any type of governing document such as an operating agreement, bylaws, or certificate of formation or incorporation. Thus, the Cahill Court maintained that the restrictions on terminating the split-dollar agreement were such an agreement or restriction.

There is an exception from the general Code Section 2703 rules if the following requirements are met:[xv]

- The agreement is a bona fide business arrangement,

- It is not a device to transfer the property to a member of the decedent's family for less than full and adequate consideration; and
- The terms of the agreement are comparable to similar arms' length transactions.

Each of the above requirements must be independently satisfied.[xvi]

The reason the Code Section 2703 argument is so critical to the Cahill case is because of the argument proffered by the taxpayer supporting the estate's value of the interest to be included in the gross estate. The taxpayer argued it would not make economic sense for the ILIT to agree with the trustee of the revocable trust (Survivor Trust) to the termination of the split-dollar agreements because the ILIT would lose the death benefit realizable if the insurance were held until death. Therefore, reasoned the taxpayer, termination of the IGSD arrangement was so unlikely that the rights involved had no economic value as of decedent's death. The limited economic value was also argued by the taxpayer to be correct because the decedent's estate would have to wait until the death of the son and daughter-in-law, which given their age would likely be far into the future.

Other courts have recognized the time period involved for an investment to have the desired rate of return. In Mandelbaum the court listed as a valuation factor: "…the period of time for which an investor must hold the subject stock to realize a sufficient profit…"[xvii] Critical to the resolution of the case will be a determination as to whether it is the split-dollar receivable that is to be included in the decedent's estate, or whether that agreement is disregarded and the full cash value of the policy included in the estate.

There was no disagreement that the underlying life insurance policies in Cahill have significant cash value. The IRS's argument is that but for the restriction on terminating the IGSD, the taxpayer (the revocable trust or Survivor's Trust in Cahill) could immediately realize that value. Therefore, if the IRS can successfully characterize the IGSD agreement as a restriction on the right to sell or use the property under Code Section 2703 the "restriction" could be ignored in determining the value of the rights held by the revocable trust. That would result in an inclusion of the greatest value the revocable trust could realize, which in the Cahill case was the cash surrender value of the policy.

The fact that the Tax Court refused to dismiss the case suggests that there is some measure of merit to the IRS argument. Judge Goeke, in the Morrissette order dated 6/21/18, stated that “the restriction on the decedent’s termination rights is a restriction for purposes of section 2703(2),” and he cited the Cahill decision. But practitioners should understand that the Cahill and Morrissette Courts both merely concluded that summary judgment that Code Section 2703(a) does not apply was inappropriate as to this issue.

The taxpayer’s arguments that a IGSD agreement is not the type of restriction that is subject to Code Section 2703 was not accepted by the Court. The estate argued that Code Section 2703(a) should not apply because the IGSD agreements are analogous to promissory notes and are not subject to Code Section 2703(a). Even though this argument failed, and might fail at trial (but that remains to be seen), this might suggest, as discussed below, the use of loan split-dollar arrangements in lieu of economic benefit IGSD.

If negating the applicability of Code Section 2703 is not feasible, then the taxpayer would have to rely on the Code Section 2703(b) exception, that the IGSD agreement was a bona fide business arrangement, not a device to transfer, and similar to comparable arm’s length transactions.

Query how the last of the three tests would be met. Code Section 2703 was seemingly intended to address buy-sell agreements, which exist in large numbers between unrelated owners of closely held businesses. What would be the litmus test for an arms’ length IGSD transaction?

Gift Argument Dismissed by Cahill Court

The estate also argued that Code Sections 2036 and 2038 should not apply because the discrepancy between what decedent paid, $10 million, and what decedent received in return under the IGSD agreement worth approximately $183,700, has been or would be accounted for as gifts. The Court dismissed this argument.

Loan IGSD To Address Cahill/Morrissette Issues

The split-dollar regulations address the gift and income tax implications of a split-dollar transaction.[xviii] In contrast, the *Cahill* and *Morrissette* cases

address the estate tax implications of economic benefit split-dollar. Therefore, using loan split-dollar arrangements may enable practitioners to avoid or address some of the troubling facts in *Cahill*.

One possible loan split-dollar scenario might be as follows:

As a preface to the arrangement the grantor/lender/senior lists non-tax reasons for entering into the transaction. It might be that senior has already taken care of his children and now wants to do something specific for his grandchildren, something for them to remember him by. If there is a business involved, as in Morrissette, it may be to fund a buyout of the children in favor of the grandchildren. Because of the unique nature of life insurance, senior determines that life insurance policies on his children's lives, payable to a dynasty trust at the death of the insureds, are appropriate. Senior might also note that he cannot personally obtain life insurance, or if he can, the cost is too high.

