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- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today’s program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.
Kelley Miller is an attorney with Reed Smith LLP, resident in the firm’s Washington, DC office, where significant aspects of her practice involve handling complex federal and state tax controversies. Ms. Miller’s practice is premised on using the right tools at the right time to help her clients pay no more tax than legally due. A former Attorney Advisor to the United States Tax Court, Ms. Miller regularly advises clients on federal and state tax planning opportunities and represents clients in civil and criminal tax matters before state tribunals and administrative agencies—including the Internal Revenue Service—state and federal courts. In addition to her law practice, Ms. Miller has been or is an Adjunct Professor of Law at Georgetown University Law Center, Temple University Beasley School of Law, and Western New England College School of Law.
Richard is the managing member of Richard L. Harris LLC. He works nationally and has over 40-years experience consulting on life insurance and transactions involving life insurance, particularly as they involve estate or business continuation planning. His clients are ultra-affluent and their advisors. Apart from consulting, he also acts as a purchasing agent for clients buying life insurance and he, serves as an expert witness.

His publications include articles about split-dollar arrangements in Trusts & Estates, Estate Planning, Steve Leimberg’s Newsletters, and Journal of Practical Estate Planning. With Martin Shenkman he created “Indexed and Annotated Regulations 1.61-22 and 1.7872-15”.

Among his accomplishments, Richard is Chair of the Insurance Committee for Trusts & Estates, on the editorial advisory board of Wealth Strategies Journal, a member of the American Bar Association Real Property Trusts & Estates Committee on Insurance and Financial Planning, and Professional Expert, WR Newswire An AALU Washington Report.

Richard graduated from Long Island University where he majored in Accounting and Literature.

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AGENDA

1. Result of Morrissette
2. Why important
3. Economic benefit split-dollar arrangements
4. Economic Benefit Intergenerational split-dollar
5. Morrissette – What happened
6. Morrissette – What Tax Court said
7. Alternative – Loan split-dollar
8. Benefits and complexities of Private Split-Dollar
   A. Gift taxes
   B. Estate taxes
   C. Control
   D. Administration
9. Appropriate policies
The *Morrissette* Case & Its Impact on Split Dollar Life Insurance Planning
The Facts and Circumstances of Morrissette

The Morrissette Succession Plan

• Arthur Morrissette, Sr. started a moving company in the Washington, D.C., suburbs in 1943 with a single truck, but quickly grew his business to become an industry leader known as Interstate Van Lines. Over the next 70 years, Arthur and his wife, Clara, built a formidable empire.
The Facts and Circumstances of *Morrissette*

**The Morrissette Succession Plan**

• In 2006, Clara Morrissette – now widowed – set into motion a plan to pass Interstate stock to her sons and, ultimately, to trusts for her grandchildren.

• First, Mrs. Morrissette made her sons trustees in her revocable trust; second, she created three dynasty trusts – one for each of her sons.

• The shareholder agreements set forth arrangements whereby the dynasty trusts would purchase the stock held by each of the Morrissette brothers when one of them died.
The Facts and Circumstances of *Morrissette*

**The Morrissette Succession Plan**

• In order to fund these buyouts, each dynasty trust would secure a life insurance policy on the lives of the two other brothers.

• Mrs. Morrissette, ever mindful that the only way she could make sure the insurance policies would not lapse and that the proceeds would be available to fund the buy-sell agreements, arranged to pay all the projected premiums for the policies in lump sums out of her own revocable trust, which she managed.
The Facts and Circumstances of *Morrissette*

The Morrissette Succession Plan

• The lump-sum amounts Mrs. Morrissette advanced to pay premiums on the policies was sufficient to maintain them for her sons' projected life expectancies (which at the time ranged from approximately 15 to 19 years).

