Life Insurance Planning

Does *Levine* case signal renewed life for intergenerational split-dollar planning?

By R. Matthew Pate, JD, LL.M.

The recent case of *Estate of Levine*[1] has given proponents of a life insurance strategy known as "intergenerational split dollar" cause for optimism, but while the taxpayer achieved a notable victory in this case, planners and clients should continue to tread cautiously, as such arrangements will continue to invite IRS scrutiny around a host of issues.

What is Intergenerational Split Dollar?

Under a traditional split-dollar life insurance arrangement, the costs and benefits of a life insurance policy are generally divided (or split) between two parties—typically in either the employment or the estate planning context.

- For example, an employer may acquire a life insurance policy on the life of a key employee and endorse a portion of the death benefit to the employee's designated beneficiary as an employee benefit.
- Alternatively, an irrevocable trust may acquire a life insurance policy on the grantor's life funded through a split-dollar loan arrangement to minimize the gift tax costs of premium payments while removing a portion of the death benefit from the taxable estate. Life insurance proceeds are then available to provide liquidity for estate taxes upon the grantor's death.

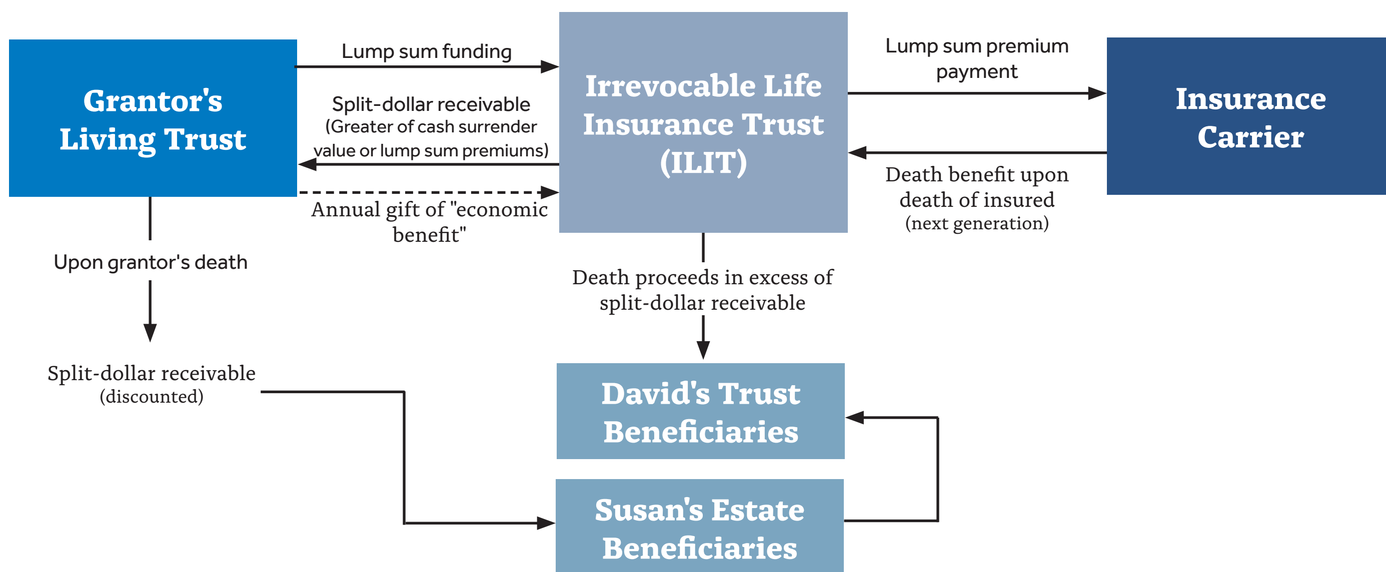
Intergenerational split-dollar (IGSD) arrangements are employed in the estate planning context as well, but not for liquidity at the grantor's passing. As the name implies, intergenerational arrangements insure subsequent generations under a split-dollar plan while obtaining favorable estate tax valuations on the retained split-dollar benefit.

EXAMPLE: Susan (age 85) has a large estate and has utilized all of her available lifetime gift tax exemption. Susan's son David is age 55, insurable, and has no life insurance coverage currently in place.

