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The Washington Report

Wealth Transfer Edition

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This Washington Report is prepared exclusively for Finseca Influencer members by Todd I. Steinberg (Partner) and Jennifer M. Smith (Senior Counsel) at Loeb & Loeb, LLP.

Highlights from the 59th Heckerling Institute on Estate Planning

MARKET TREND: Given expected but uncertain changes in tax laws, methods to cope with uncertainty and discussion of planning that clients will need to be independent of any tax changes remain high on the priority list.

SYNOPSIS: Highlights of the 59th Annual Heckerling Institute on Estate Planning ("Heckerling") included a focus on: (1) how the uncertainty surrounding the potential sunset or extension of the Tax Cuts and Jobs Act ("TCJA") will affect planning throughout the remainder of 2025 and the need to coordinate with client and allied advisors now to prepare for a potential year-end "rush," (2) the approaching "silver tsunami" in closely held businesses given the number of age 55+ owners who will soon be retiring and their significant need for business succession planning, particularly in light of the recent Connelly decision on life insurance funded buy-sell arrangements, and (3) recent case law developments that affect family limited partnerships, marital trust planning, and the gift tax treatment of intra-family loans.

TAKE AWAY: Given the rapidly evolving legislative landscape, advisors should get in front of clients now to plan how to move forward if and when we start to see more certainty regarding upcoming tax law changes. For many clients, that planning should involve a review of business succession needs, as this is a largely underserved area of overall planning.

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As always, Heckerling covers a wide array of estate and wealth transfer tax planning topics. Below are few insights reflecting select comments and presentations by some of Heckerling panelists.

GET POTENTIAL CLIENTS ON PLANNING "ROSTERS" NOW[1]

Rush to the End? At the time of the conference, many Heckerling panelists believed that the 2026 sunset of the wealth transfer tax provisions in the TCJA would not occur as scheduled, with Congress providing some form of extension ranging from two to eight years. Many panelists also believed that we likely will not see a tax bill until the end of 2025, as the administration and Congress have other legislative priorities on the table. Yet the recent release of budget resolutions by the House and Senate budget committees suggest that we may see proposed tax legislation sooner, including longer-term changes, not just extenders. There are no specifics in the budget proposals, as yet, and other issues still may affect the direction of any tax legislation, including concerns over the increasing deficit and debt service obligations.[2]

With all this uncertainty, Heckerling panelists indicated that planning later in the year could become problematic since it may become more challenging to find available and experienced attorneys, accountants, and appraisers as the year progresses. The "go-to" referrals for these advisors may be unwilling take on new clients or new planning in the last quarter of 2025, making even simple or primarily non-tax motivated life insurance transactions, like a "basic" irrevocable insurance trust or a buy-sell funding plan, difficult to implement and fund appropriately.

Plan to Plan. Pragmatically speaking, what does this mean for life insurance planning? Get in front of clients now to ensure that they can secure their place on their advisors' planning "roster." As discussed in recent Washington Report #01.24.25, clients may consider creating a minimally-funded irrevocable trust now, which they can place "on the shelf" to use later in the year if and when they are ready to proceed. Most clients eventually will have reasons to use a well-drafted irrevocable trust for their desired wealth transfer planning, even if it does not occur in 2025 (and whether motivated by tax or non-tax objectives).

Hedge with One Spouse's Exemption. Married clients who cannot make full use of both their gift tax exemptions or who want a potential "hedge" against the year-end uncertainty may consider using just one spouse's full exemption. For example, one spouse, as the donor, could fund a spousal lifetime access trust (SLAT) so that the donor-spouse fully uses their $13.99 million gift and GST tax exemption. The spouses do not elect to split gifts in 2025. If the gift and GST tax exemptions ultimately drop to roughly $6.8 million due to a TCJA sunset, then the non-donor spouse will still have $6.8 million of exemption for planning (assuming no prior gifts), allowing the couple to benefit from $20.79 million of total gift and GST tax exemption. If the spouses had split the gift to the trust in 2025, each spouse would have made a gift of $6.995 million to the trust, and neither spouse would have any gift or GST tax exemption remaining in 2026. They would have lost out on almost all of their "bonus" gift and GST tax exemptions.[3]

