Levine and Split-Dollar Life Insurance Planning

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Levine and Split-Dollar Life Insurance Planning

By: Martin M. Shenkman, Esq.
Jonathan G. Blattmachr, Esq. and
Lawrence M. Lipoff, CPA

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Levine and Split-Dollar Arrangements

Introduction

Introduction to Levine Case

- A recent Tax Court case decision provided a resounding victory to the taxpayer who had pursued what some might view as an aggressive split-dollar life insurance plan to minimize estate taxes. Estate of Marion Levine v. Commr,. 158 T.C. -- No. 2, February 28, 2022.
- This follows prior cases that indicated problems for held pretty strongly against other taxpayers who had implemented somewhat similar split-dollar arrangements, using somewhat similar arrangements. Understanding what the taxpayer did right in the Levine case, and how that contrasts to what taxpayers did wrong in a prior case, Estate of Cahill v. Commr, T.C. Memo 2018-84, may provide guidance to can be used to guide taxpayers contemplating such planning or other planning, including the use of FLPs.
- But even better guidance may be possible. A careful reading of the Levine case to identify steps the Levine Court found favorable, might be used to craft a roadmap of how to implement a similar plan.
- Importantly, the points in the roadmap below should be considered by taxpayers undertaking almost any type of estate planning.

Introduction to Levine Case

Although many view Levine as a major taxpayer victory for split-dollar, it is only one decision of the Tax Court where two prior decisions (Cahill and Morrissette) appear less favorable. And no appeals court has yet to weigh in.

There may be serious gift tax issues when entering a split-dollar arrangement which could be viewed as quite negative.

There could also be a significant income tax consequence in that the value of the receivable is quite low, and gain may be triggered when the receivable is paid.

Introduction to Levine Case

- Threshold areas of focus may include:
- (1) what should someone with an intergenerational split-dollar life insurance plan currently in place do;
- (2) might planners who have avoided recommending intergenerational split-dollar insurance planning since Morrisette I and II (discussed later) and Cahill have reason to restart intergenerational split-dollar life insurance planning (presumably following the Levine structure exactly as presented) and
- (3) for permutations of the intergenerational split-dollar life insurance planning for qualified terminal interest property (QTIP) trusts and foreign nongrantor accumulation trusts with large undistributed net income (UNI) balances where §§2036, 2038 and 2703 of the Internal Revenue Code are potentially not relevant, have even more reason to implement intergenerational split-dollar life insurance?

Split-Dollar Arrangements

Background

What is Intergenerational Split-Dollar Life Insurance?

- Before providing a split-dollar insurance planning roadmap based on the Levine case, an explanation of what split-dollar life insurance is may be useful. "Split-dollar" is not a type of life insurance. Rather, it is an arrangement under which the proceeds of a cash value policy are split, divided or shared at death and, in some cases, may also provide for a splitting of the cost of premiums on the policy.

- In the family context, split-dollar insurance arrangements are referred to as "private" or "family" split-dollar, in contrast to when the arrangement is used for a key employee (or for a shareholder). See, e.g., PLR 9636033 (not precedent). In a private or family split-dollar insurance plan is when two trusts or persons purchase insurance on the life of a particular family member.

- Typically, when split-dollar is used in an estate plan, an irrevocable life insurance trust ("ILIT") is the owner of the policy. The premiums for the policy involved are often paid by the taxpayer or a proxy for the taxpayer. In the Levine case. the payor of the premiums was a revocable trust established by Mrs. Levine. A similar structure was used in a prior case, Estate of Cahill (which seems to have resulted in a "defeat" for the taxpayer).

What is Intergenerational Split-Dollar Life Insurance?

