Intergenerational Split-Dollar Life Insurance

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A. Introduction

Several years ago, Practical Drafting mentioned three pending cases relating to intergenerational split-dollar life insurance. The last of the three, *Estate of Marion Levine*, *et al. v. Comm'r*, 158 T.C. No. 2 (2022), has been determined and is a significant defeat for the Internal Revenue Service (IRS).

Levine was before the Tax Court earlier in a different context. See *Levine v. Comm'r*, T.C. Docket No. 9345-15, the court entered an order on July 13, 2016 granting summary judgment to the estate. The case was discussed on pages 12483-12487 of the July 2016 issue of Practical Drafting and deals with adequate disclosure for split-dollar arrangements and IRC Sec. 6501(e)(2) and Treas. Reg. §301.6501(f)(2).

Levine will probably be appealed by the IRS and, by agreement, the appeal will be heard by the Eighth Circuit Court of Appeals.

B. Summary

The summary at the beginning of the opinion describes the facts and the court's holdings as follows:

D, the deceased, entered into split-dollar life-insurance arrangements which required her revocable trust to pay premiums for life-insurance policies taken out on the lives of her daughter and son-in-law. When the arrangements terminate, D's revocable trust has the right to be paid the greater of the premiums paid or the cash surrender value of the policies. An irrevocable life-insurance trust was the owner of these policies. D's children and grandchildren were the beneficiaries of the irrevocable trust, and F, a family friend who was substantially involved in the family's businesses, was the sole member of the investment committee that managed the irrevocable trust. F and two of D's children also acted as D's attorneys-in-fact and as the revocable trust's successor co-trustees. As the sole member of the irrevocable trust's investment committee, only F had the right to prematurely terminate the life-insurance policies: the arrangements gave D and the other two attorneys-in-fact no rights to terminate the policies or the arrangement itself.

1. *Held*: Treasury Regulation §1.61-22 governs only the gift-tax consequences of this transaction.

2. *Held, further*, as of the date of her death, D possessed a receivable created by the arrangements, which was only the right to receive the greater of premiums paid or the cash surrender values of the policies when they are terminated.

3. Held, further, I.R.C. §§2036(a)(2) and 2038 do not require inclusion of the policies' cash-surrender values because D did not have any right, whether by herself or in conjunction with anyone else, to terminate the policies because only the irrevocable trust had that right.

4. *Held, further*, I.R.C. §2703 applies only to property interests that D held at the time of her death. There were no restrictions on the split-dollar receivable, so I.R.C. §2703 is inapplicable.

The first two paragraphs of the opinion state:

Marion Levine entered into a complex transaction in which her revocable trust paid premiums on life-insurance policies taken out on her daughter and son-in-law that were held by a separate and irrevocable life-insurance trust. Levine's revocable trust had the right to be repaid for those premiums. Levine has since died, and the question is what has to be included in her taxable estate because of this transaction — is it the value of her revocable trust's right to be repaid in the future, or is it the cash-surrender values of those life-insurance policies right now?

We considered aspects of similar transactions both in *Estate of Morrissette v. Commissioner*, and in *Estate of Cahill v. Commissioner*, but in this one we have novel questions of how to decide what the revocable trust transferred before Levine's death and what it held when she died.

C. Background

The opinion provides a lengthy statement of the facts, much of which is interesting as background but is not needed to describe what the court dealt with and decided.

The plan was developed by a family advisor who was not a lawyer, Bob Larson. He discussed it with the decedent and her two children. The plan was put into effect by Larson and the two children acting by a power of attorney. The children, Nancy and Robert, were trustees of the decedent's revocable trust (the Revocable Trust).

The irrevocable trust (the Insurance Trust), the owner of and holding the insurance policies, was created under South Dakota law. The opinion states:

First he [Swanson, the family lawyer] created the trust that would own the split-dollar life-insurance policies — the Marion Levine 2008 Irrevocable Trust (Insurance Trust).[11] Irrevocable life-insurance trusts are typically used as a vehicle to own life-insurance policies to reduce gift and estate taxes. See *Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, 98 T.C.M. (CCH) 534, 535 n.3, aff'd, 653 F.3d 1012 (9th Cir.2011). If done properly, a life-insurance trust can take a policy out of its settlor's estate and allow the proceeds to flow to beneficiaries tax free. *Id*. Levine's Insurance Trust was signed at the end of January 2008 by her children and Larson as attorneys-in-fact and the South Dakota Trust Company, LLC (South Dakota Trust) as an independent trustee. The Insurance Trust's beneficiaries were Robert, Nancy, and Levine's grandchildren — the grandchildren that Levine naturally wanted to take care of.