• Finalizing this plan, Mrs. Morrissette was confident that Interstate stock held by or for the benefit of her sons would be acquired by the dynasty trusts, and would eventually benefit her grandchildren and future generations of her family.
The Facts and Circumstances of *Morrissette*

**The Split-Dollar Life Insurance Policies**

- Mrs. Morrissette advanced approximately $30 million to make lump sum premium payments on the insurance policies for her three sons.

- The financing for these life insurance policies was structured as “split-dollar arrangements,” meaning that the cost and benefits would be split between the trusts.

- In this case, while Mrs. Morrissette paid a lump sum amount to cover the premiums on these policies, the policies themselves were designed to pay out varying amounts to the trusts for both Mrs. Morrissette and her sons.
The Facts and Circumstances of Morrissette

The Split-Dollar Life Insurance Policies

• Specifically, upon the death of any of her sons, Mrs. Morrissette’s revocable trust would receive the greater of either the cash surrender value of that policy or the aggregate premium payments on that policy, while each dynasty trust would receive the balance of the policy death benefit.

• The amounts Mrs. Morrissette retained are known as split-dollar receivables (the “Receivables”).
The Facts and Circumstances of *Morrissette*

**The Split-Dollar Life Insurance Policies**

• In a typical case, a company advances funds to a trust to pay premiums on insurance on the life of the owner of the company, and the split-dollar receivable is payable upon the death of that owner.

*What was unique in this case is that the split-dollar receivable wasn’t payable until the death of one of Mrs. Morrissette’s sons.*
The Facts and Circumstances of *Morrissette*

The Split-Dollar Life Insurance Policies

• Accordingly, in this case, the split-dollar receivable became an asset in Mrs. Morrissette’s estate.

• Given her sons’ life expectancies (the sons were all in their late 60s and 70s when the agreement was made), this asset was not likely payable to the Estate for 20 years.

• So, a seminal issue arose upon filing the estate tax return:

  **How should the Receivables be valued for gift and estate tax purposes?**
The Facts and Circumstances of *Morrissette*

Gift and Estate Tax Reporting

• From 2006 through 2009, Mrs. Morrissette reported gifts made to the dynasty trusts based upon the cost of the current life insurance protection based on tables published by the IRS determined under the economic benefit regime.

• After Mrs. Morrissette’s death, her estate retained an independent valuation firm to value the Receivables includible in her gross estate as of the date of her death. The total value reported on her estate tax return for the Receivables was $7.48 million.
The Facts and Circumstances of *Morrissette*

**IRS Challenges the Morrissette’s Agreement**

- The Internal Revenue Service ultimately issued two notices of deficiency to the Estate.

- The first notice was for a gift tax liability for the tax year ending December 31, 2006, which determined that the Estate had failed to report total gifts in the amount of $29.9 million — the amount that Mrs. Morrissette paid in a lump-sum payment of policy premiums.

- The second notice grossed up Mrs. Morrissette’s lifetime gifts by $29.9 million, and determined additional estate tax liability attributable thereto.
The Facts and Circumstances of *Morrissette*

The Estate Files a Petition to the USTC

• The Estate moved for partial summary judgment on the threshold legal question presented by this scenario – specifically, whether the split-life arrangements should be governed under the economic benefit regime as set forth in section 1.61-22 of the Income Tax Regulations.

• If the arrangements were properly governed under this regime, then the Estate would have been correct that the total value reported for the Receivables should be based on the present value of the right to collect the Receivables in 15 to 20 years (again, based on the sons’ actuarial life expectancies).
The Facts and Circumstances of *Morrissette*

**The Estate Files a Petition to the USTC**

- The Estate filed its motion for partial summary judgment January 2, 2015.

- Over the next 11 months, and at the direction of the Tax Court, the parties filed in total four cross pleadings on the petitioner’s operative motion.

- The hallmark of the respondent’s pleadings was the Internal Revenue Service’s argument that the petitioner’s motion should be denied because it was factually unclear as to whether or not the revocable trust had conferred upon the dynasty trusts an economic benefit apart from the current cost of the life insurance protection obtained.
The Facts and Circumstances of *Morrissette*

**The Estate Files a Petition to the USTC**

- Over the course of a year, the parties filed five cross pleadings in this case.