- The parties to the split-dollar arrangement can agree to allocate policy costs and benefits between them in a variety of ways. For example, in the Levine case, Mrs. Levine's revocable trust advanced the funds for her life insurance trust to purchase policies on her children's lives. And the insurance trust had to pay the trust back an amount equal to the greater of premiums paid or the cash surrender value of the policies on the earlier the insured's death or the termination of the split-dollar arrangement.
- 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 prior cases in which the taxpayers lost, Cahill and Morrissette, as well as the current Levine case in which the taxpayer seems victorious, only deal with economic benefit split-dollar.

What is Intergenerational Split-Dollar Life Insurance?

- In these types of economic benefit split-dollar arrangements, the insurance trust (ILIT) generally pays only for the term cost of the life insurance which is not material in the early years of the arrangement. Another party, sometimes called the cash value sponsor, 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 generally a significant portion of the insurance cost in the early years of the arrangement. In the Levine case, Mrs. Levine's revocable trust advanced premiums to her insurance trust.
- Note that in the classic economic benefit split dollar arrangement, the cash value sponsor (e.g., the revocable trust in the Levine case) gets back the greater of premiums paid or cash value. Of course, before death, cash value may not equal premiums paid.

What is Intergenerational Split-Dollar Life Insurance?

- A split-dollar arrangement can potentially accomplish estate planning goals:

1. It may reduce the current gifts the donor/insured is required to make to the ILIT to purchase the desired life insurance. Because Mrs. Levine's revocable trust advanced funds to the ILIT to pay premiums, the ILIT did not need Mrs. Levine to make a taxable gift to it to fund those purchases.
2. It may assure that the insurance proceeds are excluded from the donor/insured's taxable estate. Mrs. Levine was not the insured rather one of her children was. Further, as explained below, she never had any interest in the insurance policies involved.
3. The value of the receivable due to the taxpayer (which as stated above is equal to the greater of premiums paid or the cash value of the policy), or in the Levine case Mrs. Levine's revocable trust, might be valued at substantially less than the face value of the monies advanced to the insurance trust. The $6.5 million advance in the Levine case was valued at about a third ($2.5 million) of that amount as of the time of her death, resulting in Mrs. Levine's estate eliminating 2/3rds of that value from her taxable estate. That seems to have been a substantial savings

Split-Dollar Arrangements

Summary of an Inter-generational Split-Dollar Arrangement

1. The person funding the insurance purchase is usually of advanced age.
2. The person funding the life insurance may, but does not always, borrow the money from a lender.
3. The insurance policy is paid for with a single premium or premiums paid over a brief period, e.g., several years as contrasted to a more typical longer period.
4. The insured is an adult child of the person advancing funds for the policy. The adult child or children are typically middle age, e.g., 40-60.
5. The person advancing the funds, e.g., Mrs. Levine, often dies within a relatively brief period of time after the split dollar plan is created. The estate of the person advancing the funds values the interest in the IGSD at a substantial discount from its face value, using a discounted cash flow analysis. The rationale for a significant discount is that the donor's estate is entitled to its repayment when the insured child dies years in the future, and therefore the present value of that repayment may be significantly less than what might ultimately be paid to the estate.

The IRS challenge to IGSD

- The IRS challenged the plan from various perspectives (e.g., the fiduciary relationships, as discussed below). But three key challenges were based on three different Sections of the Internal Revenue Code:
- Inclusion of the entire cash value as of the death of the person advancing the funds for premium payments under Sections 2036
- Inclusion of the entire cash value as of the death of the person advancing the funds for premium payments under Section 2038.
- Disregard pursuant to Section 2703 of the “restrictions” of the split dollar agreement for the advancer of the premiums to access the cash value of the policy
- The challenge pertains to what is the asset that is included in the taxpayer’s estate, and what is the value of the interest under the split-dollar plan that is included. In a split-dollar plan, the taxpayer transfers funds used by the insurance trust to pay the premium payments in exchange for a repayment right. (see Rev Rul 64-328).

