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TOPIC: Tax Court Rules Again that Intergenerational Split-Dollar Arrangements are Economic Benefit Arrangements, Governed By Section 1.61-22 of the Final Split-Dollar Regulations

CITES: Estate of Marion Levine, Deceased v. Commissioner of Internal Revenue, Tax Court Docket No. 9345-15 (July 13, 2016); Estate of Morrissette v. Commissioner, 146 T.C. No. 11 (2016); Final Split Dollar Regulations, I.R.B. 2003-46.

SUMMARY: In this intergenerational split dollar case, the Estate of Marion Levine filed a summary judgment motion with the Tax Court on September 15, 2015, "for the reason that the [gift tax] Notice of Deficiency was too late, and therefore, there is no deficiency owed." The IRS argued, however, that the gift tax statute of limitations never began to run, since the transaction was not "adequately disclosed" on the return.

Before oral argument on the estate's summary judgment motion, the Tax Court issued its opinion in the Estate of Morrissette which we reported on in WRN# 16.05.10 (May 10, 2016). In the Tax Court's order and decision in the Levine case, the court indicated that "this made the [oral] argument [on the gift tax statute of limitations] quite brief – Petitioner said Morrissette controls, and Respondent agreed."

The court further noted that the IRS disagreed with the result in Morrissette and that by opposing the motion the Levine estate had preserved its right to appeal. The Tax Court therefore granted the Levine estate's summary judgment motion and held that there was no deficiency in gift tax and no penalties due from petitioners for tax year 2008.

RELEVANCE: As noted in our Washington Report discussing the Morrissette case, the IRS has been arguing in all of the audits of single premium generational split-dollar arrangements that they could not use the economic benefit regime of the Final Split-Dollar Regulations, because they provided "other benefits" to the trust which owned the policy.

Under that theory, the arrangement did not qualify for the exception to the normal rule that donor/donee collateral assignment split-dollar arrangements entered into after the effective date of the Final Regulations were required to use the loan regime. That exception requires that the "only" benefit that can be provided to the owner of the policy is death benefit protection for the current year. If the arrangement were required to use the loan regime of the Final Regulations, since no interest was provided (because the parties did not contemplate that they were entering into a loan arrangement), the arrangement would be considered a gift term loan under those Regulations. This characterization would have bunched all of the interest over the younger insured's life expectancy, discounted back to present value, as a gift in the initial year of the arrangement.

The IRS argued, alternatively, that Mrs. Levine had made a gift of the entire premiums, that she made a gift of all future economic benefits, and that her gift was equal to the value of her right of repayment of not less than the cash value of the policies.

Interestingly, the IRS did not argue in its gift tax notice of deficiency in Levine that any gift would also have been a generation-skipping transfer.

As with Morrissette, the Levine decision held only that there was no so-called "gift on inception" under any of the gift tax theories advanced by the IRS.

What is important are two key issues neither the Morrissette nor Levine courts discussed: These are (1) the valuation of the receivables owned by the estates and (2) any of the legal arguments made by the IRS in its related estate tax notice of deficiency to the Levine estate, discussed below.

Finally, unlike Morrissette, in Levine, there is no indication that there was any "business purpose" for the arrangements. In Morrissette, the apparent impetus for the split-dollar arrangement was to provide liquidity to enable the Morrissette family to retain the business. The Levine case, on the other hand, appears to be a more typical inter-generational split-dollar arrangement, one entered into for family insurance and estate planning motives, rather than for any business reasons; accordingly, its holding on the gift tax issue should have broader application.

Unlike Morrissette, in Levine, the original IRS audit only dealt with the estate tax return; the gift tax audit was, as noted above, a separate, later audit. In the estate tax audit, the IRS determined in its Notice of Deficiency that the fair market value of the split-dollar arrangements includible in the decedent's gross estate was their "actuarial values" (a term the Service did not define here), rather than the estate's appraised value.

Alternatively, as it has in other audits, the IRS also argued:

> 1) that the value of the arrangements which were includable in the decedent's gross estate was the full value of the premiums paid, rather than the appraised value of the receivables,
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> 2) that the value of the split-dollar arrangements includable in the decedent's gross estate under Sections 2035, 2036 and 2038 was the cash surrender value of the policies, rather than the appraised value of the receivables (on the theory that the decedent transferred property for less than full consideration and retained the right to income from the property and/or the right to determine who would enjoy the property), and
>
> 3) that the value of the split-dollar arrangements includable in the decedent's gross estate under Section 2703 was the cash surrender value of the policies (on the theory that the decedent's inability to unilaterally terminate the arrangements was a restriction on the right to use the transferred property and should be disregarded in valuing the transfer).

Finally, the IRS argued that the value of the decedent's estate should be increased in an amount to be determined, based on the present value of the estate's right to receive the greater of the premiums paid or the cash surrender value of the policies.

The IRS did not argue here, as it has in other similar audits, that Section 2702 applied to include the value of the policies in the decedent's gross estate (on the theory that the decedent transferred property and retained an interest in it which was neither an annuity nor a unitrust interest).

NOTE: None of the IRS estate inclusion arguments or valuation arguments made in the Notice of Deficiency on the estate tax return were a part of the Levine estate's motion for summary judgment nor were they a part of the Court's decision. All of these legal issues, as well as the fair market value of the receivables owned by the estate remain to be determined, either by the Court or in a settlement between the parties.

Accordingly, like the Morrissette decision on its gift tax summary judgment motion, the Levine Tax Court decision on the estate's gift tax summary judgment motion, while helpful, does not, as some commentators have indicated, "approve" single premium economic benefit intergenerational split-dollar arrangements.

Finally, note that neither of these cases deals with loan regime generational split-dollar, where this particular gift tax issue under the Section 61-22 Regulations doesn't arise.

Stay tuned for the estate valuation of these split-dollar receivables and the estate tax inclusion issues raised by the IRS, to be determined in both Morrissette and Levine.

FACTS: Mrs. Levine created the Marion Levine 2008 Irrevocable Trust on January 31, 2008. The Marion Levine Revocable Trust and the irrevocable trust entered into split-dollar agreements that covered a John Hancock policy and a Pacific Life policy, both insuring her daughter and son-in-law. Under the terms of the agreements, the revocable trust was obligated to pay all policy premiums while the policies were in effect, and the Irrevocable Trust assigned an interest in the policies to the revocable trust to secure repayment of its advances. The revocable trust's assigned interest was the greater of the policies' cash values or the total premiums paid. There was a single premium payment on one policy and there were two premium payments on the other.

On a timely filed gift tax return, Mrs. Levine reported gifts to eight donees of the irrevocable trust of the economic benefit provided to the irrevocable trust under the split-dollar arrangements. The 2008 gift tax return was filed on April 15, 2009; under the usual three year statute of limitations, any gift tax assessment arising from that tax year would have had to been made by April 15, 2012.

However, the Notice of Deficiency with regard to the 2008 gift tax return assessing a gift deficiency and a penalty under Code Section 6662 was not sent until February 24, 2015, well after the gift tax statute of limitations would have closed.

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