- A single or "lump-sum" loan is made to the dynasty trust. This loan is made repayable at the death of the insureds respectively.[xix] The applicable federal rate used is determined by the life expectancy of the insured using the appropriate table.[xx] If the life expectancy is greater than nine years, the long-term rate is used. For July 2018 the rate is 3.06%.
- The loan is secured by just the death benefit of the policies.[xxi]
- The loan is nonrecourse and representation is made on the income tax return of the earlier filer stating that it is the intent the loan will be repaid to assure the IRS respects the transaction as a loan.[xxii]
- Interest is accrued.[xxiii] While there will be OID at the death of the grantor and on until the loan is repaid, a substitute or successor grantor may eliminate the issue. This is beyond the scope of this article.
- After the lender dies, the loan cannot be settled until the death of the insured.

How does the above structure address some of the issues in *Cahill*?

- Although the policy secures the loan, the cash surrender value is not collateral.
- The loan is for the life of the insured.

- The loan can't be repaid until the death of the insured.
- There are non-tax reasons for the arrangement.
- All the requirements in the loan split-dollar regulations are followed.
- It is clear that the transaction is a loan.
- §2703 may not apply because the applicable restrictions are those allowed by regulation and should therefore not be disregarded.

All of the above make it difficult to argue that the cash value is the real value of the transaction and that the related parties can end the transaction before death.

Insurance Policy Planning to Address Cahill/Morrissette Issues

One of the issues in the Cahill case is that the underlying policy had substantial cash value. It was that value that the IRS argued, under various theories, should be included in the taxpayer's estate. Might the nature of the underlying life insurance policy selected by the plan mitigate against such a challenge? Suppose Guaranteed Universal Life Policy[xxiv] is used. For someone that sees the benefit of providing, in trust, a benefit for her grandchildren that is guaranteed, this may be a viable planning option. The cash value in such policies can be low or non-existent. The IRS would determine the Interpolated Terminal Reserve or the adjusted PERC value as the policy value.[xxv] Even if that is used, unless a carrier values the policy at a very high amount, the number may still be considerably lower than the amount of the receivable.

The Regulations stipulate: "If, however, because of the unusual nature of the contract such an approximation is not reasonably close to the full value of the contract, this method may not be used."[xxvi] Guaranteed Universal Life policies were not in existence when the regulations were issued and they are certainly different when compared with whole life, it's limited pay and endowment variables, which were the only permanent forms of insurance available at that time. In fact, there are companies that do such appraisals.

In *Schwab*[xxvii] the court came up with its own method of valuing the policy that took the monthly cost of the term insurance for the guaranteed time the policy would be in force without any further premiums being paid.

There is another important difference. There were no “willing buyers” for life insurance policies when the Regulations were issued in 1974. In contrast, today there is a robust life settlement market that can be used as a valuation model.

Borrowing Planning to Address Cahill/Morrissette Issues

There is one other fact in *Cahill* that might be addressed to differentiate other IGSD transactions. The loan in Cahill was from an outside lender, Northern Trust, and was collateralized by the cash surrender value of the three policies involved. This was apparently a “bad fact” in the Cahill case. To the extent that the borrower (senior family member, G-1) can obtain a personal loan (one without recourse to the cash value of the life insurance policy), it separates the two transactions and may be a better fact.

Conclusions/Recommendations

While uncertainty remains pending the conclusion of Cahill, Morrissette and Levine, practitioners need to take action now. What might be considered?

- In part, wait and see on existing economic benefit ISGD plans. The Levine case went to trial earlier this year and that decision might follow Cahill, or might possibly provide a different application of 2036/2038/2703. Morrissette and Cahill may also go to trial on these issues so some practitioners may opt to enhance existing plans but defer new plans until more is known. The other part is to consider reviewing existing economic benefit IGSD to see whether any enhancements might be made in light of some of the issues raised in Cahill and Morrissette. For example, might there be ways to further corroborate the non-tax motives for a transaction?
- Should a client opt to proceed with a new economic benefit IGSD consider warning the client of the issues in writing?
- Do not implement a new economic benefit IGSD plan that features very large discounts on the donor’s estate’s receivable. Some might prefer to rely on a loan split-dollar arrangement that was not addressed in the recent cases.
- Consider implementing a new economic benefit IGSD plan that has economic merits unrelated to a possible estate valuation discount on the donor’s receivable. For example, a grandmother has substantial assets and can fund a split dollar plan where her children are the

insureds and her grandchildren are the beneficiaries of the ILIT's holding the policies. Her children cannot afford to pay the premiums and welcome grandmother's support. Grandmother is 82 and healthy and is not about to die. Clever estate planning with grandmother's assets (e.g. GRAT's) may enable the ILIT's to repay grandmother.