Code Section 2036 Challenge

- Code Section 2036(a)(2) can apply to include in the value of the taxpayer's gross estate the value of all property that the decedent had transferred during lifetime for less than full and adequate consideration in money or money's worth not in a bona fide sale or exchange, 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.

Code Section 2038 Challenge

- Includes in the gross value of an estate all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale or exchange for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his or her death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3 year period ending on the date of the decedent's death.

Levine Comments on 2036 and 2038

- As to Code Sections 2036 and 2038 the Levine Court held that it "…*was the Insurance Trust that bought the policies and held them. These policies were never owned by the Revocable Trust, and there was no "transfer" of these policies from the Revocable Trust to the Insurance Trust… The "property" is also not the receivable itself. That property belonged to the Revocable Trust and now it belongs to the Estate. It wasn't 'transferred'; it was retained*." The Levine Court concluded that Mrs. Levine did not retain any right to possession or enjoyment of the property transferred. The
- The Tax Court held that, unless Mrs. Levine jointly held the right to terminate the split-dollar life-insurance policy with the irrevocable trust that held the policies, which she did not under the terms of the split-dollar contract, the cash value of the policies held in the insurance trust were not included in her gross estate. The only asset in her estate was her rights under the split-dollar agreement which she could not unilaterally accelerate or terminate.

Levine Comments on 2036 and 2038

- The IRS argued that Mrs. Levine, through her attorneys-in-fact, stood on both sides of the transactions (the advance and the split-dollar agreement) and therefore could unwind the split-dollar transactions at will. This meant that Mrs. Levine, through the attorneys-in-fact, had the power to surrender the policies at any time for their cash-surrender values. But the court found that this was not the case because an independent trustee owed a fiduciary duty to beneficiaries, the grandchildren, who were different than the beneficiaries of Mrs. Levine's estate.

Code Section 2703 Challenge

- The IRS argued that the special valuation rules under Code Section 2703 applied to Levine's split-dollar arrangement. Section 2703(a) provides that "…*the value of any property shall be determined without regard to — (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or (2) any restriction on the right to sell or use such property*."
- The IRS argued that when Mrs. Levine, acting through her attorneys-in-fact, entered into the split-dollar arrangement, she placed a restriction on her right to control the $6.5 million in cash and the life- insurance policies. And the restriction on Mrs. Levine's right to unilaterally access the funds transferred to the insurance companies for the benefit of the Insurance Trust is what should be disregarded when determining the value of the property under Code Section 2703(a)(2).
- Mrs. Levine's estate, however, argued that Code Section 2703 applies only to property owned by a decedent at the time of her death, not to property she'd disposed of before, or property like the insurance policies that she never owned at all. The Levine Court agreed.

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

General Comments

Be Meticulous in Attention to Detail

- The Levine court recounts in detail the sophistication of the family, the attention to details in all matters not only estate planning, the legitimate and substantial business operations and investments involved (not merely a passive securities portfolio as in some bad fact cases), etc. This care and diligence seemed to impress the Levine Court and appears to have given legitimacy and respect to the overall plan. This was significant and is not what occurs in many plans.
- The Levine court noted “estate planners as skilled as the ones the family retained.” The Levine Court seems impressed throughout the opinion with the professionalism of how matters were handled. Perhaps this is an indication of how important doing the opposite of what was done in so many bad fact cases is to succeeding in a challenge – be thorough, adhere to formalities, etc.

Deliberate Careful Planning

- "*Swanson [the estate planning attorney] spent a good deal of time thinking through all the advantages and disadvantages, conditions and qualifiers. He put together a PowerPoint presentation for the family in late 2007 or early 2008. Then in January 2008 he sent a letter to Larson and the children in which he described the transaction and its legal and tax implications*."
- Deliberate careful planning, well explained to the client. Too often this degree of care does not happen, primarily in many cases because clients do not wish to incur the additional fees to permit their advisers to operate in this manner. Perhaps this is all a caution to such clients that being "penny wise and pound foolish" is not the way to handle tax planning. Perhaps advisers should inform clients of the tone and comments in the Levine case to support why deliberate, documented, and thoughtful planning is worthwhile. This type of well documented planning assures the client understands the planning and may protect the practitioner from later claims that the plan or its risks were not explained.

