newsletter

Oregon Estate Planning and Administration Section Newsletter
Volume XVIII, No. 3
July 2001

Published by the Estate Planning and Administration Section of the Oregon State Bar

Disclaimers: When the Usual Rules May Not Apply

Disclaimers are useful tools, both for designing estate plans and for making postmortem corrections to plans. Most of us know the basic rules of disclaimers, but sometimes these rules do not apply. Although the situation is not, as a Firesign Theatre album once proclaimed, that *Everything You Know Is Wrong*, there are instances when a valid disclaimer seems to violate well-understood rules. A few such instances are discussed below:

1. More than nine months have passed since the decedent's death. Is it too late to use a disclaimer? Not necessarily.

The author was recently asked to assist a trustee after disclaimers had been used in an unsuccessful attempt to correct a generation-skipping problem. More than 15 months after the decedent's death, the IRS auditor had said that the original disclaimers created a new and worse problem. The solution? New disclaimers.

The decedent had created a trust that left his entire estate to his grandchildren, all of whom were adults. However, the decedent's estate was large enough to trigger more than $700,000 in generation-skipping transfer taxes. The trustee's advisors had suggested that the grandchildren and great-grandchildren execute disclaimers, so that the decedent's only child would inherit enough of the estate (passing by intestacy as a result of the disclaimers) to eliminate the generation-skipping transfer tax. The great-grandchildren were minors, so their parents had executed the disclaimers on their behalf.

On audit, the IRS contended that the minors' disclaimers were invalid because the disclaimers could be revoked by them when they became adults, in violation of the requirement in IRC § 2518(b) that disclaimers be irrevocable. (The IRS had previously made the same argument in Tech Adv Mem 7947008 (Aug. 16, 1979), applying Georgia law.) If the IRS position applied here, the great grandchildren inherited the disclaimed property, and the generation skipping transfer tax had to be paid.

Since all the great-grandchildren were still under age 21, we petitioned the court to appoint guardians ad litem for them. The guardians ad litem made new and irrevocable disclaimers. Although the new disclaimers were signed more than two years after the decedent's death, they were valid because they were made before the disclaimants reached age 21. IRC § 2518(b)(2)(B); ORS 105.630(4), 112.655(3).

The use of guardians ad litem or other court-appointed fiduciaries to make irrevocable disclaimers on behalf of minors has been approved in *Henry A. Lassiter*, 80 TCM(CCH) 541(2000) 2000-324. *See also Robert W. Goree, Jr.*, 68 TCM(CCH) 1068 (1994) *nonacq* 1996-1 CB 1, 1996-2 CB 1. For a case in which "late" disclaimers by minor grandchildren might have cured poorly planned disclaimers, *see In re Estate of Holden*, 539 SE2d 703 (SC 2000).

2. A guardian ad litem for a child has a duty to act in the child's best interest. Does that duty prevent the guardian ad litem from disclaiming property that would otherwise benefit the child? No.

In This Issue

As discussed above, having a guardian ad litem or other fiduciary make a disclaimer for a minor can insure that the disclaimer is irrevocable. In *Robert W. Goree, Jr.*, 68 TCM 1068, the decedent died intestate, leaving his second wife and the children of both marriages as his only heirs. The IRS argued that the partial disclaimers by the wife as conservator for the children and the acquiescence in the disclaimers by the guardian ad litem for the children could not be in the children's best interest, and therefore were invalid as a matter of state law. The tax court held that the disclaimers were valid. It agreed with the probate court that the wife's ability to provide for and care for the children would be enhanced if the federal estate tax liability were minimized. *See also Henry A. Lassiter*, 80 TCM 541.

Of course, a guardian ad litem might not agree to a disclaimer, particularly if the party who would receive the disclaimed assets is not a direct ancestor of the minor. This was apparently the case in *Fleenor v. Williamson*, 171 Or App 599 (2000).

3. If an adult has taken possession of property or accepted benefits from it, is it too late to make a disclaimer? Maybe not.