Swanson settled the Insurance Trust in South Dakota because its laws are favorable — it has no rule against perpetuities, but does have a taxpayer-friendly state income tax and a favorable premium tax. South Dakota is also one of the few states with a "directed" trustee statute, which allows the separation of management and administration of a trust's investments. See S.D. Codified Laws ch. 55-1B (1997). Levine's Insurance Trust named South Dakota Trust as its directed trustee. This put South Dakota Trust in charge of administration — opening up trust accounts and handling them according to the terms of the trust document. But South Dakota Trust was only the administrator — it had no authority to choose what the trust would invest in.[12] Swanson drafted the trust to have trustees whose job it would be to direct its investments. This was the "investment committee," and its membership consisted of one person — Larson.[13] Levine picked Larson for this role because he had long been very close to the Levine family yet was not a part of it. Levine knew the relationship between her children was fraught. She wanted someone she could trust to manage not just the trust but the relationship — and her children understood this. Larson has been the sole member of the investment committee since it began. South Dakota law defines this committee's fiduciary obligations to the Insurance Trust and its beneficiaries. See S.D. Codified Laws §55-1B-4 (1997). And we specifically find that, as the committee's only member, Larson was under a fiduciary duty to exercise his power to direct the Insurance Trust's investments prudently, and he faced possible liability to its beneficiaries if he breached that duty.

Larson approved the split-dollar life-insurance arrangement on behalf of the Insurance Trust in his role as the investment committee.

South Dakota directed trust provisions were first enacted as part of Chapter 55-1B "Directed Trusts" in 1997 and have been amended on many occasions since then. The Uniform Directed Trust Act was completed and approved in 2017 by the National Conference of Commissioners on Uniform State Laws.

South Dakota law (S.D.C.L. §55-1B-1) contains definitions of terms including paragraph (2), which states:

"Trust protector," any person whose appointment as protector is provided for in the instrument. Such person may not be considered to be acting in a fiduciary capacity except to the extent the governing instrument provides otherwise. However, a protector shall be considered acting in a fiduciary capacity to the extent that the person exercises the authority of an investment trust advisor or a distribution trust advisor.

Other relevant provisions are (i) the first sentence of S.D.C.L. §55-1B-6, captioned "Powers and discretions of trust protector," which states:

The powers and discretions of a trust protector are as provided in the governing instrument and may be exercised or not exercised, in the best interests of the trust, in the sole and absolute discretion of the trust protector and are binding on all other persons.

and (ii) the first sentence of S.D.C.L. §55-1B-10 captioned "Powers and discretions of investment trust advisor" and, in effect, is the same as the first sentence of S.D.C.L. §55-1B-6. See also S.D.C.L. §55-1B-4, captioned "Trust advisor as fiduciary" and confirming that Larson was acting in a fiduciary capacity.

Larson was a "trust protector" and since he was an investment trust advisor, he was acting in a fiduciary capacity.

The opinion summarized the arrangement as follows:

Between June and July 2008, Nancy, Robert, and Larson — in their capacities as Levine's attorneys-in-fact and as trustees of her Revocable Trust — executed several documents to put the split-dollar arrangement into effect. We summarize the most important parts of the deal:

- The Insurance Trust agreed to buy insurance policies on the lives of Nancy and Larry;
- The Revocable Trust agreed to pay the premiums on these policies;
- The Insurance Trust agreed to assign the insurance policies to the Revocable Trust as collateral;
- The Insurance Trust agreed to pay the Revocable Trust the greater of (i) the total amount of the premiums paid for these policies — $6.5 million — and (ii) either (a) the current cash-surrender values of the policies upon the death of the last surviving insured or (b) or the cash-surrender values of the policies on the date that they were terminated, if they were terminated before both insureds died.