Plan In Advance

- In Levine not much time passed from the implementation of the plan to Mrs. Levine's death. While that was not cited as a negative by the Levine Court, why not plan as far in advance as possible.
- In Levine the plan was implemented by Mrs. Levine's agents and trustees in June and July 2008, and on January 22, 2009, she died.
- In contrast, in the Cahill case at the time the plan was implemented the 90-year-old father could not manage his own affairs. This, as noted above, was like 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 policies were purchased in 2010. The donor/taxpayer Mr. Cahill died in 2011. How different is Levine then Cahill or Powell in this regard?

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

Financial Security for Taxpayer

- The Levine Court noted: “From the beginning, Larson [the independent trustee of the ILIT] and Levine’s children made it clear to Swanson [the estate planning attorney] that Levine wanted enough money to maintain her lifestyle until her death. This meant that any estate planning needed to be done with Levine’s excess capital—i.e., assets that she would not likely need during her lifetime.”
- Preserving adequate resources for the taxpayer engaging in planning is important to deflect a challenge of, for example, an implied agreement with the trustee of a trust, etc. Here, the taxpayers considered this important fact. In too many plans, clients do not have advisers prepare forecasts corroborating their financial comfort after proposed transfers are made

Decedent Had No Rights

- As of the date of her death, Marion Levine, the decedent, possessed only a receivable created by the split-dollar arrangements. This was only the right to receive the greater of premiums paid or the cash surrender values of the policies when they are terminated.
- She had no rights on her death or at any time prior to her death, in the life insurance policies held by the ILIT.
- She never had any rights to modify or terminate the split-dollar agreement (that power was vested solely in the ILIT investment committee (insurance trustee).
- The decedent did not have any right, whether by herself or in conjunction with anyone else, to terminate the policies because only the ILIT had that right.
- Contrast in Cahill v. Commr. 115 T.C.M. (CCH) 1463 (2018), the split dollar 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.

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

ILIT Comments

Be Careful that Only the ILIT Ever Owns the Insurance

- The Levine Court stated: "*We find that the "property" at issue cannot be the life-insurance policies, as these policies have always been owned by the Insurance Trust. The split-dollar transaction was structured so that the $6.5 million was paid by the Revocable Trust in exchange for the split-dollar receivable. It was the Insurance Trust that bought the policies and held them. These policies were never owned by the Revocable Trust, and there was no "transfer" of these policies from the Revocable Trust to the Insurance Trust.*"

ILIT Decisions By Independent Person

- Larson was the sole member of the investment committee that managed the irrevocable trust.
- Only Larson, the independent insurance trustee (investment committee) had the right to prematurely terminate the life-insurance policies. These arrangements gave the other two attorneys-in-fact for decedent no rights to terminate the policies or the arrangement itself.
- Note: This differs from Cahill where decedent/decedent's agents had the right to agree along with an independent trustee of the ILIT to a termination of the split-dollar agreement. This was a critical element of the case that supported the taxpayer victory. But how different in reality was it if Larson was a co-agent and the insurance trustee?

Better Practice: Name Independent Trustees

- Larson was under a fiduciary duty to exercise his power to direct the Insurance Trust’s investments prudently, and he faced possible liability to its beneficiaries if he breached that duty.
- Fiduciary duty is an important factor in the Court’s analysis in Levine. The Insurance director/trustee (under the title here of Investment Committee) had a fiduciary obligation to the beneficiaries to make reasonable decisions. Is this a Byrum type of argument? The Court noted above the independence of the person named (he was not family), and his business and financial acumen.
- But in Cahill, 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 that he not terminate the split-dollar 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? How different is a cousin/business partner in Cahill versus a 50-year employee/business partner who was not a relative in Levine? Would a second cousin be viewed differently? How can the facts in the two cases be reconciled to an understandable framework from which to plan?