An adult under Oregon law who is under age 21 (*see* ORS 109.425) may take possession of property or accept benefits from it, and still disclaim the property within nine months after reaching age 21, so long as he or she does not accept benefits after turning 21. For instance, if the proposed disclaimant is the beneficiary of a custodial account that terminates when the beneficiary turns 18, the disclaimant can accept the custodial account's assets after reaching age 18 and still disclaim, so long as he or she accepts no benefits, such as dividends on stock, after reaching age 21. Treas Reg § 25.2518-2(d)(3), 25.2518-2(d)(4) example 11.

Examples involving adults over 21 years old also allow some degree of acceptance of benefits. For instance, in Priv Ltr Rul 199932042 (May 19, 1999), a husband and wife had a joint brokerage account. After his wife's death, the husband deposited income from the joint account into his bank account (which had been joint but became his sole account after his wife's death). He also authorized the brokerage to transfer the investment securities in the joint brokerage account into a new brokerage account opened in his sole name. Despite these acts, the IRS allowed the husband to make a qualified disclaimer of his wife's interest in the brokerage account. Critical to this result were the husband's acts shortly after those described above. On the same day he became personal representative, he opened a new brokerage account in the name of the wife's estate and transferred one-half of each security in the original (joint) brokerage account into it. He also deposited into an estate bank account one-half of the joint brokerage account earnings he had previously deposited into his bank account.

The quick damage control helped. The IRS concluded that the husband's acts in depositing the brokerage income and transferring the brokerage assets into accounts in his name did not constitute acceptance, given that the husband never did anything further with either the securities or the funds he deposited into the bank account.

Finally, acts that look very much like taking possession or accepting benefits of property may not prevent a disclaimer. A disclaimant may continue to live in a home owned with the decedent as joint tenants or tenants by the entirety, receive an instrument of title to property, or become vested in title under ORS 114.215, and still disclaim the property. Treas Reg § 25.2518-2(d)(1); Priv Ltr Rul 8124118 (Mar. 2, 1981). Likewise, acting as a fiduciary with respect to property does not necessarily cause a loss of the ability to disclaim that property. Treas Reg § 25.2518-2(d)(2). Note that a fiduciary who is also a disclaiming beneficiary may have discretionary powers that should also be disclaimed if those powers are not limited by an ascertainable standard. Treas Reg § 25.2518-2(e)(1), 25.2518-2(e)(5) examples 11 and 12.

4. The disclaimant cannot accept consideration for making a disclaimer. Can this rule prevent elaborate prearranged plans of disclaimer to achieve desired results? Perhaps not.

There are numerous instances of successful prearranged disclaimer plans by heirs and devisees that cause the disclaimed property to pass to a surviving spouse and qualify for the marital deduction. *See e.g., Henry A. Lassiter*, 80 TCM 541 and Tech Adv Mem 9509003 (Nov. 3, 1994), in which the IRS found that "although the five disclaimants have acted in concert in making the disclaimers in order to reduce the estate tax liability of the Decedent's estate, such action does not constitute the acceptance of any consideration in return for the making of a disclaimer within the meaning of [Treas Reg] § 25.2518-2(d)(1)."

In *Estate of Monroe v. C.I.R.*, 124 F3d 699 (5th Cir 1997), the Fifth Circuit approved disclaimers by 29 devisees of Louise Monroe, some of whom were unrelated to her, made at the request of her husband's nephew. The disclaimers caused the disclaimed property to pass to the decedent's husband free of estate tax. Shortly thereafter, the husband made generous gifts to each of the disclaimants, in many cases equal to the amount disclaimed.

The Tax Court had found that the disclaimers were not qualified because they were the result of an implied promise by the husband to make gifts to the devisees if they disclaimed. However, the Court of Appeals for the Fifth Circuit reversed that decision, stating that the very purpose of disclaimers is "to facilitate post-mortem estate tax planning and to increase family wealth on the 'expectation' that there will thus remain more wealth to pass on to the disclaimants in the future."

5. The testator's intent is the "pole star" for interpreting a will. Does that mean that a disclaimer contrary to the testator's apparent intent must be rejected? No.

