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Advisor Collaboration and Intergenerational Split-Dollar Plans

A prime example of a sophisticated strategy where advisors, attorneys and life-insurance professionals can work together to add value. Just don't discount how things could play out in real time.

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In the January 2022 issue of *Trusts & Estates,* I wrote about how estate planning attorneys and tax advisors can collaborate with life insurance professionals to create comprehensive, client-centered presentations of sophisticated life insurance strategies. In this article, I'll focus on one such strategy that's lately received a lot of attention.

The Plan

Your clients are a wealthy couple who will proudly tell you (an estate planning attorney for the purposes of this example) about their successful children and their beautiful and very smart grandchildren. The clients, whom I'll refer to as "GP," tell you that their insurance professionals have proposed a plan called "Intergenerational Split Dollar" or "IGSD." GP say that the plan involves setting up an irrevocable life insurance trust (ILIT) for the benefit of their grandchildren that would own large life insurance policies on their children (and maybe their children's spouses if both should be insured together). GP would provide the funds for the insurance by way of a split-dollar arrangement with the ILIT. The ILIT would repay GP when the children/insured (C) pass away, presumably several decades from now. Apparently, if the plan is properly structured, it can provide significant tax and wealth transfer benefits for the family.

A Collaborative Effort

GP would like you and the tax advisors to collaborate with the life insurance professionals to give them a realistic assessment of the plan. By “realistic” they mean, “does it work?” Smart, savvy, inquisitive and detail-oriented in their planning, they’re asking you to go way beyond whether the plan holds water taxwise at a high level. They’re talking operationally. They’re talking economics. They’re talking risk-adjusted return. Their talking about not making today’s solution tomorrow’s problem!

You tell the clients that you’re familiar with IGSD and have followed the developments in the case law, including a recent case that was decided favorably for the taxpayer. But you’ve never been involved in one of those transactions. Perhaps the tax advisors have some hands-on experience with IGSD.

You and the tax advisors have a preliminary call with the insurance professionals, with whom you’ve worked well before. They suggest that you put together a set of points that they can seamlessly weave into their usual presentation on IGSD. “Take off the filters. If something is of interest or concern, ask us to address it,” say the insurance professionals. “Got it,” you say, “We’ll get to work.”

After a fresh review of the cases and commentary on IGSD, you and the tax advisors have a good handle on both the opportunities that IGSD can offer as well as the issues it presents. Now the mission is to transcend the tax-oriented commentary on IGSD to get into the practical things that really make it work … or not. In other words, the mission is not just about the discounts that are getting all the press but also about *not* discounting the importance of understanding how the plan would play out in real time over the decades that it could be in force.

Initial Considerations

Here’s the current, somewhat annotated version of the list, which you and the tax advisors expect the insurance professionals to help you refine so that everyone can avoid a lot of back and forth that would delay a response to GP.

- Is this going to be a nonequity collateral assignment plan (contributory or noncontributory) under the economic benefit regime, a collateral assignment plan under the loan regime or the former with a switch to the latter at some juncture? These days, do facts and circumstances suggest one regime over the other?
- Describe and, if possible, show by schematic the parties, the structure, the mechanics, the flow of dollars and, of course, any assumptions critical to the success of the plan. Given the C’s disparate ages and medical histories, as well as the likelihood that the IGSD plan could be in force for decades, it would be helpful to break the description down into stages or scenarios, perhaps in this order:
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        - On Day 1, as implemented.
        - GP dies, survived by C. This is important because the plan would survive the GP and remain in place with GP’s successor. We’ll need to see (or figure out) what would happen to the “receivable” so we can consider the legal, tax and economic implications of maintaining the plan post GP.
        - C dies while GP is alive. GP would be repaid at that time.
        - Assume that under a nonequity economic benefit plan one of the Cs under a second-to-die policy dies while the GP is still alive.
        - C (or the second insured under a second-to-die policy) dies after the GP passed away.
        - The plan is terminated while everyone is still alive. We realize that this scenario could have several subsets. We’ll discuss.
- Note that we understand that, based on the insights on plan design that you’ve gained from working on these cases with practitioners and

colleagues around the country, we could modify or add to the scenarios listed above.
- Provide policy illustrations, rendered in the key of conservative.
- Sample documents.

Tax Implications

- For each of the above scenarios, set forth your understanding of the operative tax guidance for income, gift, estate and generation-skipping transfer (GST) tax implications. If there's no change from a prior scenario, just tell us. We welcome any insights from the advanced planners at the carriers.
- Address the implications of the ILIT's ceasing to be a grantor trust before the plan is terminated. We're assuming that the ILIT will be a grantor trust to ameliorate GP's tax situation in either a contributory nonequity plan or a loan-based plan.

A Switch in Plans

- So as not to disrupt the flow and symmetry of the discussion, address as a separate topic the midcourse switch from a nonequity collateral assignment plan to a loan regime plan.
- When and why would you recommend the switch? What would be the steps involved in that transaction? Would it matter whether the switch occurred before or after the death of GP? What would be the tax issues as you understand them?

Benefits of Plan

- The tax, economic and estate planning benefits that the plan could provide for the family.

The Risks and the What-Ifs

Because we know the clients will ask:

- For each type of plan, what could go wrong, and how would that occurrence impact each of the parties? For example, what happens if the policy "underperforms?" What happens to the tax economics of a nonequity plan involving a second-to-die policy if one of the two insureds dies early on but the survivor and therefore the plan is very long-lived? What happens if the term loan(s) have to be reissued at much higher interest rates?
- In each case, what can be done if it occurs, from minor tweaks to true exit strategies?
- What if, for whatever reason, the parties just want to get out of the plan before C or both Cs pass away?
  - How would they do that? What would be the tax and economic implications? This could all depend on "when."
  - What would be the tax implications if the ILIT surrendered the policy and repaid GP or their successor? Grantor trust status would presumably come into play here.
  - What if the ILIT can't repay GP in full?

You send the list to the insurance professionals who, as expected, ask you to give them a little more context on some of the points and have some suggestions of their own for a more comprehensive presentation. You give a progress report to GP, who appreciate the collaboration because they know that collaboration "works."