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PROPOSED REGS ADDRESS GST RELIEF

The IRS has issued proposed regulations that would specify when an extension of time will be granted to allocate GST tax exemption to a transfer. The regulations stem from a Congressional mandate in Code Sec. 2642(g)(1), which was added by EGTRRA in 2001.

Judging from the number of private letter rulings issued by the IRS, perhaps no other issue poses more compliance difficulties in the transfer tax area than the timely allocation of generation-skipping transfer (GST) tax exemption. Nearly every week sees at least one taxpayer seeking an extension of time to allocate GST tax exemption to a transfer to a trust, usually on the grounds that there was a misunderstanding or mistake on the part of an attorney or accountant as to the need to make the allocation on a gift tax return (for a recent example, see IRS Letter Ruling 200818011). Given the complexity of the GST tax, which can confound even practitioners at times, it is not surprising that taxpayers can have difficulty "getting it right." Fortunately for taxpayers, the IRS has been rather forgiving in this area, granting relief in a wide range of factual scenarios.

As part of the sweeping changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (P.L. 107-16), Congress added Code Sec. 2642(g)(1), which required that the Secretary of the Treasury promulgate regulations describing the circumstances and procedures under which extensions of time would be granted to: (1) allocate GST exemption to a transfer; (2) elect not to have the deemed allocation of GST exemption apply to a direct skip; (3) elect not to have the deemed allocation of GST exemption apply to an indirect skip or transfers made to a particular trust; and (4) elect to treat any trust as a GST trust for purposes of Code Sec. 2632(c). Since the passage of EGTRRA, the IRS has published two significant pieces of guidance regarding extensions of time to allocate GST exemption. The first, Notice 2001-50, 2001-2 CB 189, provided that relief for taxpayers seeking an extension of time to make an allocation of GST exemption would be granted under Reg. §301.9100-3. Relief is generally available if (1) the taxpayer acted reasonably and in good faith and (2) granting relief will not prejudice the interests of the government. If relief is granted under Reg. §301.9100-3, the amount of GST tax exemption allocated is the estate or gift tax value of the property as of the date of the transfer, and the allocation is effective as of the date of the transfer. The second piece of guidance, Rev. Proc. 2004-46, 2004-2 CB 142, provided an alternate simplified method to obtain an extension of time to allocate GST tax exemption. This alternate method has limited applicability, being available only if certain requirements are met. Most significantly, the transfer in question must have qualified for the gift tax annual exclusion, and the sum of the amount of the transfer and all other gifts by the transferor to the donee in the same year must not exceed the annual exclusion amount for that year.

Roughly seven years after EGTRRA was signed into law, the IRS has now issued proposed regulations in response to the Congressional directive contained in Code Sec. 2642(g)(1) (REG-147775-06, published in the *Federal Register* on April 17, 2008). The proposed regulations encompass GST allocations under Code Sec. 2642(b)(1) and (2), and elections under Code Sec.

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2632(b)(3) and (c)(5), as described in the preceding paragraph. The IRS notes that the regulations, once adopted as final, are intended to replace Reg. §301.9100-3 with respect to relief under Code Sec. 2642(g)(1). (As a result, Notice 2001-50 will be obsolete once the final regulations are published; however, Rev. Proc. 2004-46 will remain in force for transferors who fall within its scope.) Relief will continue to be granted through private letter rulings. A public hearing on the proposed regulations has been scheduled for August 5, 2008.