The essence of a disclaimer is that it alters the estate plan, sometimes radically. For instance, in *Palmer v. White*, 100 Or App 36 (1989), the decedent created a trust designed to delay her daughter's inheritance by 10 years. The daughter disclaimed, which caused the mother's estate to pass immediately to the daughter through intestacy, completely defeating the mother's plan. Note that this was a nonqualified disclaimer for tax purposes.

See also Henry A. Lassiter, 80 TCM 541, in which the decedent's estate plan, written before the unlimited marital deduction, created a trust that failed to qualify for the marital deduction. The surviving spouse and the descendants, through an elaborate disclaimer plan, essentially rewrote the trust so it could qualify for the marital deduction.

Conclusion: As can be seen from the examples above, there are interesting twists in the disclaimer laws. Estate planners should be aware of the possibility that even if the facts do not fit the classic example for a disclaimer, a disclaimer may still be possible.

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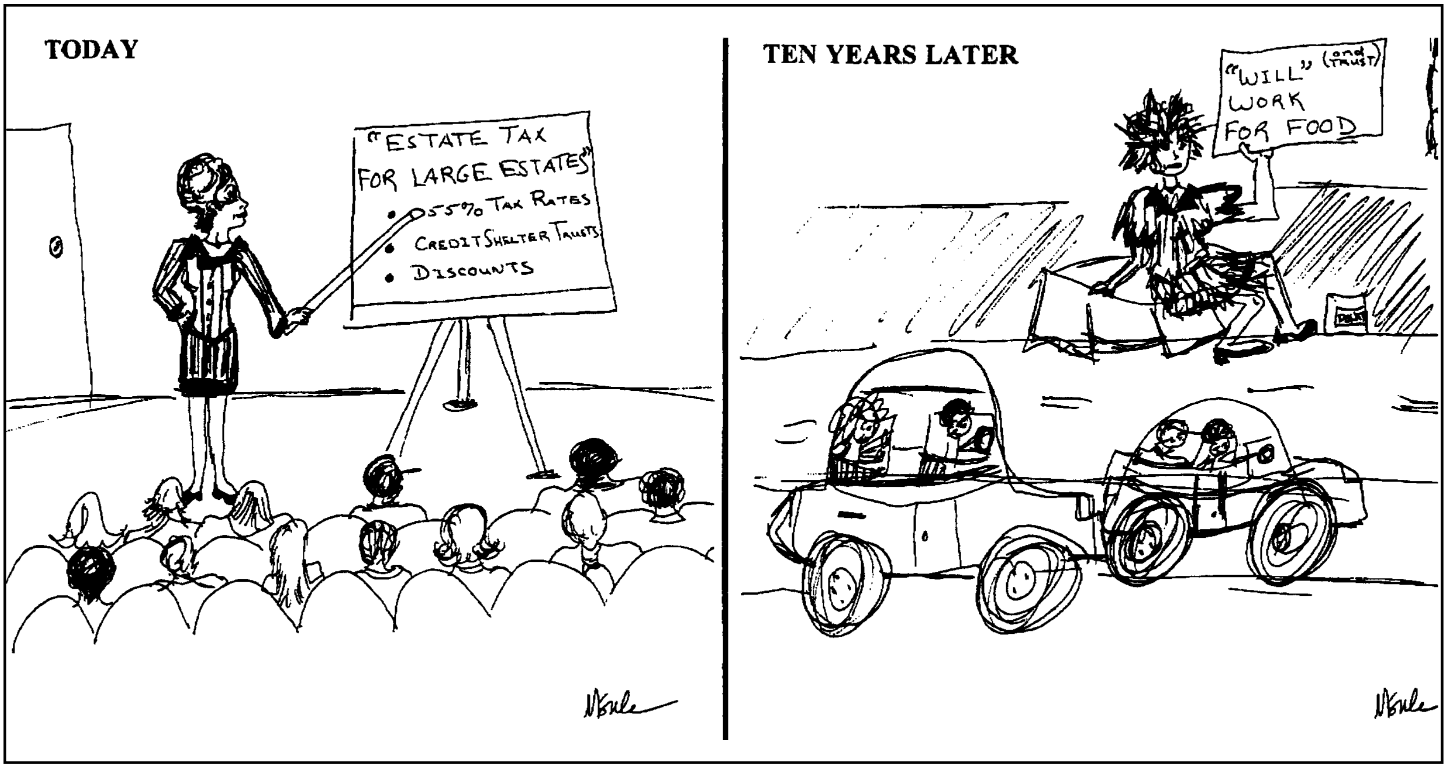