- Petitioner maintained throughout all of the pleadings that summary judgment was appropriate in this case as the only question in dispute – whether or not any additional economic benefit was provided other than current life protection – was legal, not factual.

- The Tax Court ultimately agreed with the petitioner.
The Tax Court’s Decision in *Morrissette*

**The USTC’s Decision in *Morrissette***

• With respect to the arguments raised by petitioner and respondent, respondent maintained its position in its pleadings that the lump-sum premium payments made by the revocable trust should be treated as loans owed back to the Estate and valued under the Internal Revenue Regulations referred to as the loan regime.

• Petitioner relied on other Internal Revenue Regulations issued in 2002 on how to treat, for tax purposes, split-dollar arrangements.
The Tax Court’s Decision in *Morrissette*

**The USTC’s Decision in *Morrissette***

• Notably, petitioner reasoned that since the split-dollar arrangements at issue were executed in accordance with provisions in the Regulations under the economic benefit regime, the split-dollar arrangements were not governed by the loan regime, and the Estate was not liable for the 2006 gift tax deficiency determined by the IRS.

• The Tax Court sided with petitioner as a matter of law.
The Tax Court’s Decision in *Morrissette*

The USTC’s Decision in *Morrissette*

• On the specific legal question of whether the split-dollar arrangements were governed by the loan regime or the economic benefit regime, the Tax Court applied the final Income Tax Regulation 1.61-(1)(ii)(A)(2), which provides that if

“the only economic benefit provided under the split-dollar life insurance arrangement to the donee is current life insurance protection, then the donor will be the deemed owner of the life insurance contract, irrespective of actual policy ownership, and the economic benefit regime will apply.”
The USTC’s Decision in *Morrissette*

• Then, in order to determine if any additional economic benefit was conferred by the revocable trust to the dynasty trusts, the Tax Court considered whether or not “the dynasty trusts had current access to the cash values of their respective policies under the split-dollar life insurance arrangements or whether any other economic benefit was provided.”

*Because the split-dollar arrangements were carefully structured to only pay the dynasty trusts that portion of the death benefit of the policy in excess of the Receivables payable to the revocable trust, the Tax Court concluded that the dynasty trusts could not have any current access under the final regulations.*
The Tax Court’s Decision in *Morrissette*

**The USTC’s Decision in *Morrissette***

- The Tax Court also agreed with petitioner that no additional economic benefit was conferred by the revocable trust to the dynasty trusts on account that
  
  - (i) the lump sum premium payment advanced by the revocable trust assured the revocable trust had sole access to the cash surrender value of the life insurance policies (which was essential to accomplish Mrs. Morrissette’s goal to assure that life insurance proceeds would be available to buy the stock held by any of her sons at death) and;
  
  - (ii) the fact that the revocable trust made the lump sum payments did not obviate the dynasty trusts of any obligation to pay the premiums on an ongoing basis because the dynasty trusts were not required to do so.
WHY IS THIS IMPORTANT?

The estate planning world is about to experience a tsunami in the form of Proposed Regulations under Section 2704. They effectively do away with discounts for interests in family businesses including those set up to hold specific assets.

While GRATs and Sales to Grantor Trusts can still be done, without being able to discount the asset it will be harder for those transactions to succeed.
Intergenerational Split-Dollar arrangements, if successful, can produce very large discounts for certain receivables in the estate of a decedent.

Until Morrissette no case has gone to tax court. The others have either been settled or are awaiting trial.
WHAT ARE ECONOMIC BENEFIT ARRANGEMENTS?