Let's Be Reasonable

The general standard for granting relief under Reg. §301.9100-3 has been imported into the proposed regulations, which familiarly state that: "Requests for relief . . . will be granted when the transferor or the executor of the transferor's estate provides evidence . . . that the transferor or the executor of the transferor's estate acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government" (Proposed Reg. §26.2642-7(d)(1)). However, the proposed regulations go into greater detail than Reg. §301.9100-3 in defining reasonableness in the context of the covered GST actions, providing a (nonexclusive) list of factors to be used in determining if there was reasonable action and good faith on the part of the transferor or his executor. Specifically, these factors include: (1) the intent of the transferor to timely allocate GST exemption or make an applicable election, as evidenced in the trust instrument or contemporaneous documents, such as federal gift or estate tax returns; (2) the occurrence of intervening events beyond the control of the transferor or executor that caused the failure to allocate GST tax exemption or make an election; (3) the lack of awareness by the transferor or executor of the need to allocate GST tax exemption to a transfer after exercising "reasonable diligence," taking into account the complexity of the issue and the experience of the transferor or executor; (4) evidence of consistency by the transferor in allocating GST tax exemption; and (5) the reasonable reliance by the transferor or executor on the advice of a qualified tax professional, which advice led to the failure to allocate GST tax exemption or make an election (Proposed Reg. §26.2642-7(d)(2)). As to the last factor enumerated, reliance on a tax professional will not be considered reasonable if the transferor or executor knew, or should have known, that the professional was not competent to render advice on the GST tax exemption, or was not aware of all relevant facts.

The proposed regulations also provide a nonexclusive list of factors to be used in making a determination under the second prong of the test, namely whether the government would be prejudiced by a grant of relief. The interests of the government would be prejudiced if: (1) the requested relief is an attempt to benefit from "hindsight" rather than achieve the result intended by the transferor or executor at the time the transfer was made; (2) the transferor or executor delayed the filing of the request for relief with the intent to deprive the IRS of sufficient time to challenge an aspect of the transfer, such as the value of the transferred property for gift or estate tax purposes; and (3) in certain cases, a taxable termination or taxable distribution occurred between the time for making a timely allocation of GST exemption or a timely election and the time at which the request for relief was filed, in certain cases (Proposed Reg. §26.2642-7(d)(3)). With respect to the first factor, the IRS will analyze whether the grant of relief would permit an "economic advantage" or other benefit that would have been unavailable if the allocation or election was timely made.

As under the existing Reg. §301.9100-3 regime, if an extension of time to allocate GST exemption is granted under the proposed regulations, the allocation would be considered effective as of the date of the transfer and the estate or gift tax value of the transferred property would determine the amount of exemption to be allocated (Proposed Reg. §26.2642-7(b)). (Separate rules are provided with respect to elections under Code Sec. 2632(b)(3) and (c)(5).) The proposed regulations make it clear that the amount of GST exemption that may be allocated to a transfer is limited to the amount of the transferor's unused exemption as of the date of the transfer; therefore, no portion of a post-transfer increase in the GST exemption amount under Code Sec. 2631(c) may be applied in connection with the grant of relief (Proposed Reg. §26.2642-7(c)).

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Relief Killers

As noted earlier, the IRS has been fairly liberal in granting extensions of time to allocate GST tax exemption to a transfer under the prevailing Reg. §301.9100-3 framework. In the proposed regulations, the IRS has identified some of the situations where taxpayers seeking relief will be out of luck (Proposed Reg. §26.2642-7-(e)). Relief would not be granted under Proposed Reg. §26.2642-7 to decrease or revoke a timely allocation of GST exemption or to revoke an applicable election made on a timely filed gift or estate tax return. In addition, relief would not be granted if the decision made by the transferor or executor (having been accurately informed by a qualified tax professional) was "reflected or implemented" by the (in)action that is the subject for the relief request. And, similar to the factors considered with respect to prejudice of the government's interests, relief would not be granted if (1) the filing of the request for relief was delayed with the intent to deprive the IRS of sufficient time to challenge some aspect of the transaction (e.g., valuation) or (2) the requested relief was an attempt to benefit from hindsight rather than achieve the result that was originally intended. As regards the hindsight factor, the IRS states that no relief will be granted if it would shift GST exemption from one trust to another trust, unless the beneficiaries and their respective interests are the same. "Similarly," the IRS continues, "relief will not be granted if there is evidence that the transferor or executor had not made a timely allocation of the exemption in order to determine which of the various trusts achieved the greatest asset appreciation before selecting the trust that should have a zero inclusion ratio."