Supplemental Needs Trust for the Disabled Child

Ruth would like to make plans for her 24-year-old son Andrew's future needs. He is autistic and has been suffering from epileptic seizures since age 17. Andrew appears to be able to understand everything that transpires around him, but he cannot conventionally communicate his thoughts to the outside world. His "language" consists of rudimentary vocalizations and body gestures. Andrew was classified as disabled and began receiving Supplemental Security Income "SSI" and Medicaid benefits after he reached age 18.

Andrew has lived in the same house with his mother for his entire life. Andrew is comfortable only within the confines of the house and becomes extremely agitated when confronted with unfamiliar situations. While Andrew's medical needs are sporadic, his social and emotional needs are constant. Companionship puts Andrew at ease with his surroundings and ensures that in the event of a seizure, someone with adequate knowledge will be there to meet his needs. Andrew enjoys watching TV, especially "Animal Planet" on cable television. He also enjoys hot baths, and Ruth thinks that a hot tub would be particularly beneficial for him.

Andrew's father died when he was two years old, and Ruth had difficulty making ends meet until Andrew began receiving SSI benefits. She paid off the loan on her house two years ago. Ruth is 49 years old and has worked for the last 20 years as a county clerk. She anticipates that, when she retires, Public Employee Retirement System retirement benefits will meet or exceed her current monthly income. In the last five years, Ruth has been able to save a small sum of money that she would like to use to plan for Andrew's future. She intends to continue saving money for Andrew's benefit. Other relatives, including Ruth's mother, brother, and sister, would also like to contribute on a periodic basis or otherwise make provisions in their wills for a portion of their estates to go to Andrew's benefit. Ruth, however, is worried that any regular contributions or testamentary dispositions for Andrew's benefit could disqualify him from receiving SSI and Medicaid.

Benefit Qualification: Income and Resource Restrictions

The income and resource limitations on eligibility for SSI and Medicaid are quite stringent. To be eligible for both SSI and Medicaid, an individual's countable income must be less than the Federal Benefit Rate, and he or she cannot own countable resources with a value in excess of $2,000 ($3,000 for a couple).[1] Countable income, with a few exceptions, is any payment in cash or in kind that can be used for necessaries (food, clothing, and shelter), and countable resources are nonexempt assets under the Medicaid statutes as they are administered in the state. 20 CFR § 416.1102 (1991). However, gifts or inheritance are countable and may reduce qualifying benefit payments or cause the child to lose benefits for a period of years. Items or services received by the beneficiary that cannot be used to meet the SSI beneficiary's need for food, shelter, or clothing are not countable income. 20 CFR § 416.1103 (1994).

Countable income is defined as cash or in-kind payments that can be used to meet the SSI beneficiary's need for food, clothing, and shelter.

Countable resources include any cash, liquid assets, real property, or personal property that an individual owns and that could be converted to cash, which could be used for his or her support and maintenance. 20 CFR § 416.1201(a) (1994).[2]

However, certain assets are excluded from resources in determining SSI eligibility. *See*, 42 USC 1382b; 20 CFR 416.1210 (1996). Excluded assets, with value limitations, include the individual's home, household goods and personal effects, and a car. In addition to the income and resource restrictions, there are a myriad of other requirements that must also be satisfied to qualify for benefits – such as citizenship. *Social Security Handbook*, 14th Ed., §§ 2113, 2114 (2001); 42 USC §1382(a); 20 CFR 416.202 (2000), 416.410 (1996), and 416.1205(c) (1985).

The Medicaid program is funded by the federal government, but is administered by the states. In Oregon, a person's eligibility for Medicaid is tied to the income and resource limitations for SSI eligibility. Generally, if a person qualifies for SSI benefits, they also qualify for Medicaid benefits. OAR 461-135–710.

