Wealth Transfer Planning for Ultra High Net Worth Families
Using Private Split Dollar & Grantor Trusts

A little but unknown powerful estate planning strategy that mitigates estate taxes on large tranches of assets by removing those **"targeted"** assets such as securities, private company stock, art, family business and fractional partnership or LLC interests, as well as, income and non-income real estate out of one's estate without gift taxes has received some very favorable recent tax court rulings which now completely validates the Split Dollar transaction. This now provides an opportunity for many ultra-high net worth families to further accomplish intergenerational wealth planning saving them tens of millions of dollars in estate taxes.

So, we would like to give you an overview of the key takeaways of the Morrissette I & II, as well as, the most recent case of Levine but first a little background information.

Split Dollar is not a type of insurance but merely an approach of funding or paying for a life insurance policy and sharing (or splitting) the proceeds at the time of death of the insured. As defined by Treasury Regulation Section 1.61-22(b), it is an arrangement between an owner and a non-owner of a life insurance contract in which a third-party is a "donor" of the premium and is entitled to recover those premiums and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract. The Donor (Grantor) holds the rights to be repaid the greater of the cash value *or* the aggregate premiums paid. This is called a **"right of reimbursement"** and is typically paid on death *unless* agreement is terminated by mutual consent of the Donor and the Owner (Trust/Trustee) per 2003 Split Dollar Regulations. For ease of understanding, we will call this the "Split Dollar Note" aka **"Note".** In addition, one is allowed to accrue interest on this Note. This all becomes a very important underlying technical detail supported by years of Regulations that facilitate the ultimate objective of transferring assets out of one's estate without estate, gift and generation skipping taxes.

<u>Effect of Morrissette I:</u> Basically, using split dollar rules, a donor can fund large amounts of premiums to fund cash rich insurance policies held in trust, without any gift, generation skipping or other transfer taxes. Once transferred, the value of those assets are deemed to be no longer in the estate of the Donor. Furthermore, the trust may defer interest and principal to the Donor - potentially for decades. In Morrissette, the Donor transferred over $39M.

Now, the Donor also has the ability to transfer the Note into another Trust via a sale, gift or some combination at an appraised value. At the time of transfer, it is possible, and recent court guidance suggests, that the economic value of the Note will be substantially less than the principal and accrued interest. This presents additional planning opportunities. The Note is intended to be paid upon an insured's death. The insured typically has 20 years or longer life expectancy. The note has a terminal value potentially 20+ years out growing at the long-term AFR rate (April, 2022 that rate was 2.25%). Based on this, a $100 transfer by a donor results in a $100 Note having a terminal value of $145 owed by the trust to the Donor- 20 years from now. However, what would a reasonable buyer pay for the note the Donor is holding today? While this is an oversimplification, the court suggested that a form of mortality

weighted present value calculation using a discount rate of 8.85% is reasonable for a universal life policy backed split dollar Note. Based on simplified present value calculation that value is about $28 – more than 70% less than the original $100 transfer amount. This also assumes there was good purpose for the insurance, the intent was permanent, that there was no pre-meditated termination date for the split dollar amongst other requirements.

***<u>Effect of Morrissette II</u>*: In the example above, a $100 transfer was made without gift and other transfer taxes resulting in a Note for $100. The economic parameters for appraising a Note which were acceptable to the Tax Court would allow us to move the Note out of the taxable estate at a value of $28.**

The first Morrissette case concurred that the premiums contributed are not considered "gifts" but rather non- taxable contributions of split dollar premiums not subject to gift and other transfer taxes. The second case provided us guidance on how one can value the "right of reimbursement note" and eliminated concern of Sections 2036, 2038 and 2703 applying *if* there is a bona fide business or other non-tax planning rationale to the transaction.

In the recent Levine case, it further validated the discount on the Note which in this case was in the decedent's estate and the IRS did not even question the 65% discount. Furthermore, it again clarified that neither IRC 2036 or 2038 were applicable. The IRS argued that the cash values in the Trust belong to the Grantor under these two sections of the code but they failed. This was a huge "win" for the Split Dollar transaction and has pretty much taken the legal risk out of one engaging in this transaction.

These cases collectively have provided a discernible road map for acceptable circumstances and fact patterns for Private Split Dollar planning. For any client looking to do additional estate planning to reduce estate taxes after more traditional planning is completed or for clients looking to purchase large amounts of insurance but do so in a manner which reduces the taxable estate, this planning should be reviewed carefully.

The ideal ages for this kind high impact planning is ages 45-90 with insureds under the arrangement being between ages 30-60 to make the economics compelling. Should you be interested in considering such an estate planning strategy, please contact us to discuss further.

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