It was very important, if this deal was to work, that the Insurance Trust and not the Revocable Trust own the policies. The recitals in the arrangements state that the parties do not intend to convey to Levine or the Revocable Trust any "right, power or duty that is an incident in ownership . . . as such is defined under Section[s] 2035 and 2042" in the life-insurance policies at the time of Levine's death. They also state that neither the Insurance Trust, nor its beneficiaries, nor the insureds —Nancy and Larry — would have access to any current or future interest in the cash value of the insurance policies.

Under a heading "Tax Reporting," the opinion said:

Everyone involved knew that Levine, through her Revocable Trust, had given away some of her property to the Insurance Trust and its beneficiaries — they knew, in other words, that the value of the money the Revocable Trust would get years later wasn't equal to the $6.5 million it had given to the Insurance Trust for it to buy the insurance policies on Nancy and her husband. They knew that this was a taxable gift. Swanson prepared gift-tax returns for 2008 and 2009. Larson and Nancy signed these returns in their capacities as Levine's attorneys-in-fact. Each Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, reported the value of the gift as the economic benefit transferred from the Revocable Trust to the Insurance Trust. Gifts of valuable property for which the donor receives less valuable property in return are called "bargain sales." See *Estate of Bullard v. Commissioner*, 87 T.C. 261, 265 (1986). And the value of gifts made in bargain sales is usually measured as the difference between the fair market value of what is given and what is received. *Id*. at 270–71. Not so here. The Secretary, for whatever reason, has issued regulations that provide a different measure of value when split-dollar life insurance is involved. See Treas. Reg. §1.61-22(d)(2). The number Larson and Nancy came up with after applying the valuation rules in the regulations was $2,644. See Treas. Reg. §25.2512-1.

Everyone involved also knew that the promise of the Insurance Trust to pay the Revocable Trust some amount sometime in the future was also valuable. It had to be reported on the Levine's estate-tax return. And on Levine's Schedule G, Transfers During Decedent's Life, of the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, the value of the split-dollar receivable, as owned by the Revocable Trust on the alternate valuation date, was reported as an asset worth about $2 million.[17]

The opinion describes the concern of the IRS during the audit as follows:

This shift of money from the Revocable Trust for the purchase of the life-insurance policies that benefited the Insurance Trust caught the IRS's attention. The Commissioner issued his challenge, and the joust between the IRS and the Estate began. The Commissioner noticed two things in particular. The first was the small amount — only $2,644 — that Levine reported as the gift that her Revocable Trust had made to the Insurance Trust. The second was that the Insurance Trust had promised to pay the Revocable Trust the *greater* of $6.5 million or the policies' cash surrender value at *either* the death of both Nancy and her husband or upon termination of the policies. At the time of Levine's death, this value was close to $6.2 million, and the Commissioner suspected there was no insurmountable hurdle to the Insurance Trust's terminating the policies well before Nancy and her husband both died. This would mean that the Insurance Trust and Levine's descendants, as beneficiaries of the Revocable Trust, had ready access to $6.2 million, not just the $2.1 million +$2,644 that was reported on the estate and gift-tax returns.

Beginning with the audit of the federal estate tax return through the filing of briefs, the IRS considered the arrangements a "scheme" rather than a "plan." As noted in the Introduction of this article, it unsuccessfully asserted a penalty against the estate which the Tax Court rejects.

D. Analysis

The primary issue was the value of the receivable in the decedent's estate. Was it $2,282,195, or the cash surrender values of $6 million plus?

The IRS' contention that the includible amount was the latter which required a transfer by the decedent made under IRC Sec. 2036 or 2038. The opinion found that such a transfer had not been made other than the original transfer to the Irrevocable Trust of cash to buy the policies. The opinion discusses the *Morrissette* and *Cahill* opinions as follows:

If we are right that the only property that Levine transferred was cash, then our analysis under section 2036 would seem to be easy — she retained no "interest" in that *cash*. But she did get something in return — the split-dollar receivable created and defined by the split-dollar arrangements. The receivable gave her the right to the greater of $6.5 million or the cash-surrender values of the policies. Under the terms of the split-dollar arrangements, however, Levine did not have an immediate right to this cash-surrender value. She (or her estate) had to wait until the deaths of both Nancy and Larry, or the termination of the policies according to their terms. Here we find what could be a very important difference between the split-dollar arrangements here and those analyzed in *Estate of Cahill and Morrissette II*. In Levine's case, the split-dollar arrangements between the Revocable Trust and the Insurance Trust expressly stated that only the Insurance Trust had the right to terminate the arrangement.