1.61-22(B)(1)
General rule. Split-dollar is defined as any arrangement between an owner and non-owner of a life insurance policy that satisfies the following criteria:

(A) Either party to the arrangement pays, directly or indirectly, all or any portion of the premium on the life insurance contract, including payment by means of a loan to the other party that is secured by the life contract;
1.61-22(B)(1)

(B) At least one of the parties to the arrangement paying premiums under paragraph (b)(1)(i) of this section is entitled to recover (either conditionally or unconditionally) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract; and
WHAT ARE ECONOMIC BENEFIT ARRANGEMENTS?

1.61-22(B)(1)

(C) The arrangement is not part of a group-term life insurance plan described in section 79 unless the group-term life insurance plan provides permanent benefits to employees (as defined in § 1.79-0).

Important
Many arrangements (particularly in estate planning) have no specific date when the premium payer is gets paid her interest. The arrangement can continue until the death of the insured at which time the premium payer gets what she’s entitled to.
WHAT ARE ECONOMIC BENEFIT ARRANGEMENTS?

In a economic benefit arrangement, in order to avoid taxation of additional benefits (equity accruing to the non-owner) the party advancing the money is entitled to receive

The greater of premiums paid

Or the cash surrender of the policy
WHAT ARE ECONOMIC BENEFIT ARRANGEMENTS?

Non-Equity Arrangement/Reportable Economic Benefit (REB)

The value of the gift of the insurance premium payment is based on the economic benefit to the person receiving the benefit. That is based on the face amount of insurance minus what’s owed to the premium payer.

In Notice 2001-10, the IRS created Table 2001, which set new rates to measure the value of the insurance protection (i.e. economic benefit). These rates apply to all new arrangements entered into after January 28, 2002. They increase annually as the insured gets older.
ECONOMIC BENEFIT – A PRACTICAL VIEW

Insured

Insurance Company

Pays premiums

Restrictive Collateral Assignment

Gift of Economic Benefit

ILIT

Remaining death benefit passes to ILIT
The economic benefit amount is typically relatively small compared to the premium amounts, especially during the early years of the policy. Therefore should significantly reduce the gifts made by the insured.

Gifts are based on the term rates.
In many split-dollar arrangements the premium payer and the insured are the same.

Intergenerational split-dollar has three parties to the arrangement:

• Gen 1 – Creates a Dynastic ILIT
• Gen 1 ADVANCES a lump-sum payment to the ILIT to pay for policy on Gen 2.
• Insured is Gen 2 (child of Gen 1)
• ILIT is beneficiary.
INTERGENERATIONAL SPLIT-DOLLAR

The receivable is not payable until Gen 2 dies

If Gen 1 dies before Gen 2, the receivable is in the estate and appraised at fair market value.

Appraisers value receivable based on actuarial life expectancy of the insured. Discounts can go as high as 95%
The Impact of *Morrissette*

- The Tax Court’s decision marks a groundbreaking moment in estate tax jurisprudence and is most welcomed by the wealth planning and insurance communities for its beneficial application to high-net-worth individuals and owners of closely held businesses like the Morrissette family.

- The Tax Court’s resounding affirmation that the final regulations would control under these facts provides practitioners with the assurance that similarly or identically structured split-dollar arrangements would be governed by the economic benefit doctrine.
The Impact of *Morrissette*

**Top Take-Aways from Morrissette**

_We now know that compliance with the economic benefit split-dollar regulations (the “EB Regulations”) protects clients from gift tax liability, with the result that the value of the Receivables would be determined based on typical valuation principles (i.e., the amount a third party would pay to purchase the Receivables)._
The Impact of *Morrissette*

**Top Take-Aways from Morrissette**

• An insurance policy is a valuable asset, as long as you own both the death benefit and the cash surrender value. The EB Regulations realign this bundle of rights, separating the death benefit from the cash surrender value, and imposing significant gift and income tax liabilities on the parties attributable to the reallocation of the death benefit.