As previously mentioned, any gift or inheritance in excess of the Federal Benefit Rate that is made directly to Andrew could be considered countable income in the month received, and any part of such gift or inheritance remaining in the second month could be considered a countable resource of Andrew's. Any countable excess income received by Andrew would reduce his monthly SSI benefits on a dollar for dollar basis. 20 CFR § 416.410 (1996). Thus, gifts or inheritances made directly to Andrew could impact not only the monthly SSI benefit received by Andrew, but also, depending on the nature of the amount of the gift or inheritance, his SSI and Medicaid eligibility.

From the Bench

Occasionally, a court-appointed fiduciary, whether personal representative or conservator, exhibits a total lack of understanding of the fiduciary duties he or she has undertaken. This is the exception primarily because the attorneys representing fiduciaries take the time to educate their clients as to how to handle "other people's money."

It is sometimes evident that the lawyer for the fiduciary has not taken the time or trouble to explain that the funds must not be commingled with personal funds, that good records must be kept, and that the client must be prepared to render appropriate accountings in a timely manner.

We are becoming more aware every day that there are numerous "amateur" fiduciaries who do not understand their fiduciary responsibilities. Little can be done until they are represented by counsel or otherwise before the court. However, counsel for court-appointed fiduciaries should make the effort to educate their clients so they will do a better job.

William M. Keller
Pro-Tem Judge for Probate, Clackamas County

Staying Qualified: Establishing a Trust That is Not "Countable"

Within the above cited income and resource SSI eligibility rules lies the solution to Ruth's worries. If periodic contributions by Ruth and her relatives or any testamentary dispositions are transferred directly to a trust that is not a countable resource to Andrew, but which, by its terms, limits distributions from the trust for the benefit of Andrew to items and services that are not countable income to Andrew, then Andrew's eligibility for SSI and Medicaid benefits would not be jeopardized. If distributions from the trust are limited to items and services that do not represent food, shelter and clothing, then distributions for Andrew's benefit will not be considered countable income. 20 CFR § 416.1102 (1991). If the trust is established with assets that are not Andrew's and if Andrew has no "right, authority or power to liquidate the property or his or her share of the property," then the trust will not be a resource available to Andrew. 20 CFR § 416.1201(a)(1) (1994). This type of trust is a "special needs" or a "supplemental needs" trust and it is designed to supplement, but not replace, the public assistance benefits for which an individual is eligible.

Required Provisions of a Supplemental Needs Trust

The agreement establishing a third-party supplemental needs trust for the benefit of Andrew should contain certain provisions that will ensure the trust's assets are not considered a countable resource to Andrew, and that distributions from the trust are not considered countable income to Andrew. The trust agreement should explicitly state the following:

1. The trust was established by someone other than Andrew;
2. Assets used to fund the trust were owned by someone other than Andrew;
3. The trust is managed by a trustee other than Andrew;
4. The trustee has absolute discretion as to the nature and value of distributions made for Andrew's benefit;
5. Distributions to Andrew should never exceed the income or resources limitations established within the statutes and regulations governing SSI and Medicaid eligibility;
6. Distributions from the trust can be used only to supplement, but not replace, Andrew's SSI and Medicaid benefits;
7. "Supplemental needs" should be defined in general terms and in specific terms to explain the unique needs of Andrew;
8. Generally, distributions must be made to the providers of goods or services for Andrew's benefit, rather than directly to Andrew;
9. There should be dispository language that distributes any trust assets that are remaining following Andrew's death, to family, friends or charity – as desired; (Please note, the assets should NOT be distributed to the estate of Andrew, as the value would be subject to estate recovery by the state for up to the value of the benefits provided to Andrew during his lifetime.)
10. Successor trustees who will take a personal interest in Andrew's welfare should be listed;
11. There should be protective provisions that disallow use of the trust assets for payment of Andrew's creditors or for repayment of government agencies that provide services to Andrew.

See, David B. Beckham, *Trusts*, in *Estate Planning for People*

With Developmental Disabilities, 31 (The Arc of Oregon, 1998); Richard W. Fee, *The Special Needs Trust,* 2 NICHCY News Digest 6 (1992).