Independent Institutional General Trustee

- South Dakota Trust Company was the general trustee of the trust and was an independent institutional trustee.
- The use of not just an independent trustee but an independent institutional trustee seemed favorable in the Court's view of the case. The cost relative to most plans of naming an institutional trustee is quite modest yet many clients resist because of the cost. Again, the Levine case provides confirmation that this step may well be worth the cost involved.
- Many clients prefer the use of family trustees because they will not charge and will accommodate any request. But the latter is exactly what using an institutional trustee may infuse more independence, reality and respect for any transaction. Again, another take home lesson from Levine

Be Certain Person Holding Power to Modify Split Dollar is Fiduciary

- The Levine Court noted: "*The terms of the Insurance Trust expressly state that Larson—in his role as the single-member investment committee—shall be considered to be acting in a fiduciary capacity*…"
- The fiduciary obligation must be to a distinct/different beneficiary: "Levine's children are not the only beneficiaries under the Insurance Trust. Her grandchildren are also beneficiaries, and Larson has fiduciary obligations to them as well."

Careful Drafting: Don't Let POA Defeat Independent Beneficiary

- Be certain in drafting the ILIT (or other documents) that the independent/distinct beneficiary cannot be removed by a exercise of a POA. Had the children in Levine held a lifetime POA that could have defeated the grandchildren's rights the results may have been different.
- The Levine Court stated: "*So if Nancy and Larry hoped to extinguish the interests of their own children, they couldn't do so until they themselves directly named some other beneficiary to take their place. This means that during the lives of Nancy and Robert, their children will remain beneficiaries of the Insurance Trust, and a decision by Larson to surrender the policies would mean the grandchildren would receive nothing. This would breach his fiduciary duties to them.*"

Caution: IRS Argument

- In Levine the Court Stated: "…*Commissioner makes his thrust. He contends that Levine—through her attorneys-in-fact—stood on both sides of these transactions and therefore could unwind the split-dollar transactions at will. This meant that she—again through the attorneys-in-fact—had the power to surrender the policies at any time for their cash-surrender values*."
- In Levine there was an identity of fiduciaries Larson was an agent and trustee of the ILIT. If possible, structure the transaction with independent and different fiduciaries. Why not make the agent under the power of attorney/successor trustee under the revocable trust, different then the person named as ILIT trustee (investment committee in this instance).

Different Beneficiaries Under ILIT and Estate, etc.

- The Levine Court noted the: "…*fiduciary obligations Larson owes to the beneficiaries of the Insurance Trust—obligations that would prevent him from surrendering the policies*. " Be certain the facts comport with that requirement.
- Decedent's children and grandchildren were the beneficiaries of the irrevocable trust.
- The Court noted: "The Insurance Trust's beneficiaries were Robert, Nancy, and Levine's grandchildren— the grandchildren that Levine naturally wanted to take care of."
- The different/distinct beneficiaries should be persons the decedent wants to benefit and that should be documented.

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

Split Dollar Loan Arrangements

Decedent/Revocable Trust Have No Rights under Split-Dollar Docs

- The Court stated: "*It was very important, if this deal was to work, that the Insurance Trust and not the Revocable Trust own the policies. The recitals in the arrangements state that the parties do not intend to convey to Levine or the Revocable Trust any "right, power or duty that is an incident in ownership . . . as such is defined under Section[s] 2035 and 2042" in the life-insurance policies at the time of Levine's death. They also state that neither the Insurance Trust, nor its beneficiaries, nor the insureds— Nancy and Larry—would have access to any current or future interest in the cash value of the insurance policies. We also specifically find that only the Insurance Trust—and that means Larson—had the right to terminate the arrangements*."
- The Court noted as significant what some might call self-serving statements and contractual restrictions in the split-dollar legal documentation.