Gather Ye Affidavits

A good chunk of the procedural requirements contained in Reg. §301.9100-3(e) has been included in the proposed regulations. The transferor or executor must submit a "detailed" affidavit describing the events that led to the failure to timely allocate GST tax exemption to a transfer or to timely elect, as the case may be, and the events that led to the discovery of that failure (Proposed Reg. §26.2642-7(h)(2)). The taxpayer is required to attach to each affidavit "copies of any writing (including, without limitation, notes and e-mails) and other contemporaneous documents . . . relevant to the transferor's intent with regard to the application of GST tax to the transaction" for which relief is being requested. In addition, the transferor or executor must submit detailed affidavits from individuals who possess knowledge about the events that led to the failure to allocate or elect, and/or to the discovery of the failure (Proposed Reg. §26.2642-7(h)(3)). These individuals include: (1) each agent or legal representative of the transferor who participated in the transaction in question and/or the preparation of the related return; (2) the estate and/or gift tax return preparer; (3) any person who made a "significant contribution" to the preparation of the relevant tax return(s); and (4) each tax professional who advised or was consulted by the transferor or executor with regard to any aspect of the transaction. If one of these individuals has died, is incompetent, or refuses to provide an affidavit, the affidavit submitted by the transferor or executor must contain the information or knowledge that the transferor or executor "believes" such individual had about the transfer. ✦

VALUATION

Regs Consider Decline Due to Market Conditions

Citing Congressional intent relating to the predecessor to Code Sec. 2032, which was enacted after the 1929 stock market crash, the IRS has issued proposed regulations that limit the availability of the alternate valuation date election. Under the proposed regulations, the election would only be available in circumstances where the decline in value of a decedent's property is due to market conditions, not voluntary actions.

Under Code Sec. 2032, an executor may make an irrevocable election to value all of an estate's property on the alternate valuation date. If the election is made, the valuation of the estate's property is determined as follows: (1) property that is distributed, sold, exchanged, or otherwise disposed of within six months after the decedent's death is valued on the date of distribution, sale, exchange or other disposition or (2) property not distributed, sold, exchanged, or otherwise disposed of within six months of the decedent's death is valued as of the date that is six months after the decedent's death. On April 25, 2008, proposed regulations amending Reg. §20.2032-1, regarding the availability of the alternate valuation date election, were published in the Federal Register (NPRM REG-112196-07). The amendments seek to clarify under what circumstances the election will be available. Specifically, the amendments address two conflicting court decisions where the estates elected to use the alternate valuation date to report reductions in the value of each estate's property that were attributable to post-death changes to the character of the property.

A Brief History

The predecessor to Code Sec. 2032 was originally enacted, according to the Congressional record ac-

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LIFE INSURANCE

Notice Provides Limited Safe Harbor for Modification of SDA

CCH: In Notice 2008-42, IRB 2008-15, 747, the IRS ruled on the implications of the modification of a split-dollar arrangement for purposes of Code Secs. 101(j) and 264(f). Could you begin by providing our readers with some background on the significance of Code Sec. 101(j)?

A recent IRS Notice provides a favorable result with respect to the modification of a split-dollar arrangement for purposes of two particular provisions of the Internal Revenue Code. However, it fails to address the larger issue concerning the impact of a modification for purposes of the split-dollar regulations generally. For his comments on this latest IRS pronouncement, we contacted Lee Slavutin, MD, CLU, a principal of Stern Slavutin-2 Inc., an insurance and estate planning firm in New York City, and a member of the CCH Financial and Estate Planning Advisory Board.

Code Sec. 101(j) and Split Dollar

Dr. Slavutin: Code Sec. 101(j) was added to the Code by the Pension Protection Act of 2006 (P.L. 109-280). As you may recall, this provision was sparked by the revelation that certain large companies had purchased life insurance policies on the lives of rank-and-file employees, but had never informed the employees or their families of the purchase. The company was the owner and the beneficiary of the policy, so that when the employee died, the company would collect the insurance proceeds.