To clarify that the trust is not a resource of Andrew for the purposes of SSI and Medicaid eligibility, the supplemental needs trust should contain provisions establishing the following:

1. Andrew does not have the power to sell, assign, transfer, encumber or in any manner dispose of his interest in the trust;
2. Neither the income nor principal of the trust shall be liable for the debts of Andrew;
3. Andrew's access to trust principal or income is restricted; and
4. The trust agreement cannot be revoked by Andrew.

Qualifying Distributions

The types of distributions that can be made from a supplemental needs trust that would not be considered distributions for food, shelter or clothing, and which would not affect Andrew's eligibility for SSI or Medicaid benefits, would include the following:

1. Health insurance premiums;
2. Dental care;
3. Plastic or cosmetic surgery or other medical care considered not medically necessary by insurers or benefit programs;
4. Deductible amounts for the beneficiary on any insurance policies covering the beneficiary so long as that payment would not disqualify the beneficiary from receipt of public benefits;
5. Psychological support services;
6. Recreation and transportation;
7. Supplemental nursing care and similar care which public assistance programs do not otherwise provide, including payments for those providing services in the home;
8. Telephone, communications and television services;
9. Education costs, including the costs of books, educational opportunities, and individual tutoring or guided reading;
10. Electric wheelchair and other mobility aids;
11. Mechanical bed or other furniture with therapeutic potential;
12. Periodic outings and vacations;
13. Companions;
14. Companion's expenses for travel, reading, driving, and recreation or cultural experiences;
15. Hair and nail care;
16. Stamps and writing supplies;
17. More sophisticated medical, dental or diagnostic treatment, including experimental treatment, for which there are not funds otherwise available;
18. Private rehabilitation training;
19. Private case management to assist the beneficiary or to aid the trustee;
20. Medication, drugs, or treatment prescribed by a physician or other healing art practitioner for which there are not other funds available;
21. Fees and costs of protective proceedings or criminal proceedings;
22. Attorney fees; and
23. Assistance to enable the beneficiary to become self-employed or employable, including vocational or business start-up assistance.

A list of allowable distributions specific to Andrew's situation should be included in the trust established for Andrew's benefit, as this will assist Ruth and any successor trustee. The trust agreement should provide that such distributions may be made only if SSI, Medicaid, or other public assistance that might be received by Andrew, will not cover the listed items or services. Further, the trust agreement should provide that its list of "supplemental needs" disbursements is not exhaustive, and there are other potential needs that would appropriately be met by the trust.

A Confident Future

A supplemental needs trust will enable Ruth to plan for Andrew's future. Ruth can contribute her own assets to the trust with knowledge that, even after her death, the trust will provide for Andrew's needs that are not covered by SSI and Medicaid benefits. Others, including Ruth's relatives, can contribute assets to the trust by making gifts during their lifetimes or by testamentary dispositions, with knowledge that the trust assets will be used for Andrew's benefit. Most important, by establishing a supplemental needs trust to plan for Andrew's future needs, his quality of life can be improved without affecting his eligibility for SSI or Medicaid benefits.

This article should not be construed as legal advice. This general discussion of a supplemental needs trust is limited to the type of trust that is established with assets owned by someone other than the public assistance beneficiary or his or her spouse. All of the pertinent statutes, regulations and administrative rules (which are not all included in this discussion) should be read and understood before drafting a third-party supplemental needs trust. An attorney knowledgeable with drafting supplemental needs trusts should be consulted. There are other types of trusts that may be established using assets owned by the public assistance beneficiary or his or her spouse, but such trusts are beyond the scope of this article.

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[1] In Oregon, as of January 1, 2001, an individual's monthly income must be less than $530.

[2] 20 CFR § 416.1201(a)(1) (1994) provides: "If the individual has the right, authority or power to liquidate the property or his or her share of the property, it is considered a resource. If a property right cannot be liquidated, the property will not be considered a resource of the individual (or spouse)."