[1] See generally, Turney P. Berry, Austin Bramwell and Sarah Moore Johnson, "352 Days and a Lifetime to Go: Practical, Prudent Planning Pointers for 2025 and Beyond," Presentation at the 59th Heckerling Institute on Estate Planning ("Heckerling"), January 13, 2025.
[2] Underscoring that this is a rapidly developing area, as this Washington Report was being drafted, the Death Tax Repeal Act was reintroduced on February 13, 2025 in the House by Representative Randy Feenstra (R-Iowa) and in the Senate by Senate Majority Leader John Thune (R- South Dakota). This proposed Act seeks to eliminate the federal estate and generation-skipping transfer taxes, lower the top marginal gift tax rate to 35%, and permanently set the gift tax exemption at $10 million, adjusted for inflation since 2016. The Act and a discussion of its provisions and potential for enactment are being monitored by Finseca and will be addressed in other releases.
[3] See generally, Steven R. Akers, Samuel A. Donaldson, Amy E. Heller, "Recent Developments 2024," Presentation at Heckerling (Jan. 13, 2025).

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If the creation of a "one exemption" SLAT requires a couple to shift assets between them to enable one spouse to fully fund the trust, then be mindful of timing of the spouses' transfers and the potential application of the step-transaction doctrine. This doctrine was applied in *Smaldino v. Commissioner*,[4] where LLC interests transferred by husband to his wife were held by her for only one day before she transferred those same interests to a dynasty trust. The Court concluded that the wife never had any real control over the interests, the transfer to the wife did not comply with the requirements for transfers of LLC interests under the LLC operating agreement, and the LLC agreement was never updated to reflect wife's ownership of the interests for any period of time.

Cleary, Smaldino is a "bad facts" case, but if there is a planning time crunch later this year, it will become important to avoid this potential pitfall. Steps may include:

- Ensuring some time elapses from the transfer between spouses and the transfer to the SLAT (certainly more than one day is advisable). There should be enough time so that there is a real risk of change in value of the assets while held by the recipient spouse. That timeframe may vary depending on the assets transferred (marketable securities versus real estate).[5]
- Complying with the formalities of change of title and making sure legal documentation of the transfer to the recipient spouse is properly completed and filed.
- Having the recipient spouse give assets to the SLAT that differ in amount or type from what was received (if cash was received, give marketable securities; if securities were received, give a different portfolio of securities, or give some mix of cash and securities).

Be Mindful of Income Tax Consequences. Finally, in any planning with gift tax exemptions, remember to consider the potential income tax ramifications, particularly if transfer tax exemptions remain the same or increase in 2026. Transferring low basis assets to an irrevocable trust may result in a greater income tax liability than potential estate tax liability due to the loss of a basis step-up in the asset, particularly in states with high state income tax rates like New York or California (which also has no state estate tax).

THERE IS A SIGNIFICANT NEED FOR BUSINESS SUCCESSION PLANNING

A "Silver Tsunami." Several Heckerling presenters focused on business succession planning. Panelists noted the approaching "silver tsunami" in small business ownership, as more than 2.9 million small businesses, which provide 63% of the economy's jobs, are owned by people age 55+. As these owners start to retire, there will be enormous business value to turn over. Yet, over 80% of these businesses have no business succession arrangement (BSA) in place, leaving a largely untapped area of planning.[6]

[4] T.C. Memo 2021-127 (Nov. 10, 2021).
[5] *See Holman v. Commissioner,* 130 T.C. 170 (2008) (6 days between transfer from one spouse to the other and then a subsequent transfer to an FLP was sufficient for volatile, publicly traded stock).
[6] *See generally*, Ellen K. Harrison and Natalie Reitman-White, "Lloyd Leva Plaine Distinguished Lecture - Taking Care of Business: New Approaches to Business Succession Planning," Presentation at Heckerling (Jan. 14, 2025).