- Avoid "bad facts:"
  - The Court questioned and was almost critical of the use of a five-year loan to fund premiums in Cahill. Why use a 5-year loan when the obligation may extend 30 years? Why use a loan if the loan interest may exceed the cash value earnings rate?
  - Do not implement a IGSD plan with a very old taxpayer, in poor health, who is incapable of decision making (i.e. who is reliant on an agent under a durable power or a trustee under a revocable trust act on her behalf), with a limited life expectancy.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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[ii] Estate of Morrissette v. Commissioner, 146 T.C. 171 (2016).

[iii] Estate of Cahill v. Commissioner, T.C. Memo. 2018-84 (June 18, 2018); Morrissette v. Comr. Tax Court Docket No. 4415-14.

[iv] Estate of Morrisette v. Commissioner, 146 T.C. 171 (2016).

[v] All three cases can be monitored on the US Tax Court web site – www.ustaxcourt.gov – Go to Docket Inquiry – Individual Party Name - Morrissette – Docket No. 4415-14, Richard Cahill – Docket No. 10451-16, Marion Levine – Docket 013370-13.

[vi] Treas. Reg. Sec. 1.61-22.

[vii] Estate of Clara M. Morrissette, 146 T.C. No. 11, April 13, 2016; Estate of Marion Levine, Docket No. 9345-15, Order and Decision, July 13, 2016; LISI Estate Planning Newsletters by Howard Zaritsky (#2408), Lee Slavutin (#2414), Alan Jensen and Brent Berselli (#2418), Lee Slavutin (#2436), Lee Slavutin and Richard Harris (#2443) and Espen Robak (#2444).

[viii] Estate of Richard Cahill T.C. Memo 2018-84, June 18, 2018; Estate of Clara Morrissette, Docket No. 4415-14, Order, June21, 2018.

[ix] Estate of Powell v. Commissioner, 148 T.C. No. 18.

[x] Espen Robak, CFA: Intergenerational Split Dollar Valuation Issues, Steve Leimberg's Estate Planning Newsletter #2444.

[xi] Treas. Reg. Sec. 1.61-22.

[xii] See also: Estate of Bongard v. Commr., 124 T.C. 95, 112 (2005); Estate of Hurford v. Commr., T.C. Memo. 2008-278; Strangi v. Commr, T.C. Memo. 2003-145, aff'd, 417 F.3d 468 (5th Cir. 2005).

[xiii] Estate of Powell v. Commr., 148 T.C. ___, (slip op. at 16) (May 18, 2017).

[xiv] Treas. Reg. Sec. 20.2036-1(b)(3).

[xv] IRC Sec. 2703(b).

[xvi] Treas. Reg. Sec.25.2703-1(b)(2).

[xvii] B. Mandelbaum, 69 TCM 2852, Dec. 50,687(M), TC Memo 1995-255, aff'd in unpublished op., CA-3, 96-2 USTC ¶60,240, 91 F.3d 124.

[xviii] Treas. Reg. Sec.1.61-22 and Sec.1.7872-15.

[xix] Treas. Reg Sec. 1.7872-15(e)(5)(ii). See 1.61-22(b) (1)(i) which provides in part: "Either party pays … all or any portion of the premiums on a life insurance contract."

[xx] Treas. Reg. Sec. 1.72-9; 1.7872-15(e)(5)(i) and (ii)).

[xxi] Treas. Reg. sec. 1.7872-15(a)(2)(i)(C) provides in part: "The repayment is to be made from, or is secured by, the policy's death benefit proceeds, the policy cash surrender value, or both."

[xxii] Treas. Reg. Sec. 1.7872-15(d).

[xxiii] Treas. Reg. Sec. 1.7872-15(g)(4).
[xxiv] While they will build cash value over time, Indexed Universal Life with secondary guarantees without an accelerated cash value rider may be a nice compromise.

[xxv] Treas. Reg. Sec. 20.2031-8.

[xxvi] Treas. Reg. Sec. 20.2031-8(a)(2). Keith Buck's article "Life Insurance Valuation: What Advisors Need to Know" LISI Estate Planning Newsletter #1638, May 10, 2010 describes the multiple possible outcomes in valuing identical policies.

[xxvii] "Richard Harris on Schwab: Appeals Court Upholds Fair Market Value of Life Insurance Policies" LISI Estate Planning Newsletter #2098, May 14,2013. See Treas. Reg. Sec. 25.2512-6 which is the gift tax regulation counterpart to the estate tax Treas. Reg. Sec. 20.2031-8.