Under an intergenerational split-dollar plan, Susan's living trust funds an irrevocable trust for the benefit of David and the grandchildren with a lump sum $10 million transfer that in turn purchases a paid-up (i.e., no additional premiums are due) life insurance policy on David's life with a death benefit of $40 million. The agreement states that Susan's living trust is to be repaid the greater of cash values or cumulative premiums paid upon David's death.

---

1 *Est. of Levine*, 158 T.C. ___ (No. 2) (2/28/2022).



Under the regulations that govern the taxation of split-dollar plans,[2] the initial lump sum transfer is not a taxable gift to the trust—the gift value is based on the actuarial cost of insurance protection (i.e., "economic benefit") provided under the insurance annually (generally equivalent to a much lower term insurance rate).

Furthermore, because the split-dollar benefit is not payable until David's death, the actuarial value of such "receivable" in Susan's taxable estate is much lower than the initial $10 million payment. For example, assuming a life expectancy for David of 35 years and a 4% discount rate, the $10 million split-dollar benefit payable to Susan's living trust at her death would be worth approximately $2.5 million, significantly reducing the value of Susan's taxable estate (and saving $3 million in estate taxes assuming a 40% rate).

Initial Cases

The first notable case ruling on key aspects of intergenerational split-dollar arrangements was *Estate of Morrissette*.[3] In that case, the Tax Court upheld the application of the favorable economic benefit split-dollar regulations to an arrangement as described above; however, the discount claimed for estate tax purposes (75%) was not addressed in the initial opinion, which was limited to specific questions on summary judgment.

In *Estate of Cahill*[4] the estate claimed an even larger discount (98%) on the value of a similar split-dollar receivable. The Tax Court opinion addressed a number of questions at issue under summary judgment and largely ruled in favor of the IRS, without directly addressing valuation specifically. As a result, the case settled with the estate conceding the estate tax valuation of the IRS.

In a follow up ruling in *Morrissette* ("Morrissette II")[5] the Tax Court rejected certain IRS arguments sustained in *Cahill*, but otherwise largely upheld the IRS valuation, thereby eliminating the bulk of the discount claimed by the estate (upholding significant understatement penalties as well).

Estate of Levine

In *Estate of Levine*,[6] issued on February 28, 2022, the Tax Court followed much of the logic of Morrissette II on the legal questions, but also upheld the estate on the valuation question, permitting a 65% discount on the value of the receivable. The primary distinction with earlier cases was the termination provision in the split-dollar agreement; to wit, the agreement could only be terminated early by the Trustee of the Irrevocable Trust, who was in turn an independent third party.

The cases can therefore be divided into essentially three categories:

- Taxpayer defeat on key legal questions leading to concession on valuation – *Cahill*;
- Pyrrhic taxpayer victory on key legal questions but defeat on sole

---

2 26 CFR 1.61-22.
3 *Est. of Morrissette*, 146 T.C. No. 11 (U.S.T.C. Apr. 13, 2016).
4 *Est. of Cahill*, TC Memo 2018-84.
5 *Est. of Morrissette*, T.C. Memo 2021-60.
6 *Est. of Levine*, Id.

issue of consequence (valuation) – *Morrissette*;

- Taxpayer victory on legal questions as well as on valuation – *Levine*.

Does *Levine* Provide an Effective Template for IGSD?

While the Tax Court in Morrissette II agreed that the fair market value of the split-dollar rights could be calculated using a discounted cash flow methodology, the fact that the ILIT trustees were the beneficiaries of the trust as well as the executors of the estate gave them the ability to terminate the agreement at that point.

Coupled with the fact that termination would most likely be desirable (since all assets would then be flowing to the same trusts), the court concluded that the valuation of the receivable was equivalent to the policy's then cash value (i.e., what would be owed at such point).

The court in fact referenced the likelihood that the parties would terminate the arrangement upon expiration of the statute of limitations on estate tax return deficiencies.

