Heckerling Institute Report
Report #5 - Life Insurance/Planning and Drafting

The following is Report #5 from our on-site reporters regarding some of the highlights from the events and presentations that are taking place at the 34th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 10-14, 1999 at the Fontainebleau Hilton in Miami Beach, Florida.

This Report covers both Donald Jansen's Tuesday morning session entitled "Life Insurance Potpourri: No Employer? - Try Family Split Dollar and Other Recent Developments" and Howard McCue's Tuesday afternoon session entitled : Planning and Drafting to Influence Behavior (of Children and Grandchildren)."

This report was filed by on-site reporter, Stephen Leimberg. Steve is also a presenter at this year's Institute. He will be co-presenting (and reporting on) the TRU Revolution Special Session on Tuesday afternoon with Robert Wolf and Susan Porter.

Topic: Life Insurance: Recent Developments
Speaker: Donald Jansen of Fulbright and Jaworski

Details: After reviewing recent cases and rulings involving life insurance, Don Jansen covered the three typical uses of private split dollar (1) "Parent helps child", (2) "Keep control of the cash values and retain them for retirement - yet get the proceeds of out the estate", and (3) Shift wealth at minimum gift tax cost. He noted the two theories of taxation (no compensation or stock-holding involved so no income) and (the wife is making an interest-free loan to the trust) and reiterated the history and taxpayer - favorable conclusions of recent rulings.

Don was the second speaker in two days who mentioned that there was "a cloud on split-dollar". He noted that there are rumors of a major change in the income taxation". He expressed surprise since the Treasury has a major task force studying split-dollar but said that "there may be something going on in the IRS on ALL split dollar arrangements." He didn't elaborate but my impression is that the IRS will move in the direction of 7872 treatment, i.e. below market loan theory. This would cause premium payments to be treated as a series of loans with below market rates. So the paying "family member would realize interest income equal to the applicable federal rate on the amount of premium paid."

Don reminded us that even in the taxpayer-favorable PLRs 9636033 and 9745019, the only two rulings to focus specifically on private split dollar, the IRS was asked to respond only on gift and estate tax issues and didn't examine the income tax ramifications.

He cautioned that - as in every split dollar ruling issued in recent years - that the rulings state "we express no opinion regarding the application of Section 7872 to this transaction." He also cautioned that it was essential for planners to explain the trade-off (pay estate tax on the cash value when the "owning non-insured spouse dies to get the death benefit out of the estate yet still retain control of the cash value) and to provide for disposition of the non-insured spouse's interest.

Don also warned planners to be careful of equity in private split dollar situations. He expressed concern that "there is a risk that the equity build-up each year might constitute additional gifts to the trust or third party owner under an analogy to TAM 9604001." The IRS "might still argue that the equity is transferred for gift although not income tax purposes with regard to private split dollar."

My take on Don's talk is, "proceed cautiously in the area of private split dollar!" We only have a couple of PLRs and these are (only) PLRs.

Topic: Planning and Drafting to Influence Behavior
Speaker: Howard "Scott" McCue of Mayer, Brown, & Platt

Summary: The line between guiding and controlling beneficiaries is sometimes thin. Howard examined modern business structures and trust designs as vehicles for enabling planners and their clients to accomplish personal as well as tax objectives. He focused on the use of incentive trusts, FLPs, various split-interest (charitable and private) trusts in this context and strategies to involve younger family members in the planning for multi-generational transfers of wealth.

Details: Howard's witty and insightful talk gave three major reasons for the increased interest in behavior influence planning in both clients and planners: (1) the explosion of wealth, (2) the fact that the tools and techniques we've used have worked and more wealth is continually being shifted, and (3) "the tax system as we know it can not endure".

The key to understanding his talk and its major import is his statement that "If repeal becomes a reality, after the initial flurry of planning against the reintroduction of the tax (or a worse substitute), clients will go back to planning to accomplish what they really want and intend, rather than what we force them into in the name of the avoidance or minimization of enormous transfer taxes. Estate planners who have thought about the effects of planning and drafting on beneficiary behavior will be better able to attract and keep the best clients."

Howard pointed out that we need to consider whose behavior we are trying to influence and control and reminded us that we are constantly impacting behavior of people even if we don't consider that impact (e.g., a spouse in a QTIP situation) and think carefully about what types of behavior we can and should encourage - or discourage. "Almost everything we do has some impact on behavior; it's only a question of, "Is what we are doing sensible?"

He discussed a number of techniques and stressed the importance of devices that rest control and flexibility in the client(s), i.e. FLPs, LLCs, S corporations, and charitable structures such as foundations or donor advised funds that allow families to work together to develop shared values and charitable lead trusts that, if the children are involved, can teach patience, frugality, and stewardship.

He favors tools are techniques such as discretionary trusts which adjust well to changing values over time and don't unduly restrict flexibility. But he stressed the importance of providing clear guidelines and protecting the trustee through exculpation clauses. Incentive trusts, which have a place as an important tool, must be carefully thought-out so as to meet changing circumstances and the "real intent" of the donor. A provision such as "earn a dollar - get a dollar" for example, where there were two children with drastically different incomes may not have the result the client intended.

His bottom line was, "Talk to your clients about how they want to influence behavior, and be sure they consider the implications of the steps toward that goal that they take.   As Warren Buffett said, "I want to give my children enough so they can afford to do anything they want to do - and not enough so they can afford to do nothing".

That's it for Report #5.

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