“Clarification” of Tax Consequences of Split-Dollar Life Insurance Arrangements

Split-Dollar Life Insurance Arrangements

The terms “split-dollar arrangement” and “split-dollar plan” generally refer to a variety of arrangements under which a whole life insurance policy is purchased on an employee’s life with the premium cost and the incidents of ownership (current insurance protection, the right to policy dividends and paid-up additions, the right to have the cash value upon surrender or partial surrender of the policy, the right to borrow against the cash value and the death benefit, and the right to designate a beneficiary) shared in some manner between the employee and the employer. There is an endless variety of ways in which the split interests in policy rights and features may be allocated.

A typical pattern would have the employee apply for and own the policy. The employer would advance all or a portion of the premium and take back an interest in the death benefit or the surrender proceeds equal to the accumulated premium outlay (or the total benefit or proceeds, if less) secured by a collateral assignment of the policy. The employee would own all incidents of the policy subject to the employer’s lien, including the right to designate the death beneficiary of any excess proceeds and the right to borrow or withdraw from any excess cash value. The employer would be entitled to receive back its premium outlay, usually without interest, either at the employee’s death or from the cash value at some earlier stated time. Ordinarily the arrangement would be evidenced by an agreement that would govern when and how the parties’ respective rights could be exercised and other significant features of the arrangement.

Traditional Tax Analysis

Before this spring, tax authority in this area began and ended with three tax rulings: Rev Ruls 64-328, 1964-2 CB 11; 66-110, 1966-1 CB 12; and 67-154, 1967-1 CB 11. Beyond the specific questions addressed in those rulings, reference had to be made to underlying principles of taxation, rather than to authority dealing specifically with the facts and circumstances of proposed transactions, which differ markedly from one another. Some additional support for the traditional treatment was garnered from a series of inconsistent and incomplete Private Letter Rulings on various specific transactions.

The general expectation was that the tax results of a split-dollar arrangement between employer and employee would be as follows:

1. The employee would recognize each year an amount of compensation income equal to the one-year term value of the current insurance protection in excess of the employer’s lien. This could be determined from a table published by the IRS or by the insurer’s premium for a standard-risk one-year term policy, which was often less than the IRS tabular value. If the employee was obligated to pay any portion of the premium, the employee was entitled to reduce the current imputed income by the amount of the current premium.
2. The employee would recognize income equal to any current dividends paid on the policy, whether payable in cash or in additional policy benefits (paid-up additions, etc.).
3. IRC § 72 would govern taxation of the cash value. Thus neither the employee nor the employer would recognize any income attributable to the increasing cash value of the policy until and unless value in excess of basis was withdrawn. (The policy would typically be structured so that it would not be a modified endowment contract to avoid reversal of the rule allowing basis to be recovered before taxable gain.) It was unclear whether the employee’s premium payment applied to reduction of current imputed income could also serve to establish additional basis in the policy.
4. It was expected that the employer’s lien would be satisfied with tax-exempt funds, either from the death proceeds or as a recovery of basis from the cash value at the time agreed to by the parties. For this reason, the parties would probably give thought to restricting the employee’s access to the cash value before the employer’s lien had been satisfied to assure the employer would be paid from tax-exempt basis.

Later Developments

Under the facts set out in the Revenue Rulings cited above, the employee apparently never gained any equity interest in the policy because the employer’s premium outlay, hence the employer’s lien, was always at least as much as the annual increase in the policy cash value. But the “equity split-dollar” arrangement evolved under which the employer’s lien was for only the employer’s premium outlay, which was fixed from year to year and which did not keep pace with the increasing cash value. It was argued that because the cash value would be taxed under IRC § 72, the only way the increase in the cash value could be recognized as taxable income would be if there was a withdrawal in excess of basis. Once the cash value equaled or exceeded the employer’s lien, the balance was free and clear to the employee at termination of the arrangement. The life insurance industry became more and more aggressive in marketing split-dollar arrangements, not as a means of providing the executive and his or her employer with life insurance protection, but as a technique of providing deferred compensation or retirement-like benefits via the transfer of an interest in aggressive policy cash values to the employee. Split-dollar arrangements arguably afforded that benefit without the disadvantages entailed in the use of qualified and nonqualified deferred-compensation plans. Perhaps this development encouraged the IRS to take a different approach than the traditional analysis suggests, analyzing split-dollar arrangements as property transfers in informal rulings having negative results for the taxpayer. For example, Private Letter Rulings began to appear suggesting that the employee ought to recognize income from year-to-year under IRC § 83 principles as the cash value grew in excess of the employer’s lien.

