

Leveraging Premium Payments for Wealth Transfer

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- What is it?
- Types of Split-Dollar Arrangements
 - Economic Benefit Regime
 - Loan Regime
 - Ownership determines regime with one exception
- Normally temporary financing

- Loan Regime – Trust Owns Policy
 - Trust:
 - Receives maximum cash value
 - Controls investment
 - Pays AFR rate

SPLIT-DOLLAR ARRANGEMENTS – WHICH REGIME?

- Economic Benefit Regime Applies If:
 - Premium payor owns policy and Trust has right to designated death benefit payment
 - *or*
 - Trust owns policy and deemed owner rules apply

LOAN REGIME

Split Dollar Regs only apply to a loan if:

- Payment made by lender to policy owner (Trust),
- Payment is loan under general principals of federal tax law, and
- Repayment is to be made from or secured by the policy death benefit, cash value or both
- But application very broadly construed.

LOAN REGIME

SPLIT-DOLLAR FINAL REGULATIONS (APPLY FOR GIFT AND INCOME TAX PURPOSES)

- Consequence of Split Dollar Regs applying to Loan Arrangement:
 - Adequate AFR tested as contingent payment unless Representative Statement filed by lender and borrower
 - Split Dollar Regs state that loan will be considered bona fide
 - Harsh gift tax treatment for below-market loans if term loan (term based on LE is term loan)
 - If interest paid directly or indirectly by Lender, requirement to pay interest is disregarded (below-market loan rules will apply)
 - Charge imposed if interest is forgiven
 - FIFO repayment requirement

LOAN REGIME

- Insured uses a loan because he/she wants to reduce the gift and GST cost of funding policy premiums
 - Insured and ILIT enter into a loan regime split-dollar arrangement
 - Insured lends premiums to the ILIT in exchange for a note bearing AFR interest, paid or accrued.
 - Either one large loan or loans each year for each premium payment

LOAN REGIME

- Insured uses very restricted or no collateral assignment to avoid Section 2042 upon default
- Generally use an irrevocable grantor trust
 - Issues with drafting to create a grantor trust
- At the Insured's death, the loan (plus accrued interest, if applicable) is includable in his or her estate
 - The trade-off is no gift or GST consequences vs. estate tax inclusion of the note

PRIVATE ECONOMIC BENEFIT SPLIT-DOLLAR

- General rule – premium payer must own policy to obtain economic benefit regime
- Exception: the Deemed Owner Rules allow trust to own policy.
- Requirements for Deemed Owner Rules:
 - Non-equity Split dollar
 - No benefits other than economic benefit
 - Private, employer/employee, corporation and shareholder.
 - No such rule for partnerships

INTERGENERATIONAL SPLIT-DOLLAR

- G1 creates trust for descendants (G3 plus)
- Trust owns policy on G2's life
- G1 is premium payor
- Economic benefit or loan regime between G1 and Trust
- -----
- G1 can't unilaterally terminate
- G1 transfers receivable interest at death or by gift

INTERGENERATIONAL SPLIT-DOLLAR

SPLIT-DOLLAR FINAL REGULATIONS (APPLY FOR GIFT AND INCOME TAX PURPOSES)