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Components of Successful Business Succession Planning.[7] When developing a BSA, presenters noted the need to treat the plan as a long-term process, not a one-off transaction. This planning takes time and requires on-going maintenance to ensure success. Advisors need a detailed understanding of the owner's planning goals and business operations, including a review of existing shareholder or buy-sell agreements. Our own experience in working with closely held business owners is consistent with the panelists' comments. We often find that owners have no succession plan or, potentially worse, they believe they have a plan, but it has significant gaps, including the failure to:

- Select or abide by a pre-determined or negotiated valuation method or formula that accurately reflects the company's fair market value at the time of the buy-out.
- Comply with the requirements of IRC §2703, which establishes the criteria for a BSA to fix the estate tax value of a business interest.[8]
- Address buy-sell triggers other than death, such as disability, retirement, bankruptcy/divorce, or the sale of an interest to a third party.
- Provide an adequate funding mechanism for the buy-out. Generally, if there is an over-reliance on cash payments and/or promissory notes, a deceased/departing owner may not be provided with sufficient liquidity when needed (such as for the payment of estate expenses and taxes).
- Specify payment terms and interest rates for deferred payments and promissory notes (with security and collateral issues considered).
- Comply with all requirements of the agreement, including regular reviews of funding arrangements or periodic updates of value and corresponding adjustments to the purchase price.

Any review or development of a client's BSA should address these issues.

Adapting Insurance-Funded BSAs Post-Connelly. Heckerling panelists emphasized that last year's decision in U.S. v. Connelly[9] (as discussed in Washington Report, The Supreme Court's Decision In Connelly…) has enhanced the need for the review and proper structuring of BSAs funded with life insurance. The main take-aways from Connelly are: (1) as a threshold matter, parties must comply with all terms of the BSA, particularly valuation procedures, if they expect their BSA to be respected for tax purposes, (2) agreed-upon values that are unsupported by independent, professional fair market value appraisals generally will not fix the estate tax value of a deceased owner's business interests (*particularly in family contexts, which attract higher scrutiny*), and (3) redemption BSAs, where the company owns the life insurance and uses the proceeds to buy out the deceased owners, will be less efficient for estate tax planning, since the business's receipt of the policy death benefits will *increase* the estate tax value of the company and, consequently, the deceased owner's interest for estate tax purposes.

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[7]*See generally*, Thomas W. Abendroth, "Seven (not so) Secret Ways to Successful Business Succession," Presentation at Heckerling (Jan. 14, 2025).
[8]To fix the fair market value of a business interest for transfer tax purposes, IRC § 2703 requires the BSA to be a bona fide arrangement comparable to similar arm's-length business contracts. The BSA cannot be a method to transfer property to the owner's family members for less than full value. See *Huffman v. Commissioner*, T.C. Memo 2024-12, where the Tax Court found that an agreement among the family business owners did not control the value of the shares for gift tax purposes, because the agreement was not comparable to similar, arms-length arrangements.
[9]602 U.S. ___ (2024) (note - no page number in the reporter has yet been assigned); 133 AFTR 2d 2024-1680 (S Ct, 6/6/2024).
[10]*See generally,* Thomas W. Abendroth, Natalie M. Perry, and Aaron M. Stumpf, "Business as Usual? Buy-Sell Agreements, Life Insurance and Business Valuation after Connelly," Presentation at Heckerling (Jan. 15, 2025).