As a result of passage of the Pension Protection Act, Code Sec. 101(j) provides us with a new set of rules governing employer-owned life insurance (EOLI), effective for contracts issued after August 17, 2006. A typical example of EOLI would be a so-called key man insurance policy where the company owns and is the beneficiary of a policy on a key employee. Another would be an insurance policy owned by a company pursuant to a buy-sell stock redemption agreement.

As part of the new rules under Code Sec. 101(j), an employer must comply with certain employee notification and consent requirements. The employee must be informed in writing about the life insurance policy and must consent to the policy's issuance. This rule applies to all companies, not just public companies. There is also a new form—Form 8925, Report of Employer-Owned Life Insurance Contracts—that must be filed by the employer to notify the IRS of how many policies it owns covering employees and whether those employees have been notified in writing as to the existence of the policy. Although these are not onerous requirements, the ramifications of not complying with the rules can be quite painful. Specifically, the death benefit payable to the company on the employee's death would lose its income tax exemption to the extent the amount of such death benefit exceeded the premiums and other amounts previously paid by the company with respect to the policy.

CCH: What is the potential impact of Code Sec. 101(j) on split-dollar arrangements?

Dr. Slavutin: The most obvious example is an employer-owned policy, such as an endorsement arrangement, in which the employer owns the life insurance policy and endorses a portion of the death benefit to the employee's family or to a trust for the benefit of the employee's family. Another possible example is a policy owned by the employee or a trust for the employee's family, where the employee or the trustee has assigned an interest in the policy to the employer as collateral security for the premium payments. This is the classic collateral assignment split-dollar arrangement. Whether the employer has an ownership interest for purposes of Code Sec. 101(j) under this set of facts is a question that I think could reasonably be argued either way, it is not a clear cut situation. Accordingly, there is potential exposure to loss of the income tax exemption and I believe it is prudent to act on the side of caution and meet the Code Sec. 101(j) notice and consent requirements.

Code Sec. 264(f) and Split Dollar

CCH: Following up on our original question, what is the significance of Code Sec. 264(f)?

Dr. Slavutin: In comparison to Code Sec. 101(j), Code Sec. 264(f) is a relatively obscure provision, originally included in the Code by the Taxpayer Relief Act of 1997 (P.L. 105-34). It is effective for life insurance policies, annuity, and endowment contracts issued after June 8, 1997, in tax years ending after that date, and to contracts issued on or before that date if there is a material increase in the death benefit or there is some other material change in the contract.

Basically, this provision concerns a situation in which a business is borrowing money for whatever reason, such as to buy a building, or to buy equipment or inventory (note that the borrowing is not necessarily related to the life insurance policies). The company is paying interest on the loan and legitimately deducting the interest expense. If this business owns life insurance policies that have cash value, a portion of the company's interest expense deduction may be disallowed. The potential disallowance is calculated based on a ratio of the amount of money held in the cash value of these policies to the total assets of the business.

For the sake of simplicity, let us assume a business owned a number of insurance policies having a total cash value of $500,000 and the total value of the assets of the business, including the cash value of the insurance policies, was $2.5 million. In this case, Code Sec. 264(f) could disallow 20 percent (.5 ÷ 2.5) of the company's interest expense deduction. Of course, there are a number of exceptions to this general rule, such as for a policy covering a person who is an employee, officer, or director of the business. Another exception applies to a policy covering a person who is a 20-percent owner of the entity or a policy covering the joint lives of a 20-percent owner and his or her spouse.

For a corporation this provision will generally not pose a problem, but for a partnership there could be an issue. For one thing, a partner does not meet the statutory definition of an employee. Consequently, in the case of a partnership with more than five equal partners, no one partner can meet the 20-percent ownership exception, and because a partner is not considered an employee, the exceptions to Code Sec. 264(f) would not apply.

If a partnership owns policies in a split dollar plan (endorsement or collateral assignment, as described above), then Code Sec. 264(f) may be triggered.

