

# Split-Dollar Life Insurance Arrangements: Exciting Estate Planning Opportunities

## What Allows Split-Dollar to Function So Well

Presented by:  
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# Split-Dollar Basics

CONSIDER THIS:

Take a dollar bill and cut it in half. Give half to someone else.

Can either of you do anything with the dollar without the other?

VOILA: Split-Dollar

# Split-Dollar Basics

## CONSIDER THIS:

Instead of a dollar bill the money involved has to do with the purchase of a life insurance policy.

Two parties:

- A party that provides some or all of the funding for a life insurance policy in exchange for getting their money back (either with interest or without)
- A party that names a beneficiary of the policy – less the amount due the funder

Neither can exercise rights to the policy without the other.

# Split-Dollar Basics

In the old days (pre 2001)

- One party advances money to another party to pay some or all of the premiums on a life insurance policy
- The funder can get back premiums paid or the greater of premiums paid or the cash surrender of the policy
- ADVANCE – not a loan
- The other party gets to name the beneficiary of the difference between the face amount of the insurance and the amount due the funder.

# Split-Dollar Basics

## RENT

- Rev Rul 55-713 – interest-free loan
- Rev Rul 64-328 instead of interest-free loan PS58 – corrects Rev Rul 55-713
- Rev Rul 66-110 – insurance companies *published* term rates
- Value is *Annual Renewable Term* rate based on amount the party who names the beneficiary of the difference

# Split-Dollar Basics

## 2001-2003: The Split-Dollar World Changes

- PS 58 Table no longer available
- Table 2001 – much lower term rates
  - Effectively ends reverse split-dollar
- Carrier terms rates available only if Annual Renewable Term **regularly offered and regularly sold** (Notice 2002-8(II)(3))
- Any equity (cash value of policy greater than premiums paid) that accrues to the party who controls the death benefit is subject to income tax

# Split-Dollar Basics

## 2001-2003: The Split-Dollar World Changes

New regulations in Sept. 2003

90 Pages including preamble

- §1.61-22
- §1.7872-15

**Creates New Opportunities**

# What the Regulations Say

## Economic benefit split-dollar §1.61-22

*§1.61-22(a)(b) and (c)* provide the definition of split-dollar for both economic benefit and loan arrangements

- §1.61-22(b)(2) excerpted and paraphrased

In General – arrangement between owner and non-owner of a policy where either party “...**pays directly or Indirectly, ALL** or any portion of the premiums on the life insurance contract...” (emphasis added)

# What the Regulations Say

## Loan Split-Dollar – New Game in Town

Important provisions  
§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 the Regulations Say

## Loan Split-Dollar – New Game in Town

### Important Provisions §1.7872-15(d)(i) & (ii)

Loan treatment can be guaranteed – even if nonrecourse

“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.”

# What the Regulations Say

## Loan Split-Dollar – New Game in Town

### Important Provisions

§1.7872-15(e)(5)(ii)

Loan can be repayable at death of the insured

- Applicable Federal Rate (AFR) determined by life expectancy using table in §1.72-9
  - If life expectancy is more than nine years, long-term AFR is used
  - August, 2018 long-term AFR – 2.95%

# What the Regulations Say

## Loan Split-Dollar – New Game in Town

### Important Provisions

§1.7872-15(g)(4)

(See also Examples in §1.7872-15(h)(5))

Interest can be accrued

Grantor Trust rules §§671-679 and §1.671-2

- No OID if Grantor Trust
- (Successor Grantor?)

# WHAT WE CAN DO NOW

- Lump sum loan for all premiums
- With interest accrued no taxable gifts or GST inclusion
- Guarantees loan treatment
- A loan for the life of the insured(s)

# Split-Dollar Life Insurance Arrangements: Exciting Estate Planning Opportunities



## Intergenerational Split-Dollar Arrangements

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# Intergenerational Split-Dollar

Why?

Technique that can pass assets down at a discount from older clients to heirs.

# Intergenerational Split-Dollar

## Three parties

- Senior who funds the policies
- Child who is insured
- ILIT for benefit of grandchildren (and beyond)
- The receivable is payable while funder-grantor is alive or insured's death
- Value is determined after death
  - Fair market value
  - Willing buyer willing seller

# Intergenerational Split-Dollar

## Question

What is the value of a receivable

- Due at some indeterminate date in the future?
- Loan interest below market rate?
- Interest may be accrued?
- Secured by the death benefit of a life insurance policy owned by an ILIT?

# Morrisette – IRS Attacks

Problem: IRS doesn't like these arrangements

- Attacks them as
  - Gifts at inception
  - Additional economic benefits conferred (*equity split-dollar*)
  - Reverse split-dollar
  - Split-dollar loan

Recent settlement – valuation – 90% discount;  
settlement 50% discount

# Morrisette

Morrisette - *Estate Of Clara M. Morrisette v Commissioner*  
146 T.C. No 11, Docket No 4415-14, April 13, 2016

- Lump sum \$30 mil loan to assure policies remain in force
- Buy sell between children/insureds
- Creation of ILIT by revocable trust and split-dollar agreement between Mrs. M's rev trust and ILIT created by rev trust – done by court-appointed conservator
- Taxable term costs were reported each year
- At death estate claimed 75% discount for receivables based on life expectancies of the insureds

## Morrisette – IRS Attacks

IRS issued notices of deficiency and penalties– totaling \$16,560,215!

# Morrisette – IRS Attacks

1. It's a gift
2. It's reverse split-dollar
3. It's loan split-dollar
4. Premiums were prepaid

# Morrisette – Estate and Tax Court Answer

Attorneys brilliantly petitioned for partial summary judgment - IRS didn't settle before the case was heard

- Whether or not these were split-dollar arrangements was a matter of law, not of facts
- IRS said it was matter of facts
- Court agrees and rules in favor of petitioners
- But it ain't over till it's over

Additional case – *Levine*

- Was combined with *Morrisette* but settled on statute of limitations issue
- Going forward IRS has weaker bargaining position

# Split-Dollar Loans – An Alternative

## WHY LOANS?

- Loan treatment can be guaranteed
- Interest can accrue – no taxable gifts
- Loan can be for life of the insured
- All premiums can be loaned up front