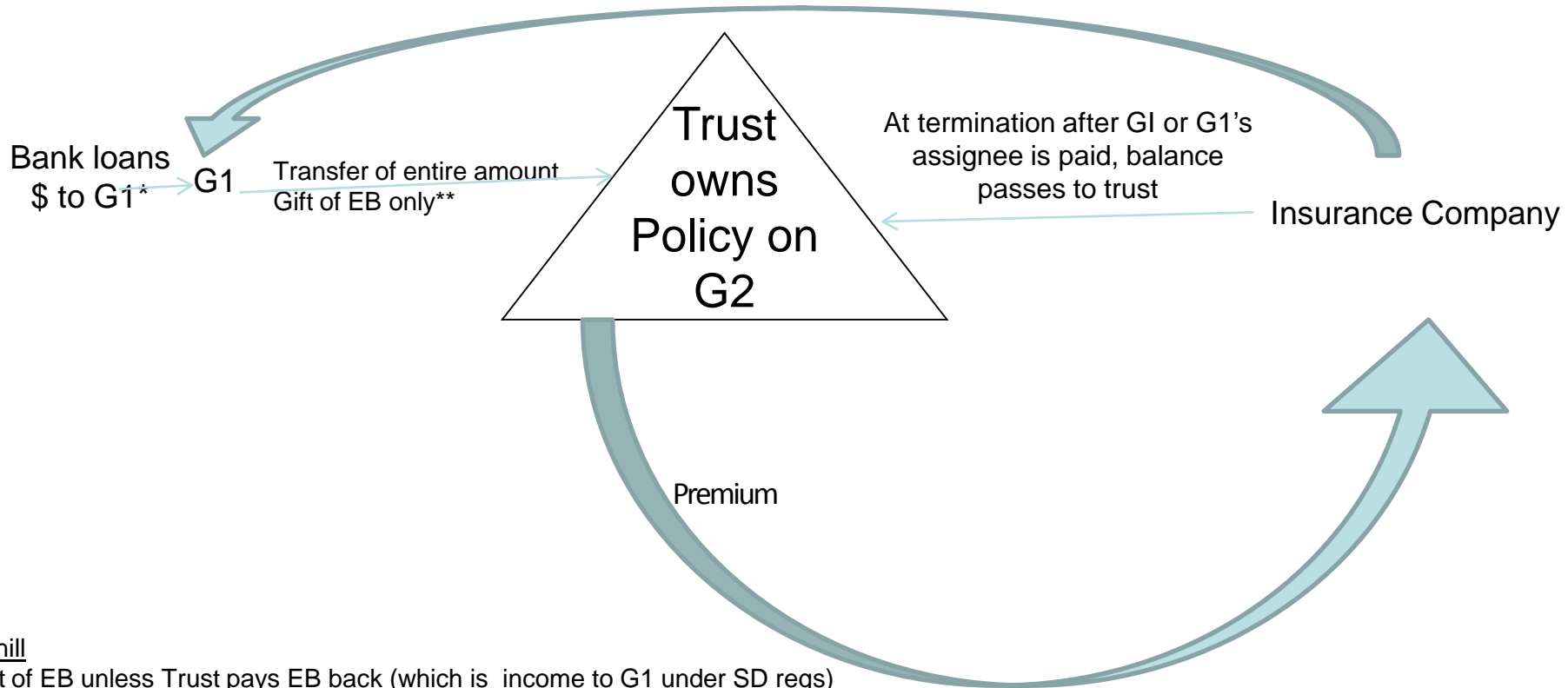
- Economic Benefit:
 - Need Deemed Owner Rules for EB treatment if Trust owns policy
 - No gift on Formation (Morrisette and Levine)
 - At death, advancement is includable in premium payor's estate for estate tax purposes, unless gifted during lifetime
- Loan Arrangement:
 - Don't need Deemed Owner Rules for EB treatment if Trust owns policy
 - Morrisette, Levine, or Cahill do not address loans
 - At death of lender, loan is includable in lender's estate for estate tax purposes, unless gifted during lifetime.

INTERGENERATIONAL SPLIT-DOLLAR

Parties: G1 G2 (Insured) Policy Dynasty Trust Insurance Company Bank

Intergenerational Economic Benefit Split-Dollar

Greater of Cash Surrender Value Or Amount Advanced,
payable at termination to G1 or G1's assignee



* Cahill

**Gift of EB unless Trust pays EB back (which is income to G1 under SD regs)

INTERGENERATIONAL SPLIT-DOLLAR

INTERGENERATIONAL SPLIT-DOLLAR

- Remember Economic Benefit Rules:
 - Need Deemed Owner Rules for EB treatment if Trust owns policy
 - Need Non-equity EB if want Deemed Owner Rules (no other benefit)
 - No gift on Formation (Morrisette and Levine)

- Additional Items
 - Bank Loan:
 - Allows G1 to put more into Trust to buy more insurance and create larger side fund
 - At G1's death, receivable that is being valued includes Bank loan proceeds, but G1 also owes full amount of loan back to bank
 - Receivable of \$10 million (\$5 million Bank loan proceeds, \$5 million G1's funds)
 - Value of receivable at G1's death is \$200,000 (Cahill discounted receivable by 98%)
 - G1's estate owes bank \$5 million (estate tax deduction) and owns only \$200,000
 - Gift to Dynasty Trust:
 - EB each year, not full amount advanced
 - Gift of interest if not accrued
 - G1 cannot terminate arrangement without consent of Trust
 - G1 loans cash if available, consider "loan of things" (Frazer)
 - G2 needs to be insurable to extent of desired policy amount
 - G2 dies before G1, transaction fails, unless G1 transfers receivable
 - No authority if SD Regs permit this or the consequence of transfer
 - There are separate rules under the SD Regs for transfers of a contract (policy) that disallow any discounts in the value of the transfer

INTERGENERATIONAL SPLIT-DOLLAR

- Morrisette, Cahill
 - Outstanding Question: Value of Receivable
 - Resolved:
 - No gift on Formation
 - Economic Benefit arrangement is SD Regs followed
 - Recent Developments:
 - SD Regs only apply for income and gift tax purposes, what are the estate tax ramifications?
 - Does Section 2703 apply?
 - Is it a Step transaction?
 - Is it a modification?
 - Do Sections 2036 or 2038 apply?