• These rules benefit the government through the income tax treatment of economic benefit split-dollar arrangements.
The Impact of *Morrissette*

**Top Take-Aways from Morrissette**

- The Tax Court’s decision opens the door to intergenerational split-dollar arrangements – providing a blueprint for the wealth management community for passing family assets (like closely held businesses) through the generations, with predictable estate and gift tax consequences for the original owners.
The Line of Cases Following *Morrissette*


  - The Tax Court entered summary judgment in favor of the taxpayer on July 13, 2016 in *Estate of Levine*, resulting in no gift tax deficiency or penalties, on the basis of the *Morrissette* opinion

1. What are the distinguishing factual characteristics of these cases (as compared to each other and to *Morrissette*)?
2. What are the positions that the Service is advancing in each of these cases?

*Final Observations and Predictions...*
Issues

• Are these arrangements really split-dollar?

• How should the receivable be valued?
Morrissette:
Matter of law rather than matter of fact.
The arrangement is split-dollar.
WHAT ARE LOAN SPLIT-DOLLAR ARRANGEMENTS?

1.7872-15 a)(2)(i)

(C) The repayment is to be made from, or is secured by, the policy's death benefit proceeds, the policy's cash surrender value, or both.
WHAT ARE LOAN SPLIT-DOLLAR ARRANGEMENTS?

1.7872-15 a)(2)(i)
General rule. A payment made pursuant to a split-dollar life insurance arrangement is treated as a loan for Federal tax purposes, and the owner and non-owner are treated, respectively, as the borrower and the lender, if—

(A) The payment is made either directly or indirectly by the non-owner to the owner (including a premium payment made by the non-owner directly or indirectly to the insurance company with respect to the policy held by the owner);
WHAT ARE LOAN SPLIT-DOLLAR ARRANGEMENTS?

1.7872-15 a)(2)(i)

(B) The payment is a loan under general principles of Federal tax law or, if it is not a loan under general principles of Federal tax law (because of the nonrecourse nature of the obligation or otherwise), a reasonable person nevertheless would expect the payment to be repaid in full to the non-owner (whether with or without interest)

; and
1.7872-15(d)(2)
(i) Requirement. An otherwise noncontingent payment on a split-dollar loan that is nonrecourse to the borrower is not a contingent payment under this section if the parties to the split-dollar life insurance arrangement represent in writing that a reasonable person would expect that all payments under the loan will be made.
1.7872-15(d)(2)
(ii) Time and manner for providing written representation. The Commissioner may prescribe the time and manner for providing the written representation required by paragraph (d)(2)(i) of this section. Until the Commissioner prescribes otherwise, the written representation that is required by paragraph (d)(2)(i) of this section must meet the requirements of this paragraph (d)(2)(ii). Both the borrower and the lender must sign the representation not later than the last day (including extensions) for filing the Federal income tax return of the borrower or lender, whichever is earlier, for the taxable year in which the lender makes the first split-dollar loan under the split-dollar life insurance arrangement.
1.7872-15(d)(2)(ii)
This representation must include the names, addresses, and taxpayer identification numbers of the borrower, lender, and any indirect participants. Unless otherwise stated therein, this representation applies to all subsequent split-dollar loans made pursuant to the split-dollar life insurance arrangement. Each party should retain an original of the representation as part of its books and records and should attach a copy of this representation to its Federal income tax return for any taxable year in which the lender makes a loan to which the representation applies.
BONUS FEATURES

Treatment as a loan can be guaranteed, even for non-recourse transactions.

No annual payments on the loan have to be made. Interest can be accrued. (1.7872-15(j)(5) Example 1)

Original Issue Discount (OID) rules apply but if loan is to grantor trust and grantor is the lender there is no income tax effect.

Life insurance proceeds can be used to make Graegin Loan if estate lacks liquidity to pay taxes.
BONUS FEATURES

A loan can be made for the life of the insured.