The split-dollar arrangements we analyzed in *Morrissette II* and *Estate of Cahill* were different. Look at the language in those arrangements. In *Morrissette II*:

The Donor and the Trust may *mutually* agree to terminate this agreement by providing written notice to the Insurer, but in no event shall either the Donor or the Trust possess the unilateral right to terminate this Agreement.

And in *Estate of Cahill*:

This Agreement may be terminated during the Insured's lifetime *only* by written agreement of the Donor *and* the Donee acting unanimously. Such termination shall be effective as of the date set forth in such termination agreement.

This difference matters. Unlike what we saw in *Morrissette II* and *Estate of Cahill*, we see here a carefully drafted arrangement that expressly gives the power to terminate only to the Insurance Trust. It gave Levine herself no unilateral power to terminate the policies and no language like that in the arrangement at issue in *Estate of Cahill* or *Morrissette II* that gave her that right acting in conjunction with the Insurance Trust. See *supra* pp. 16–17. By requiring *both* parties' approval, the arrangements that we analyzed in *Morrissette II* and *Estate of Cahill* necessarily *required* each decedent's approval to terminate the arrangement. The opposite is true here, where only the Insurance Trust could terminate the arrangement. Without any contractual right to terminate the policies, we can't say that Levine had any sort of possession or rights to their cash-surrender values. If the contest between the Estate and the Commissioner were confined to the tiltyard defined by the transactional documents, we would have to conclude that sections 2036(a) and 2038 do not tell us to include the polices' cash surrender values in the Estate's gross value.

The court referred to cases which held that a reserved right is not a power if its effect is merely the same as what local law would be absent the right. *Helvering v. Helmholz*, 296 U.S. 93 (1935); *Estate of Tully v. United States*, 528 F.2d 1401 (Ct. Cl. 1976). It then said:

We therefore agree with *Helmholz* and *Estate of Tully* that general default rules of contract — rules that might theoretically allow modification of just about any contract in ways that would benefit the IRS — are not what's meant in phrases like section 2036's "right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom," or section 2038's "power . . . by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power)." What's meant are rights or powers created by specific instruments. A more extensive reading, as the old Court of Claims noted in *Estate of Tully*, would swing a broadax to fell large swaths of estate and retirement planning that Congress meant to allow to stand.

We therefore conclude that the Commissioner doesn't win as a matter of law here.

The court qualified its conclusion by saying:

But we do think he's correct that we also must avoid being so blinded by any formal gleam from the Estate's armor that we overlook some practical chinks that deals like this may have: Can the Commissioner dismount from purely legal or theoretical arguments and start wielding shorter, sharper weapons forged from the particular facts of particular cases?

The Commissioner thinks he can, and would have us focus on our holdings in *Estate of Strangi*, 85T.C.M. (CCH) 1331, and *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), cases in which we concluded that section 2036(a)(2) clawed value back into a decedent's taxable estate despite the drafting skills of talented estate lawyers. In both *Estate of Strangi* and *Estate of Powell* we distinguished the Supreme Court's opinion in *United States v. Byrum*, 408 U.S. 125 (1972), in which an estate won, so we can begin by summarizing that case.

In *Byrum*, the Supreme Court held that a decedent's right to vote shares of stock in three corporations that he had transferred to a trust for the benefit of his children did not cause those shares to be included in his estate under section 2036(a)(2). The Court noted that any powers the decedent might have had were subject to a number of different "economic and legal constraints" that prevented those powers from being equivalent to the right to designate a person to enjoy trust income. *Id*. at 144. One of these constraints was that the decedent, as the controlling shareholder of each corporation whose stock was transferred into the trust, owed fiduciary duties to minority shareholders that limited his influence over the corporations' dividend policies. *Id*. At 142–43. The Supreme Court also noted that an independent corporate trustee alone had the right under the trust agreement to pay out or withhold income, *id*. at 137, so the decedent had no way of compelling the trustee to pay out or accumulate that income, *id*. at 144. That the decedent had fiduciary duties to these minority shareholders — duties that were legally enforceable — was important to the Supreme Court's analysis. *Id*. at 141–42.