Only the ILIT could Terminate

- "*The Insurance Trust shall have the sole right to surrender or cancel the Policy during the lifetime of either insured. In addition, the Insurance Trust may terminate this Agreement in a writing delivered to the other party, effective upon the date set forth in such writing*."
- This was a key fact in the case.
- However, it is noted that Larson was a key employee of family business enterprises, but that point and the possible implications to the family controlling Larson's actions do not appear to be discussed in the case.
- The above structure was also quite different then in the Cahill case wherein the decedent in conjunction with the trustee could determine to terminate the arrangement. An essential difference between the results in Cahill and Levine, which was a focal point of the Levine favorable decision, was a line or two in the split-dollar documentation specifying who could terminate the arrangement.

Split-Dollar Docs Must Specify Only ILIT Trustee Can Terminate

- *"The split-dollar arrangements we analyzed in Morrissette II and Estate of Cahill were different. Look at the language in those arrangements. In Morrissette II: The Donor and the Trust may mutually agree to terminate this agreement by providing written notice to the Insurer, but in no event shall either the Donor or the Trust possess the unilateral right to terminate this Agreement."*
- The difference seems quite limited but apparently enough to suffice. In Cahill the decedent had to agree to the termination but could not unilaterally terminate. In Levine a long-time employee and business partner alone controlled the decision.

Watch the Precise Language in the Contract Docs

- The Levine Court noted: "*…general default rules of contract—rules that might theoretically allow modification of just about any contract in ways that would benefit the IRS—are not what's meant in phrases like section 2036's "right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom," or section 2038's "power . . . by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power)." What's meant are rights or powers created by specific instruments*."
- This is the crux of the Court's reasoning in Levine that deflects the IRS challenge under Sections 2036 and 2038. The split dollar agreement expressly gave the right to the ILIT trustee to make the decision and that is a key difference between the documentation in Cahill and Levine.

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

Premium Financing Considerations

Premium Financing Should Be Long Term and the Cost Less than the Return on the Policies

- Is this even possible?
- So, the term of the longest loan in the Levine case was 60 months. Compare this to the Cahill case which was viewed as a victory for the IRS. In Cahill, the transaction may not have been economically viable for the long term because the loan term was for five years. The lender in Cahill, also an independent institution, Northern Trust, did not have to renew the loan.
- There is no indication in Levine that any lender had to renew loans.
- In Cahill, the loan interest rate may have exceeded the guaranteed rate of return on the policy cash value. That factor does not appear to be analyzed in Levine.
- Then why was the transaction in Levine viewed so much more favorably than the transaction in Cahill?
- Might longer term loans or loans with some indication of they can be renewed be safer?

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

Valuation Considerations

Don't be a Valuation Pig

- In Levine the Insurance Trust had promised to pay the Revocable Trust the greater of $6.5 million or the policies' cash surrender value at either the death of both Nancy and her husband or upon termination of the policies. At the time of Levine's death, this value was close to $6.2 million, but the value of the Revocable Trust's interests was determined to be $2.1 million.
- Contrast the above valuation reduction in Levine to that reduction claimed in Cahill. In Cahill $10 million was transferred to the insurance trust. The Cahill estate claimed the discounted value of the future repayment was $183,700, which is 1.9% of the cash value.
- The discount sought by the taxpayer in Cahill was dramatically larger than the relative discount sought in the Levine case. Was the excessive nature of the discount in Cahill part of the reason for the Court's reaction? But how much of a discount is then "reasonable" before incurring the Court's wrath?