1.7872 (e)(5)(ii)(C) the term of a split-dollar loan payable on the death of an individual (including the death of the last survivor of a group of individuals) is the individual's life expectancy as determined under the appropriate table in § 1.72-9 on the day the loan is made. If a split-dollar loan is payable on the earlier of the individual's death or another term determined under paragraph (e)(4)(iii) of this section, the term of the loan is whichever term is shorter.
(D) Retirement and reissuance of loan. If a split-dollar loan described in paragraph (e)(5)(ii)(A) of this section remains outstanding longer than the term determined under paragraph (e)(5)(ii)(C) of this section because the individual outlived his or her life expectancy, the split-dollar loan is treated for purposes of this section as retired and reissued as a split-dollar demand loan at that time for an amount of cash equal to the loan's adjusted issue price on that date. **However, the loan is not retested at that time to determine whether the loan provides for sufficient interest.**
EXTRA BONUS

For purposes of determining forgone interest under paragraph (e)(5)(ii)(B) of this section, the appropriate AFR for the reissued loan is the AFR determined under paragraph (e)(5)(ii)(B) of this section on the day the loan was originally made.

In other words, if a loan for life was made in November 2014 the interest rate used for someone under the age of 80 would be 2.91%. (7520 rate 2.20%)
If the individual is still alive at life expectancy the new rate is the demand loan rate as of November 2014 – 0.28%!
THE PENALTY BOX

Below market interest rates.

• If this is a gift transaction between the lender and the borrower, the difference between the rate charged and the appropriate AFR is considered a gift.

• If this is a transaction in which an employer is making the loan to someone designated by the employee:
  The employee realizes income taxable benefit
  The borrower receives a gift from the employee
1.7872 (a)(4) Certain interest provisions disregarded.

(i) In general. If a split-dollar loan provides for the payment of interest and all or a portion of the interest is to be paid directly or indirectly by the lender (or a person related to the lender), then the requirement to pay the interest (or portion thereof) is disregarded for purposes of this section. All of the facts and circumstances determine whether a payment to be made by the lender (or a person related to the lender) is sufficiently independent from the split-dollar loan for the payment to not be an indirect payment of the interest (or a portion thereof) by the lender (or a person related to the lender).
WHAT YOU CAN DO WITH SPLIT-DOLLAR

What tools do you have with the following features?

• Little or no taxable gifts
• Generation-skipping
• Covered by Regulations
• No penalty if individual dies while the transaction is still in effect.
WHO DOES THIS HELP?

You have clients who:

• Don’t want to pay gift taxes
• Maxed out their gifting and want to do more.
• Don’t want to pay estate taxes from the assets in their estates
• Don’t have liquidity to pay estate taxes and loans (including under Sec. 6166) are too onerous
• Want to move money down to future generations in a “Family Bank”
• Are seeking non-correlated assets to reduce risk
• Want to leave an inheritance but don’t want to be constrained regarding their investments or their life style
ESTATE TAX LEVERAGE

What’s in estate:
• If Economic Benefit Arrangement what is in the estate is the greater of the money advanced or the cash value of the policies
  • Pre Sept. 2003 Equity split-dollar
  • Cash advanced
• If Loan Arrangement what is in the estate is the loan plus accrued interest (if any)

What’s not in estate:
• The insurance proceeds and any investments greater than the amount that has to be repaid

Can be generation-skipping to avoid all future transfer taxes

Richard L. Harris LLC
Economic Benefit Arrangement

- Money transferred is called an Advance, NOT a loan
- Gift is cost of annual renewable term insurance regularly sold by the insurance company or Table 2001
- Gift is smaller than premium
- Taxable term rate may be less than interest on a loan
  - Especially if second-to-die policy
    - When one insured dies it reverts to the single life rate on the survivor
  - Tax consequences are knowable at the outset based on term rates
- Switch to loan method when term costs exceed interest rates
  - Caveat: Interest rates are a moving target

Insured may be someone other than party advancing the premiums
GIFT TAX LEVERAGE

Loan Arrangement
• Gifts are less than premium, if made or imputed
• If interest is not paid, unless accrued gift is the interest based on the applicable AFR based on the agreement
• Gifts, when made, should be in $1,000 amounts and not made at time interest is due
• New interest rate every time a loan is made based on appropriate AFR at that time
  • Each loan and agreement can have different terms to capture best AFR
  • Future consequences not known because of ever-changing interest rates

HOWEVER...