We have been careful to distinguish *Byrum* in later cases when we see something behind a transaction's facade that suggests appearance doesn't match reality. *Estate of Strangi*, 85 T.C.M.(CCH) at 1333–34, featured a decedent who could act with others to dissolve a family limited partnership to which he had transferred property in exchange for a 99% limited-partner interest. The decedent in *Estate of Strangi*— through his son-in-law — also had the right to determine the amount and timing of partnership distributions. *Id*. at 1337. This led us to distinguish *Byrum*, because in *Byrum* the son-in-law had fiduciary duties to other members of the family limited partnership; in *Estate of Strangi*, the son-in-law's potential fiduciary duties — as the decedent's attorney-in-fact and 99% owner of the family limited partnership — were duties he owed "essentially to himself." *Id*. at 1343.

We decided *Estate of Powell* on essentially the same grounds as *Estate of Strangi*. In *Estate of Powell*,148 T.C. at 394–95, a fiduciary also owed duties to the decedent both as his attorney-in-fact and as partner in a family limited partnership. We found that there was nothing in the record of that case to suggest that as a fiduciary he "would have exercised his responsibility as a general partner of [the family limited partnership] in ways that would have prejudiced decedent's interests." *Id*. at 404. And we again determined that whatever duties were owed were duties that "he owed almost exclusively to decedent herself." *Id*.

Here's where the Commissioner makes his thrust. He contends that Levine — through her attorneys-in-fact — stood on both sides of these transactions and therefore could unwind the split-dollar transactions at will. This meant that she — again through the attorneys-in-fact — had the power to surrender the policies at any time for their cash-surrender values. (Remember that, under the terms of the split-dollar arrangements, if the Insurance Trust surrendered the policies before the deaths of both Nancy and her husband, it would immediately owe the Revocable Trust the full cash-surrender values of the policies.) The Commissioner argues that these powers constitute the right to possession and enjoyment of, or the right to income from, the split-dollar receivable under section 2036(a)(1). If he's right, we would have to value the receivable at the policies' cash-surrender values.

We agree that Robert, Nancy, and Larson — as Levine's attorneys-in-fact — stood in the shoes of Levine for this split-dollar arrangement. That is the point of giving someone a power of attorney. The Revocable Trust is the entity that paid the $6.5 million, and its co-trustees are Nancy, Larry, and Larson. The Insurance Trust, however, owns the life-insurance policies, and its trustee is South Dakota Trust. South Dakota Trust is directed by the investment committee, and the investment committee's only member is Larson. This, however, means that the only person that stood on both sides of the transaction is Larson — in his role as the investment committee and as one of Levine's attorneys-in-fact.

We therefore must look at each of Larson's roles in this transaction to consider how to apply sections 2036(a) and 2038. Under the 1996 power of attorney and Minnesota law, all actions taken by Larson as an attorney-in-fact are considered to be actions of Levine. See Minn. Stat. §523.12(2008).[25] The Insurance Trust's instrument, however, states that the Insurance Trust is irrevocable. We have no reason to doubt that this means what it says. And the consequence is that Levine irrevocably surrendered her interest in the Insurance Trust and had no right to change, modify, amend, or revoke its terms. Once it was created, Levine had no legal power over its assets. Levine did not have the power to surrender the policies by herself. Since Larson — in his role as an attorney-in-fact — could not take any action which Levine could not take herself, we find that he could not surrender the policies in his capacity as attorney-in-fact. This means that even if we treat the Insurance Trust, the policies, or *that* Trust's rights under the split-dollar deal as the "property transferred" (and thus the property whose value we look for) under section 2036, Levine did not retain any right to possession or enjoyment of the property transferred.

To get around these problems, the Commissioner has to argue that Larson has the right to designate who shall possess or enjoy the cash-surrender value of the policies, either by surrendering them or by terminating the entire arrangement. See *Estate of Cahill*, 115 T.C.M. (CCH) at 1467. For example, in *Estate of Cahill*, we found that section 2036(a)(2) applied when the decedent jointly held the right to terminate the split-dollar life-insurance policy with the irrevocable trust that held the policies. *Id*. We think that's the only way the Commissioner can include the combined cash-surrender values of the life-insurance policies in Levine's estate under section2036(a)(2) or section 2038.