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Although *Connelly* just confirmed a risk that had long been associated with *insurance-funded redemption* BSAs, it creates additional complexity in structuring BSAs for clients going forward. Many business owners like the simplicity of redemption arrangements. Only one insurance policy is needed for each owner, and the business owns, pays for, and oversees the policies. Now, however, that simplicity is countered by the need to address the added estate tax liability resulting from the inclusion of the insurance proceeds in the company's fair market value at the owner's death, which may require a *gross* up in the life insurance death benefits owned by the company or the acquisition of additional life insurance by owners (potentially held in a personal life insurance trust) to help offset the increased value.

Cross-purchase arrangements, where each owner owns life insurance on each other owner to buy the deceased owner's interest, avoid the redemption problem but require multiple policies on each owner, which quickly becomes complicated when there are more than two owners. Alternatives such as trusts or special purpose "insurance LLCs," which are designed to hold the policies on the owners and buy out their interests, also require additional documentation, planning and maintenance. Overall, this means more time and analysis on behalf of the clients and advisors to decide what options will work best, from a practical, cost, and tax standpoint. In addition, when BSAs involve life insurance funding, they also must:

- Require maintenance of the insurance policies in-force and include provisions for monitoring the policy's status/performance and the timely payment of premiums.

- Provide mechanisms to ensure that the policies offer adequate death benefit coverage commensurate to the agreed upon buy-out price (and require reviews of coverage as needed to adjust to changes in that determined price).

- Decide who receives any insurance proceeds that exceed the buy-out price (e.g., the business, the remaining owners, etc.).

- Comply with any employer-owned life insurance **(EOLI)** tax provisions, including execution of notice and consent statement by insured owners, to avoid any potential income tax on payment of the policy death benefits under IRC §101(j).

Clients should schedule regular reviews with advisors to ensure compliance with the above requirements, no less frequently than annually. Further, when considering any restructuring of an existing insurance-funded BSA, advisors should watch for the potential application of the transfer for value and reportable policy sale rules under IRC §§101(a)(2) and (3) if there will be any transfers or deemed transfers of life insurance policies between or among the business, the business owners, and/or related trusts or entities, or any §1035 exchanges of existing policies. Triggering those rules could inadvertently subject otherwise tax-free policy death benefits to income tax, unless the policy transfers fall under one or more specifically defined exceptions.[11] Underwriting and/or EOLI compliance issues also may arise if new or additional life insurance is recommended to address an increase in the company's value or to offset estate tax risks.

[11] Exceptions to the transfer for value rule apply for (a) a transfer of a policy or interest therein that is not a reportable policy sale, has a basis for determining gain or loss in the hands of a transferee as determined by reference to the basis in the hands of the transferor (a "carry-over" basis), and does not fall under another exception, or (b) a transfer of a policy or interest therein that is not a reportable policy sale, was not previously transferred in a reportable policy sale, and is a transfer to any of: (i) the insured (including a wholly-owned grantor trust as to the insured), (ii) a partner of the insured, (iii) a partnership in which the insured is a partner (LLCs taxed as partnerships fall under the partnership exceptions), or (iv) a corporation in which the insured is a shareholder or officer. Note that a transfer of a policy on an insured shareholder of a corporation to another shareholder of the corporation is not an exception to the transfer for value rule. See Treas. Reg. §1.101(b) and (c). A transfer of a policy is not a reportable policy sale if the acquirer of the interest in the policy has a substantial family, business, or financial relationship with the insured apart from the acquirer's interest in the life insurance, as determined under the applicable regulations. See Treas. Reg. 1.101-1(c).

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Thinking Outside the Box. Businesses and their owners do not always fit into typical succession planning categories, particularly if the owners want the business to carry forward with a particular legacy or purpose after their departure. In these cases, transfers to family members are not always the best solution, due to potential family conflicts and/or the lack of family members with an interest in carrying on the business. Transfers to employees, such as through internal sales or employee stock ownership plans (ESOPs), are possible, but can be expensive if the business is valuable, and, in the case of ESOPs, require compliance with complex regulations. Sales to other third parties may result in fundamental changes to the business's structure and philosophy. Advisors who are willing to think outside the box and explore unique concepts will be better able to find a solution that meets the particular client's goals and circumstances.