Richard L. Harris LLC
GIFT TAX LEVERAGE

A lump sum loan is made up front
• Annual premiums paid from lump sum
• Interest accrued or paid from lump sum (investment results)
• Balance of lump sum is invested
  • If loan is to ILIT that is Grantor trust, income tax payments on taxable earnings can come from Grantor
  • If interest accrues:
    • NO GIFTS!
    • No OID if it is a Grantor trust
    • OID only comes into effect when the trust is no longer a grantor trust and effect is non-cumulative
  • If loan is for life of insured lock in a rate forever
    • October 2016 long-term AFR = 1.95% (7520 rate 1.60%)

Insured can be someone other than the lender

Richard L. Harris LLC
CONTROL

Private split-dollar gives the insured greater flexibility over how their annual exclusions and lifetime gifts are used and allows them to preserve these gift tax savings devices for other (perhaps more effective) uses.

Premiums are not gifts – they are not irrevocably gifted to the Trust. The Grantor has the ability to terminate the split-dollar arrangement and recover the premium payments according to the agreement.
Fiduciary Duty

- Applying for the life insurance policy
- Entering into the split-dollar arrangement (economic benefit or loan regime)
- Preparing the collateral assignment
- Time of repayment
- With loan arrangements, determination of loan rate
- Annual reporting/Policy review
- Exit strategy
There are no specific “guidelines” regarding the annual administration of the split-dollar arrangement; however, the insured and Trustee should consider:

- Economic benefit calculation: confirm who does the reporting and assure the gift to trust is made and tracked
- Loan interest: proper reporting and tracking of annual loan interest
- Assure promissory notes are prepared and updated as loans “mature.”
Sample Economic Benefit Reporting
Joint Life Policy
Male Age 63 / Female Age 62

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<td>Reportable Economic Benefit</td>
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* Reflects the carrier’s term rate based on the insureds’ attained ages
Sample Loan Interest Reporting

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<td>Trust Death Benefit</td>
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</table>

* Reflects the current mid-term AFR; calculations assume the loan interest is paid each year
LIFE INSURANCE

Life insurance is an effective way to transfer assets for two reasons:

1. Potential for growth

   • Death benefits usually exceed the total premiums paid
   • The difference between the total premiums paid and the policy death benefits represents additional assets available at the insured’s death to be paid to beneficiaries;
2. Unique and valuable tax benefits

- Policy cash values grow income tax deferred
- Death benefits are generally income tax free
- Policy death benefits may avoid estate taxes if the policy ownership is properly structured
Generally, any life insurance policy can be used.

A wide range of life products exist to meet various levels of risk tolerance.

High quality carriers and products are important.

Special design considerations include death benefit type based on type of split-dollar arrangement.

Fiduciary responsibility: understand the parameters for selecting the insurance product.
Special Note:

Variable life product consideration: to avoid potential violation of Reg U, consider the use of assets other than the policy or just the death benefit as collateral.
**SUMMARY**

Split-dollar is alive and well

- Little or no taxable gifts
- Generation-skipping
- Covered by Regulations
- No penalty if individual dies while the transaction is still in effect.
SUMMARY

Applies to clients who:

• Don’t want to pay gift taxes
• Maxed out their gifting and want to do more
• Don’t want to pay estate taxes from the assets in their estates
• Don’t have liquidity to pay estate taxes and loans (including under Sec. 6166) are too onerous
• Want to move money down to future generations in a “Family Bank”
• Are seeking non-correlated assets to reduce risk
• Want to leave an inheritance but don’t want to be constrained regarding their investments or their life style
Create an ILIT (grantor trust; power of substitution).