“Clarification”—Or A New Approach

Ultimately, in January 2001, the IRS announced in Notice 2001-10, 2001-5 IRB 459, that the tax consequences of split-dollar arrangements would be clarified in light of the dearth of previously published authority considering split-dollar arrangements in which the employee obtains an interest in the cash value. Henceforward split-dollar arrangements will be regarded either as a loan by the employer to the employee with the employee using the loan proceeds to purchase the policy or else as a property transfer from the employer to the employee in which the various economic benefits to the employee are accounted for in a manner consistent with the early Revenue Rulings and the basic tax principles underlying them. According to the Notice, the new principles will be as follows:

1. The IRS will accept the parties' characterization of the transaction if (i) it is consistent with the substance of the arrangement, (ii) it has been consistently followed by the parties since the inception of the arrangement, and (iii) the parties fully account for all economic benefits to the employee consistently with their characterization.
2. If the conditions just stated are all met, the IRS will accept characterization as a loan of premium from the employer to the employee followed by purchase of the policy by the employee. The tax consequences will then be determined under IRC § 7872 (loans with below-market interest). The employee will not have additional compensation income imputed from the value of current insurance protection (consistent with the theory that the employee purchased the policy with borrowed money). If the employer's advances are not repaid in accordance with the terms of the arrangement, the employee will have additional gross income as a consequence of loan forgiveness. Taxation of distributions from cash value will be governed by IRC § 72.
3. If the employer's payments are not consistently treated as loans, the economic benefits to the employee must be accounted for consistently with established principles, which generally means:
    (a) The employer acquires a beneficial ownership of the policy through its share of premium payments.
    (b) The employee has current income attributable to the value of current insurance protection reduced by any payments made by the employee for the protection.
    (c) The employee will have additional income equal to any dividends or similar distributions made to the employee, including any applied to provide additional policy benefits.
    (d) The employee will have compensation income under IRC § 83 to the extent that the employee acquires a substantially vested interest in the cash surrender value, reduced by any consideration paid by the employee for that interest.
4. Until further guidance is published, the IRS will not treat the employee as having current income attributable to the increase in the cash value above the employer's lien, and any contrary guidance will be prospective only.
5. If an employer pays the premium but acquires no beneficial interest in the policy, then the premium is treated as compensation income to the employee.
6. The IRS will accept a reasonable allocation of ownership and tax consequences established by the parties that is consistent with these principles.

Notice 2001-10 is described as interim guidance. The IRS has requested comments in general and on a number of specific issues related to split-dollar life insurance arrangements and promises additional guidance on the subject, including guidance on the treatment of arrangements already in place.

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- October 4-10, 2001 (Sponsored by ALI-ABA) **International Trust & Estate Planning Meeting,** Chicago, IL. Telephone: (800) CLE-NEWS.
- October 24-26, 2001 (Sponsored by ALI-ABA) **Basic Estate and Gift Taxation and Planning,** New Orleans, LA. Telephone: (800) CLE-NEWS.
- October 25-27 2001 (Sponsored by ALI-ABA) **Creative Tax Planning for Real Estate Transactions Meeting,** San Francisco, CA. Telephone: (800) CLE-NEWS.
- Nov 4-9, 2001 (Sponsored by Chaminade University Tax Foundation) **38th Annual Hawaiian Tax Institute**, Sheraton Moana Surfrider Hotel, Honolulu, HI. Telephone: (808) 946-2966.
- November 12-16, 2001 (Sponsored by ALI-ABA) **Planning Techniques for Large Estates (Limited Enrollment),** San Francisco, CA. Telephone: (800) CLE-NEWS.

Questions, Comments or Suggestions About This Newsletter?

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