But we also think that this argument fails to consider the fiduciary obligations Larson owes to the beneficiaries of the Insurance Trust — obligations that would prevent him from surrendering the policies. The Commissioner first questions the validity and existence of these duties. He notes that "Larson was not compensated for his role as the sole member of the Investment Committee despite the fact that petitioner has taken the position that he assumed significant fiduciary responsibilities under this role." But we don't think that matters. There is no requirement under either South Dakota law[26] or general trust law[27] that a trustee or trust adviser be compensated to have fiduciary obligations. The terms of the Insurance Trust expressly state that Larson — in his role as the single-member investment committee — shall be considered to be acting in a fiduciary capacity. Therefore we do find that Larson was under fiduciary obligations in his role as the sole member of the investment committee.

Larson's duties in his role for the Insurance Trust required him, however, to look out for the interests of *that* Trust's beneficiaries. And here is where the Commissioner makes a different and subtler argument. He contends that, since Nancy and Robert are beneficiaries of the Insurance Trust, they stand to benefit under the split-dollar arrangement regardless of whether the life-insurance policies remain in place or are surrendered during their lifetime. This means, he says, that Larson would not violate his fiduciary duties to the beneficiaries of the Insurance Trust if he either surrendered, or didn't surrender, the policies because Nancy and Robert would benefit no matter what. If Larson immediately terminated the split-dollar arrangement, surrendered the policies, and sent the money out of the Insurance Trust to the Estate and then to Levine's children, he'd just be benefiting the children in a different capacity.

To this subtle thrust, the Estate has a blunt parry: Levine's children are not the only beneficiaries under the Insurance Trust. Her grandchildren are also beneficiaries, and Larson has fiduciary obligations to them as well. According to the terms of the Insurance Trust, Levine's grandchildren would receive nothing if the life-insurance policies were surrendered. Left unmentioned is the final step in this argument — that Larson has no right to violate his fiduciary obligations by looting the Insurance Trust for the benefit of only some of its beneficiaries.

This holding rejects the position that approval of a partnership agreement by a partner-grantor requires inclusion of transferred property in the grantor's estate.

The court then said:

Levine's case is thus distinguishable from *Estate of Strangi and Estate of Powell*. Many of the same "economic and legal constraints" that existed in *Byrum* exist here. First, the fiduciary obligations that Larson owed were not duties that he "essentially owed to himself." His fiduciary obligations are owed to all the beneficiaries of the Insurance Trust, which include not just Levine's children, but her grandchildren. As we've already discussed, if Larson surrendered the life-insurance policies, those grandchildren would receive nothing as beneficiaries. That makes these fiduciary obligations more analogous to the duties owed to the minority shareholders in *Byrum*, which like them are duties that do limit the powers of the person who holds them. They are also legally enforceable duties, established by South Dakota state law, see, e.g., S.D. Codified Laws §§55-2-1, 55-1B-4 (2008), and if Larson breached these duties or was put in a position where he was forced to do so, he would be required under S.D. Codified Law §55-2-6 (2008) to inform all of the beneficiaries of the Insurance Trust, and he could be removed. He could also be subject to liability under South Dakota law for breach of his duty. See, e.g., *Matter of Heupel Fam. Revocable Tr.*, 914 N.W.2d 571 (S.D. 2018) (trustee breaching fiduciary duties removed and required to personally reimburse trust).