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

Rational Purpose for Insurance and Plan (Other Than Discounting)

Insurance On Lives of Children Made Sense

- The attorney for the decedent identified the "…*children's situation and learned that they themselves also had large real-estate holdings and completely lacked any estate plans. So, he suggested to them and Larson that there just might be a way for Levine to invest her excess capital to provide her with a good return, while at the same time meshing with the Levine children's needs for estate plans of their own*…who themselves have a sufficient net worth to qualify for large life-insurance policies."
- In Footnote 11: the Court said: "…we find him [Swanson the attorney] credible when he said that he also viewed the Insurance Trust as something Nancy and Robert could use in their own eventual estate planning.
- This suggests that there was a logical reason to have life insurance on the children's life. Contrast this with the facts in other cases where the purpose of the life insurance may have been viewed as providing a tax savings primarily or even only.
- Unrelated to Levine, insurance consultants should review their client lists and proactively contact G-2 for planning.

Have and Corroborate a Business Purpose

- The Levine Court noted: “In the Commissioner’s view, this entire transaction was merely a scheme to reduce Levine’s potential estate-tax liability and, if it was a sale, it was not bona fide because it lacked any legitimate business purpose.”
- Although the taxpayer succeeded in Levine endeavor to corroborate and document a business purpose and that the plan is not a scheme.

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

Gift Argument

Gift Argument

- The Tax Court in Levine seems to have given the IRS a suggestion: amend the split dollar regulations for estate tax purposes. It is not certain what the Treasury would do in that regard. There is also another route for the Service, perhaps, to consider: contend there was a big gift when the split-dollar arrangement was begun.
- Split-dollar plans originally were between employers and employees with the IRS contending that the employee received each year the plan was in place an annual economic benefit equal to the value of the amount of insurance protection the employee controlled. That makes sense because, even if the split-dollar arrangement is contract between employer and employee, it would end when the employee leaves employment which could occur in any year. But in a typical family split dollar arrangement, the advancer of premiums is making a promise to pay premiums each year. So the benefit to the other party (e.g., the ILIT in Mrs. Levine's case) is all made upfront, not annually. Hence, the IRS perhaps should have argued that Mrs. Levine made a gift of up to $6.5 million when the split-dollar arrangement was inked.

Levine Planning Roadmap to Create Split-Dollar Arrangement to Withstand Challenges

QTIP Considerations

QTIP Split-Dollar Considerations

- Although some split-dollar arrangements have been entered into with QTIP trusts, it is possible the IRS will contend that the arrangement triggers Code Sec. 2044 (causing the entire QTIP to be subject to gift tax) where a gift is deemed made by the spouse who is the beneficiary of the QTIP because the transfer of the premiums in the year the split-dollar arrangement is made (or the promise to do so over years but constituting a transfer again when the split-dollar arrangement is entered into) was for less than full and adequate consideration because, as the Levine case demonstrates, the advancer of the premium funds was going to get back much less in terms of current value.

Conclusion and Additional Information

Lots of Uncertainty

Conclusion

- The tax environment may change, but at this juncture there may be no change and any change might be less dramatic than anticipated over the past few years. But none of that is a reason not to plan. Now planning can "circle back" and address all the issues not addressed in the frenzy of planning over the past few years.
- All high-income clients should review income tax planning options.
- All wealth (defined by what might be a much lower exemption and harsher transfer tax system) clients should plan now, but with caution, consideration to the uncertainty, and the proposals presently known.
- Life insurance presents answers to many of these challenges and problems, but often in ways that are markedly different than insurance planning under prior traditional circumstances.
- The informed insurance consultant has a unique opportunity to capitalize on the current environment and provide great value to clients.
- Hence, in dealing with economic benefit split-dollar, as Sergeant Esterhaus said in Hill Street Blues, "Let's Be Careful Out There."

Additional information

- Lawrence Lipoff, CPA
  lawrence.lipoff@cohnreznick.com
- Jonathan G. Blattmachr jblattmachr@hotmail.com
- Martin M. Shenkman shenkman@shenkmanlaw.com
- Interactive Legal sales@interactivelegal.com
- Peak Trust Company bcintula@peaktrust.com

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