The *Levine* case was distinguished from *Morrissette* largely upon this line—since the ILIT's independent investment trustee had the sole right to terminate the agreement, and since such trustee was bound by a fiduciary duty (including to remainder beneficiaries who were not involved in establishing the arrangement), there was no guarantee that the agreement would be terminated at any point prior to death of the insureds. Absent specific additional assets in the trust, the ILIT had no way of paying back the obligation without turning over the life insurance policies altogether.

As a result, the Tax Court agreed that the discounted value as claimed was effective for purposes of determining the value held by the estate.

So Why No Peaceful, Easy Feeling?

Morrissette and *Levine* favorably addressed key IRS lines of attack on IGSD including assertions that the arrangement should be considered either:

- A gift at inception;
- Loan split dollar;
- A form of prepaid premiums; or
- A form of "reverse" split dollar (i.e., not eligible for split-dollar treatment per the IRS).

The ability to circumvent these arguments, however, does not mean that the IRS intends to drop them, or that valuation will cease being the ultimate focus of attack.

Note as well that the valuation of a split-dollar receivable in this fashion is a more complex determination than a simple discounted cash flow projection; expected mortality based on the health of the insured(s), projected policy performance, and the suitability and likelihood of a termination prior to death of the insured will all factor into any analysis.

Implementation and administration of these complex arrangements should likewise not be minimized. The ongoing maintenance of a split-dollar plan post death of the initial funder requires specialized planning within estate planning documents to account for ongoing economic benefits provided. Novel gift and generation skipping transfer tax questions may arise in this context as well.

Lastly, questions involving income taxation of amounts paid in excess of cumulative premiums upon roll-out or termination may be present.

However, for planners comfortable with potential scrutiny and continued challenges to these arrangements, *Levine* has provided an avenue to establish a viable and possibly discountable IGSD arrangement.

Key factors in such arrangement would likely include:

- Non-tax purpose of the split-dollar arrangement (e.g., to fund a buy-sell agreement as in *Morrissette* or to establish

coverage for a child's own planning needs as in *Levine*);

- Independent party acting on behalf of the irrevocable trust with sole authority to terminate or amend the split-dollar arrangement (as was the case with the independent investment trustee in *Levine*);
- No ability of grantor or trust beneficiaries to terminate arrangement mutually or unilaterally;
- Limited use of third-party financing to fund premiums, with such financing incidental to the arrangement and commercially reasonable in light of funding options (third-party financing was viewed negatively in the *Cahill* case, although shorter term loans were used to establish the arrangement in the *Levine* case.)

Conclusion

With the *Levine* case serving as the IRS's first defeat on the crucial valuation question, the decision may yet be appealed to the 8th Circuit.

The Tax Court in *Levine* also acknowledged the incongruence of the estate tax valuation relative to the amount transferred but placed the blame on the split-dollar regulations that permit the favorable gift tax treatment.

As a result, it is also possible that the Treasury Department at some point accepts the invitation to further address the gift and estate tax treatment of split-dollar rules that were largely drafted to address income tax abuses.

R. Matthew Pate, JD, LL.M. joined The Nautilus Group in 2004 after receiving his masters in law in taxation from Southern Methodist University's Dedman School of Law. Matt leads the Nautilus Plus department, where he applies his extensive experience in estate and business succession planning, tax issues involving closely held businesses, asset protection, and charitable planning arrangements to support a select group of Nautilus Members. Matt received his BA from Georgetown University and graduated from the University of Texas School of Law in 2001.

This material includes a discussion of one or more tax related topics. This tax related discussion was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purposes of avoiding any IRS penalties that may be imposed upon the taxpayer. The cash value in a life insurance policy is accessed through withdrawals and policy loans, which accrue interest at the current rate. Loans and withdrawals will decrease the cash surrender value and death benefit. TThese materials are prepared by The Nautilus Group®, a service of New York Life Insurance Company, and are made available to all Nautilus Group member agents, and, as a courtesy to select agents of New York Life Insurance Company. Nautilus, New York Life Insurance Company, and employees or agents thereof are not in the business of providing tax, legal or accounting advice. Individuals should consult with their own tax, legal, or accounting advisors before implementing any planning strategies.
SMRU 5016396 Exp. 3/31/2026