We stress that the fiduciary duties that Larson owed to the beneficiaries of the Insurance Trust do not conflict with the fiduciary duties that he owed Levine as one of her attorneys-in-fact. In both *Estate of Strangi* and *Estate of Powell* we held that the fiduciary's role as the attorney-in-fact would potentially require him to go against his duties as a trustee. *Estate of Strangi*, 85 T.C.M. (CCH) at1343; *Estate of Powell*, 148 T.C. at 404. This is not the case here: Under Minnesota law, whenever Larson and the other attorneys-in-fact exercise their powers, they are to do so "in the same manner as an ordinarily prudent person of discretion and intelligence would exercise in the management of the person's own affairs and shall have the interests of the principal utmost in mind." Minn. Stat. §523.21 (1992). And Larson, Nancy, and Robert all credibly testified that one of the reasons for this split-dollar arrangement was that Levine wished to provide for her grandchildren and keep this arrangement in effect until the insureds died. So not only did Larson's role as an attorney-in-fact not require him to go against his duties as a trustee, the two roles reinforced each other and pushed him to fulfill Levine's stated purpose in her estate planning. They made it more likely that he would not want to cancel the life-insurance policies.

We therefore find it more likely than not that the fiduciary duties that limit Larson's ability to cancel the life-insurance policies were not "illusory". It also persuades us that we cannot characterize his ability to unload the policies and realize their cash-surrender values as a right retained by Levine, either alone or in conjunction with Larson, to designate who shall possess or enjoy the property transferred or the income from it.

We conclude that this precludes the inclusion of the cash-surrender values of the life-insurance policies in Levine's estate under section 2036(a)(2).[28]

Section 2038 focuses on a decedent's power to "alter, amend, revoke, or terminate" the enjoyment of the property in question. The Commissioner's argument under section 2038 mirrors his argument under section 2036— that the attorneys-in-fact have controlled the entirety of Levine's affairs since 1996, and that this control includes the ability to "alter, amend, revoke or terminate "any aspect of the split-dollar arrangements. He argues again that the termination of the split-dollar arrangements would provide Levine — through her attorneys-in-fact — with complete control over the cash-surrender values of the policies, and the power to do this would fall within section 2038(a)(1). He argues that it applies to section 2038(a)(1) for the same reasons that he argues it applies to section 2036. We disagree for the same reasons and need not repeat them.

The cash-surrender values of the insurance policies are not includible under section 2038(a)(1) either.[29]

The court briefly rejects the IRS position that IRC Sec. 2703 applies and notes that the section has no relevance to the valuation of the receivable because the decedent had unrestricted control of it and therefore the section does not apply. The court's conclusion is as follows:

If there is a weakness in this transaction, it lies in the calculation of the value of the gift between Levine and the Insurance Trust — the difference between the value that her Revocable Trust gave to the Insurance Trust and what it got in return. But the gift-tax case is not this estate-tax case.

And the problem there is traceable to the valuation rule in the regulations. No one has suggested that this rule is compelled by the Code and, if it isn't, the solution lies with the regulation writers and not the courts. See *Carpenter Fam. Invs., LLC v. Commissioner*, 136 T.C. 373, 387 (2011).

An important point is that under applicable state law, Larson was in a fiduciary capacity to the beneficiaries of the Insurance Trust. In some states the law does not specifically provide that a trust protector, such as Larson, is treated as acting in such a capacity. Therefore, the tax result in such a case may not be governed by Levine. Those states should consider changing their laws as to an advisor like Larson.

E. Conclusions

The estate tax result was that the receivable in Mrs. Levine's estate was valued at the stipulated value of $2,282,195. There is no discussion of how the parties arrived at this value, but it is presumably the present value of an amount (perhaps the date of death cash surrender value of the policies of $6,153,478) payable at the death of the survivor of the insureds. The court's estate tax analysis seems sound but, as noted earlier, the court was puzzled by the theory of the gift and income tax split-dollar regulation, suggesting that the transactions might better be analyzed under the gift tax with the "normal rules" of a bargain sale being used. The collection of the receivable may be income to the recipient, in this case Mrs. Levine, now deceased, but the value is discounted substantially for delay in payment.

A similar approach would be to say that split dollar transactions should be treated as net gifts for gift tax purposes. As noted above, the Insurance Trust agreed to pay the Revocable Trust an amount (agreed to be $2,282,195) which would be subtracted from the $6.5 million in determining the net gift. Either gift tax theory would work under the facts of *Levine* because Mrs. Levine died soon after the transaction was put in place and the gift tax statute of limitations was still open. How a gift tax theory could be applied where the party in Mrs. Levine's position lived for many years is unclear.