In that vein, advisors may be hearing about the use of "purpose" trusts for business succession planning.[12] A purpose trust generally refers to a trust created for a valid noncharitable purpose without a definitely ascertainable beneficiary. Many states have sanctioned these trusts by statute, and they are commonly associated with pet care or cemetery trusts. But purpose trusts can be established for any valid non-charitable purpose and will allow the trustee to select the beneficiaries based on the scope of that purpose, such as operating a business for the long term in accordance with a specified mission or philosophy.

In business succession planning, the concept typically involves an established self-sustaining business. A founding owner creates the purpose trust and may fund it with a gift of some part or all of her business interests or with assets that are used to buy out minority owners and eventually the founding owner. The purpose trust acquires controlling voting stock, and outside investors who receive non-voting preferred stock interests buy out family owners. Since there are no *designated* beneficiaries, the trust designates an "enforcer" to ensure the trustees satisfy their fiduciary obligations to uphold the trust's purpose.

Purpose trust planning for business succession is relatively new and there are many unknowns, including whether the trust will be respected as a trust for tax purposes, and thus how it should be taxed (as a trust or a corporation). Jurisdictional considerations are also key, as not all states have a statute recognizing purpose trusts, and those that do may limit their duration (such as to 21 years). While this concept may have limited applicability currently, it is an important reminder to remain aware and open to unique planning concepts when assessing the best planning for a client's particular circumstances.

RECENT CASES YOU MAY HAVE HEARD ABOUT

Family Limited Partnerships (FLPs) Still on IRS Radar. The IRS has a long history of challenging wealth transfer planning with FLPs, which generally involves placing assets in an FLP (or family LLC) and later transferring FLP interests to family members frequently with valuation discounts for lack of marketability and/or lack of control. The IRS has won some of their challenges in certain "bad fact" cases,[13] which involved (i) FLPs created without a legitimate non-tax purpose, (ii) the decedent's continued personal use of assets held by the FLP post-transfer, and/or (iii) implementation of planning by the decedent (or a family member acting on their behalf) shortly before death. In these cases, the IRS, relying on IRC §2036, has successfully argued that the FLP assets should be included in the decedent's gross estate because the decedent retained the right to possess or enjoy the property or, of more concern, the right, either alone or in conjunction with any person, to designate who should possess or enjoy the property.

[12]See note 5.
[13]See e.g., Moore v. Commissioner, T.C. Memo. 2020-40 (Apr. 7, 2020); Estate of Powell v. Commissioner, 148 T.C. No. 18 (May 18, 2017).

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In Powell v. Commissioner, the court broadly applied this last argument to find that because the decedent, who was a 99% limited partner, had the right to vote with the other partners to dissolve the partnership (a common power in partnership agreements or under state law), the decedent retained rights that resulted in inclusion of the FLP assets in her gross estate.

Estate of Fields v. Commissioner[14] is the first §2036 FLP case in almost five years, and it also involved a deathbed planning scenario similar to *Powell*. Also like *Powell*, the partnership agreement in Fields provided that the FLP could be dissolved upon an affirmative vote of the partners. This case allowed the Tax Court to double down on its Powell analysis, finding that the decedent retained the right—in conjunction with others—to acquire all income from the transferred assets and to designate the disposition of those assets by having the right to vote with the other partners on the FLP's liquidation.

More recent and sophisticated FLP planning should be able to navigate these issues by ensuring the client does not hold any rights, alone or with others, to vote on FLP dissolutions or to direct FLP distributions. But clients may have older plans that still provide them with these rights and increase their exposure, and a simple modification of the FLP agreement to remove these rights may raise other issues. For example, does removal of the client's right to vote on a dissolution complete an otherwise deemed prior incomplete gift? And will this result in potential exposure under the three-year inclusion rule under IRC §2035, which pulls back the value of property that would have been included in the decedent's gross estate if the decedent had not relinquished the power? When there is significant uncertainty or the potential for substantial exposure in these cases, term life insurance coverage may be an effective stop-gap measure to address this additional risk.

