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Intergenerational Split Dollar Life Insurance Arrangements Prevail in Tax Court

The validity of inter-generational split-dollar life insurance arrangements has been confirmed in two recent and separate Tax Court Opinions. The most recent, *Estate of Levine v. Commissioner*, Docket No. 9345-15 (Order July 13, 2016) relies entirely on the previous decision in *Estate of Morrisette*, 146 TC 11 (April 13, 2016).

In *Morrisette*, the taxpayer, Clara Morrisette, entered into two split-dollar life insurance arrangements, whereby the taxpayer's revocable trust (the CMM Trust) contributed significant funds (nearly \$30,000,000) to three Dynasty Trusts created for the benefit of the taxpayer's sons. Each Dynasty Trust then purchased a universal life insurance policy on the lives of the 2 sons who were not beneficiaries of that trust. The insurance was to provide the fund necessary to purchase stock in a closely held family business pursuant to a Shareholder's Agreement to which the Dynasty Trusts and the sons were parties.

The split-dollar agreement between the CMM Trust and each Dynasty Trust required the CMM Trust, upon the death of the insured son, to receive a portion of the death benefit equal to the greater of the cash surrender value (CSV) of that policy or the aggregate premium payments on that policy. The Dynasty Trust would receive the balance of the death benefits. Each split-dollar arrangement recited the "the parties intend that this Agreement be taxed under the economic benefit regime of the Split-Dollar Final Regulations, and that the only economic benefit provided to the [Dynasty] Trust[s] under this arrangement is current life insurance protection." The policies were collaterally assigned to the CMM Trust to secure payment of the amounts owed to the CMM Trust. Neither the CMM Trust, nor the Dynasty Trusts retained the right to borrow against the policies.

The taxpayer reported all gifts to the Dynasty Trusts using the economic benefit regime under Section 1.61-22 of the IRC. Upon the taxpayer's death, the IRS issued notices of deficiency to the Estate (one for the gift tax return filing and one for the estate tax return filing) and filed a petition for redetermination of the adjustments in both notices. The Estate moved for partial summary judgment which was opposed by the IRS, claiming there were material issues of fact as to whether the Estate provided the Dynasty Trusts an economic benefit other than the cost of insurance. The Court determined that whether the Estate provided the Dynasty Trusts an economic benefit other than the cost of insurance was a question of law, not fact.

The Split-Dollar Final Regulations, issued in September 2003 provides a special ownership rule that says "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 will apply.” *Morrisette*, at page 104.

The key question to the Court was whether the lump-sum payment of premiums made on the policies indirectly by the CMM Trust generated any additional economic benefit other than current life insurance protection to the Dynasty Trusts.

Citing the preamble to the Final Regulations, which describe a situation similar to the split-dollar arrangements between the CMM Trust and the Dynasty Trusts, the Court stated that “where a donor is to receive the greater of the aggregate premiums paid or the CSV of the contract, the possibility of the donee receiving an additional economic benefit is foreclosed.” *Morrisette*, at page 104.

The Court went beyond the preamble and dissected its reasoning further. To have an economic benefit beyond the life insurance, the donee (the Dynasty Trusts) must have current access to the cash values of the life insurance policies or some other economic benefit. Since the split-dollar arrangement between the CMM Trust and the Dynasty Trusts did not provide either party any current or future access to any portion of the cash value of the policies, neither party had any current access under the regulations. Without access to the cash values, the Dynasty Trusts did not receive any economic benefit by reason of direct or indirect access to the cash values.

Additionally, the Court ruled that the split-dollar arrangement did not relieve the Dynasty Trusts of any obligation to pay the premiums on the policies (the alleged additional benefit) because, under the Universal policies purchased, the Dynasty Trusts were not required to pay any premiums.

Because there was no further economic benefit received by the Dynasty Trusts, the CMM Trust was deemed to be the owner of the six Universal Life Insurance policies under the special ownership rule under Reg.1.61-22 and the economic benefit regime applied to these transactions.

Estate of Levine v. Commissioner relied entirely on *Morrisette*, making it likely that the IRS will appeal to the Fourth Circuit (*Morrisette*) or the Eighth Circuit (*Levine*) should it wish to overcome the Tax Court’s reasoning. For now, these two decisions offer guidance on economic regime split-dollar arrangements.