Execute private-split dollar agreement.

Trustee purchases a life insurance policy.

- Premium payor (insured, spouse or other) pays the premium
- Collateral assignment (incidence of ownership considerations)

Insured gifts annual economic benefit to Trust.

At death, the premium payor recovers the premiums and the balance of the death benefit passes to the ILIT
STRUCTURING THE ARRANGEMENT: LOAN REGIME

Create an ILIT (grantor trust; power of substitution).

Trustee purchases a life insurance policy
  • Loan made to the Trust (notes are executed)
  • Trust pays the premium
  • Collateral assignment

ILIT pays interest (interest may also be accrued)

At death, ILIT receives death benefit; ILIT repays loan balance (includable in insured taxable estate) and retains remaining death benefit proceeds
Have the borrower sign a promissory note.

Establish a fixed repayment schedule.

Charge interest at or above the minimum “safe harbor” rate.

Have the policy be collateral for the loan (variable life considerations).

Demand repayment.

Have records from both parties reflecting debt.
Show evidence that payments have been made.

Have conditions for the repayment included in the agreement.

Establish policy annual review and monitoring schedule.

Do not establish a plan to forgive payments as they come due.

Refinance with caution.
SWITCHING ARRANGEMENTS

Why switch?

Existing Economic Benefit Arrangement entered into after 2000
• Single life and insured has reached age when Table 2001 rates are higher than interest rate if converted to a loan
• Originally second-to-die and one insured has died

Pre 2000 arrangement
• Carrier no longer supports their “published” term costs and must now use Table 2001

Loan interest payment lower than economic benefit

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SWITCHING ARRANGEMENTS

The Value When Switched

• The value when switched becomes the amount of the loan
• The value of the policy at time of switch is not specifically the cash surrender value but rather the “fair market value”
• Fair market value of life insurance for gift tax purposes is covered under § 25.2512-6(a) –
  • Interpolated Terminal Reserve (ITR) plus unearned premium
  • Unless because of the unusual nature of the policy that does not accurately reflect the value
SWITCHING ARRANGEMENTS

The Value When Switched

• Regulation became final in 1974
• Universal Life (UL) policies were not in existence
• Some companies, when asked for the gift value (Form 712) of UL will give Interpolated Terminal Reserve (ITR) based on tax or statutory reserves.
  • Number is much greater than cash surrender value
• Some companies will give you
  • The ITR
  • The cash surrender value
  • The cash surrender value not taking into account surrender charges
  • They will tell the tax professional to pick one for tax purposes
• Schwab case – fair market value based on likelihood of death

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Special Rule for Pre Final Regulations (September 2003)
Arrangements that were Equity Split-Dollar

• To the extent that there is any gain that inures for the benefit of the non-premium payor that gain is subject to tax as ordinary income at the time the change is made (‘Material Modification’)
• Non-owner’s payment of economic benefit cost does not produce basis
• This appears to be separate from the fair market value gift rules
TERMINATING ARRANGEMENTS

For Economic Benefit and Loan Arrangements

- Economic benefit arrangements - value is fair market value
- If pre-regulation equity split dollar arrangement, to the extent there is equity that equity is subject to income tax
- If policy is purchased by owner at time of termination, there are no gift tax consequences (source of funds is a separate issue)
- For loan arrangements the loan plus accrued interest is the value that is used
USEFUL DOCUMENTS

• Reg. 1.61-22 indexed and annotated
• Reg. 1.7872-15 indexed and annotated
• “Private Split-dollar Arrangements - They’re not dead; they’re just different” – Trusts & Estates, May 2010
• “Split-Dollar Loan to a Grantor Irrevocable Life Insurance Trust - Is there an alternative to grantor retained annuity trusts and installment sales to intentionally defective grantor trusts?” Estate Planning, December 2009

If anyone would like any of the above please email Richard Harris – richard@rlharrisllc.com and say that you were on this webinar