Gift Tax Challenges over Marital Trust Terminations. Two recent cases, *Estate of Anenberg v. Commissioner*[15] and *McDougall v. Commissioner*,[16] have illustrated the complexity of planning with QTIP marital trusts. To avoid the estate tax exposure resulting from the marital trust, the surviving spouse may want to renounce her interest in, or accelerate transfers of, QTIP assets to children or other remainder beneficiaries (such as other family members or charities). However, if the surviving spouse transfers the income interest in a QTIP trust, IRC §2519 provides that the spouse also will be deemed to make a gift of all her interests in the QTIP.

To avoid IRC §2519, both Anenberg and McDougall involved the termination of a QTIP trust (by court order and nonjudicial settlement agreement, respectively) and distribution of all current marital trust assets to the surviving spouse. In both cases, the spouse and children, as the remainder beneficiaries, consented to the lifetime terminations. Also in each case, the spouse subsequently gave and/or sold some of the prior marital trust assets to her children or to trusts for their benefit.

In both cases, the IRS argued that the spouse had made a larger gift (upon the early termination of the marital trust) to her children pursuant to §2519, but the courts disagreed, stating that no gratuitous transfer was made by the surviving spouse because the spouse received all the QTIP assets upon termination. In McDougall, however, the IRS also raised the argument that the children, by their consent as QTIP remainder beneficiaries, made a taxable gift to the surviving spouse by relinquishing their remainder rights in the QTIP trust.

[14] T.C. Memo. 2024-90 (Sept. 26, 2024).
[15] 162 T.C. No. 9 (May 20, 2024).
[16] 163 T.C. No. 5 (Sept. 17, 2024)

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In this instance the court agreed with the IRS, finding that the children gave up valuable remainder rights by agreeing to the early termination. As the case was remanded for further consideration, the court failed to address the more crucial question, which is how each child's remainder rights should be valued for gift tax purposes. For example, does valuation of the children's deemed gift take into account the ability of the QTIP trustee to make discretionary (or mandatory) principal distributions to the surviving spouse and/or the surviving spouse's limited power to appoint the remaining trust assets unequally, and to the exclusion of any, of the children?

These cases and prior rulings may effect decantings and nonjudicial settlement agreements involving QTIP trusts, which have become commonplace methods for injecting flexibility into planning. Before engaging in these and similar planning transactions, it's important for advisors to consider the application of McDougall and review the potential effect on beneficiaries, particularly if the IRS pursues an expansion of this reasoning to apply to beneficiaries who do not actually consent to a transaction, but only receive notice and fail to object.[17]

Intra-Family Loans - Bona Fide Requirements. Use of loans between family members, grantors and/or trusts are a staple of estate and life insurance planning. A key concern is whether the IRS will respect these intra-family loans or seek to tax them as gifts. *In Estate of Bolles v. Commissioner*,[18] the 9th Circuit's review of this issue provided some favorable analysis for taxpayers, despite finding that the loans ultimately turned into gifts. Under the case facts, the mother made loans to her son who was starting an architectural firm. The mother's practice was to record the loans and keep track of interest and repayments, but no formal loan documents were signed. Each year, the mother forgave the debt up to the federal gift tax annual exclusion. The IRS argued that these loans were actually gifts.