In its opinion, the court relied upon the duties of Larson, a trust protector, to the beneficiaries of the Insurance Trust in support of the result of no estate tax inclusion. Under the South Dakota statutes referred to above on page 3, he was acting in a fiduciary capacity (see the quotation from the opinion on pages 8 and 9 above). The court's discussion makes clear that Larson acted "prudently" in carrying out his duties as the sole member of the Investment Committee. However, the court did this without discussing the scope of the words "in the sole and absolute discretion of the trust protector" in S.D.C.L. §§55-1B-6 and 55-1B-10. We regret the omission and believe the answer is in the quotation from the Comment to Section 9 in the paragraph below.

The Uniform Directed Trust Act has been passed in 16 states (Arkansas, Colorado, Connecticut, Florida, Georgia, Indiana, Kansas, Maine, Michigan, Montana, Nebraska, New Mexico, Utah, Virginia, Washington, West Virginia) and is being considered in other states (New York and Rhode Island). The language in the Uniform Act does not contain the liability language referring to willful misconduct or gross negligence, but the Comment to Section 9 indicates that such language would be acceptable. The Comment describes the willful misconduct standard as a "mandatory minimum" and states:

The terms of the trust may not reduce a trustee's duty below the standard of willful misconduct. Terms of a trust that attempt to give a trustee no duty or to indicate that a trustee is not a fiduciary or is an "excluded fiduciary" or other such language are not enforceable under subsection (b). Such provision should be construed to provide for the willful misconduct of subsection (b).

Thus, the holding of the court should also be applicable when the state law involved has enacted the Uniform Directed Trust Act.

As mentioned above, an appeal by the IRS will be directed to the Eighth Circuit which includes South Dakota.

In any event, one conclusion is certain – the regulation on split-dollar life insurance needs to be reconsidered and revised. Its problems are compounded by intergenerational insurance because the duration of the arrangement is likely to be increased.

* * *

[11] While Swanson created the Insurance Trust to own the life-insurance policies taken out as part of the split-dollar transaction, we find him credible when he said that he also viewed the Insurance Trust as something Nancy and Robert could use in their own eventual estate planning.

[12] South Dakota Trust could also be directed by the investment committee on how to deal with distributions for the trust, although it maintained discretion on how to do this.

[13] S.D. Codified Laws §55-1B-9 (2017) states: A trust instrument governed by the laws of South Dakota may provide for a person to act as an investment trust advisor or a distribution trust advisor, respectively, with regard to investment decisions or discretionary distributions. Unless otherwise provided or restricted by the terms of the governing instrument, any person may simultaneously serve as a trust advisor and a trust protector.
This allows for an investment committee of just one person.

[17] The parties later stipulated that the fair market value of the split-dollar receivable, if the Estate prevails, is a bit higher — $2,282,195.

[25] The Minnesota statute states: "Any action taken by the attorney-in-fact pursuant to the power-of-attorney binds the principal, the principal's heirs and assigns, and the representative of the estate of the principal in the same manner as though the action was taken by the principal. . .." (Emphasis added.)

[26] S.D. Codified Laws § 55-1B-4 (2008) provides:
If one or more trust advisors are given authority by terms of the governing instrument to direct, consent to, or disapprove a fiduciary's investment decisions, or proposed investment decisions, such trust advisors shall be considered to be fiduciaries when exercising such authority unless the governing instrument provides otherwise."
(Emphasis added).
And S.D. Codified Laws §55-2-1 (2008) provides that "[i]n all matters connected with his trust a trustee is bound to act in the highest good faith toward his beneficiary. . . ."

[27] Restatement (Third) of Trusts §70, cmt. d(1) (Am. L. Inst. 2007) states that "[w]hether or not a person receives compensation for serving as trustee, the person is subject to a duty to administer the trust in accordance with its terms . . . with prudence . . . and in good faith and conformity with other fiduciary duties referred to in Clause (b)."

[28] Section 2036(a) also excepts from its sweep transfers that are bona fide sales for adequate and full consideration. We need not determine whether this exception applies.

[29] Section 2038 also includes an exception for a "bona fide sale for an adequate and full consideration in money or money's worth." We need not decide whether this exception applies here.

The statements in this issue cannot be used by any taxpayer to avoid tax penalties. The previous sentence is inserted pursuant to U.S. Treasury Regulations governing tax practice.

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