The traditional factors used to decide if an advance is a loan or a gift include whether: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the tax reporting of the transaction was consistent with a loan. In the case of intra-family loans, an actual expectation of repayment and an intent to enforce the debt are particularly critical to having the advance respected as a valid loan.[19]

The Tax Court's decision, as upheld by the Ninth Circuit, focused on these last factors, primarily the son's ability to repay the loans and the mother's reasonable expectancy of and intent to enforce such payment. The decision found that the initial advances were loans, since it appeared that the son, early in his career, would build a thriving practice that could support repayment of his obligations. It was only later, when the son's circumstances changed for the worse, and the mother and son ultimately agreed that his outstanding "loans" would reduce his inheritance, that these loans were converted to gifts.

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[17]*See* CCA 202352018, where, in the case of beneficiaries consenting to the modification of an irrevocable grantor trust to permit the discretionary reimbursement of the grantor for the grantor's income tax liability attributable to the trust, the IRS found that the consenting beneficiaries made a gift to the grantor. The IRS indicated that the result would be the same if the modification was pursuant to a state statute that provides beneficiaries with a right to notice and a right to object to the modification and a beneficiary fails to exercise their right to object, despite the fact that there is a significant difference between consenting to an action and not objecting to an action (including the potential time and cost associated with filing an objection, particularly if the matter will then to proceed to court, whether the success of the objection is not assured).
[18]133 AFTR 2d 2024-1235 (CA9, Apr. 1, 2024), affirming T.C. Memo 2020-71.
[19]T.C. Memo 2020-71.

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It is interesting that the courts in the *Bolles* case initially respected loan treatment for the advances, despite the lack of loan agreements or significant efforts to collect loan payments. Of course, planning for any intended loan transaction should not follow this practice, but the case may provide some reassurance that the lack of these factors will not necessarily result in an adverse determination, especially if there are other facts supporting loan treatment.

The Bolles case clearly illustrates that characterization of intra-family transactions as loans is largely based on facts and circumstances. Split-dollar loans, on the other hand, can avoid much of this facts and circumstances analysis and be relatively assured of loan treatment if they meet the technical requirements of the final split-dollar loan regulations.[20] Specifically, a payment under a split-dollar insurance arrangement will be a loan for federal tax purposes if (i) the payment is made directly or indirectly to the policy owner by the non-owner; (ii) the repayment will be made from, or is secured by, the policy's death benefit and/or cash surrender value, and (iii) the payment is a loan under general principles of federal tax law or, if not (e.g., because the loan is nonrecourse or otherwise), a reasonable person would still expect the loan to be repaid in full. As to this last requirement, the regulations permit the parties to execute and file a written representation that a reasonable person would expect that all payments under the loan will be made.

These regulations create a limited safe harbor as to loan treatment. Further, compliant split-dollar loans will not be considered below market loans if they charge interest at the appropriate Applicable Federal Rate (**AFR**), which can eliminate potential gift tax concerns of whether an intra-family loan is charging sufficient interest.

Split dollar loans to a grantor trust holding life insurance could potentially be used to lock in the AFR and create flexibility for future wealth transfer planning. For example, a large up-front loan of cash could be secured by the policy's death benefit and cash value. The AFR would be set as of the loan date (subject to potential re-financing, if the rate later drops). The trust can invest the cash in excess of the insurance premiums payable to create a side-fund to help service the annual loan interest or eventually pay off the loan (plus any accrued and unpaid interest) if/when an exit is desired. Also, if the trust contains a substitution power, the grantor could later decide to exercise that power to swap in other assets that have greater appreciation potential. As the transaction would be a substitution, it should avoid potential issues associated with the installment sales of assets to grantor trusts, including questions regarding the sufficiency of the interest rate on the note and the need for additional collateralization apart from the assets being sold. It also can clearly specify the procedure for determining the equivalent value of swapped assets and how the grantor and trustee should address disagreements.

TAKE AWAYS

Given the rapidly evolving legislative landscape, advisors should get in front of clients now to create a plan on how to move forward if and when we start to see more certainty regarding upcoming tax law changes. For many clients, that planning should involve a review of business succession needs, as this is a largely underserved area of planning.

[20] See Treas. Reg. §1.7871-15.

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