Guidance Provided by the Notice

CCH: What exactly does the Notice say?

Dr. Slavutin: The Notice states that, if the parties to a split-dollar life insurance arrangement modify the terms of the arrangement, but do not modify the terms of the life insurance contract underlying the arrangement, the modification will not be treated as a material change in the life insurance contract for purposes of the split-dollar rules under Code Secs. 101(j) and 264(f). This is so even if the modification is treated as a material modification of the split-dollar arrangement for purposes of Reg. §1.61-22(j). In other words, the arrangement will not lose its grandfathered status for purposes of Code Secs. 101(j) and 264(f). Because many of our clients have split-dollar arrangements that predate the effective dates of these provisions, the Notice is definitely relevant.

CCH: When the Notice discusses the modification of the terms of a split-dollar arrangement, specifically what type of modification is the IRS referring to?

Dr. Slavutin: Modification to *the terms of the split-dollar arrangement* could involve, for example, a change in the definition of what constitutes a termination of the split-dollar agreement or what would occur upon termination. It could also involve a change in the provision that determines how the premiums are shared between the employer and the employee. On the other hand, to preserve grandfathered status for purposes of Code Secs. 101(j) or 264(f), the Notice requires that *the terms of the underlying life insurance policy*, such as the death benefit, must remain the same.

What the Notice Did Not Say

CCH: Almost five years have elapsed since issuance of the final split-dollar regulations (TD 9092; September 11, 2003). Although the regulations include some relatively limited guidance on what are essentially "ministerial" acts that are *not* deemed material modifications (e.g., changing the address for a premium notice, changing the interest rate on a policy loan, or changing the mode of premium payment from semiannual to quarterly), Notice 2008-42 does not appear to give us any further insight on that point. Do you agree with that assessment?

Dr. Slavutin: Yes, it is somewhat curious that the IRS has provided guidance on the fairly narrow points raised by Code Secs. 101(j) and 264(f), but has not seen fit to address the much larger issue of material modification in the context of the split-dollar regulations generally. With the lack of more specific guidance on the subject, I believe most practitioners would agree that modification of a split-dollar policy would result in a material modification for purposes of the split-dollar regulations and, therefore, a loss of grandfathered status. This is important because, in recent years I can think of many instances that called for replacement of a life insurance product. There are certainly legitimate reasons for replacing one policy with another that is better priced, better performing, etc. But, if one makes this choice, be prepared to deal with the loss of grandfathered status under the split dollar regulations.

CCH: To sum up, from your viewpoint, what is the current status of split dollar?

Dr. Slavutin: As I have stated previously (see ESTATE PLANNING REVIEW, August 21, 2007, page 60), we are seeing a renewed interest in split dollar generally. The basic reason for split dollar in estate planning remains the same—to avoid or minimize any gift tax caused by large premiums. Unlike what we were used to years ago, current arrangements are not being structured as long-term financing vehicles for life insurance, but instead as short-to-intermediate term (five to 10 year) financing tools. These work particularly well when coupled with some other estate planning technique, such as a grantor retained annuity trust (GRAT), that will allow one to effectively escape the split-dollar arrangement before it becomes too costly.✦

LIFE SETTLEMENTS INDUSTRY

Update—Viatical Settlements Model Acts and the Life-Settlement Industry

In a follow up to an interview published in 2007 (see ESTATE PLANNING REVIEW*, September 20, 2007, page 65) we asked Larry Simon, CEO and president of Life Settlement Solutions, Inc. (www.lss-corp.com) to provide us with an update on the status of the Viatical Settlements Model Acts and the life-settlement industry generally. Life Settlement Solutions, Inc. is based in San Diego, California, and is one of the largest non-viatical life-settlement providers in the industry.*

The regulatory landscape of the life-settlement industry has continued to change over the past months, as more financial professionals and state legislation have placed increased attention on the issue of how to curtail stranger-originated life insurance (STOLI). STOLI is not to be confused with life settlements, which have grown into a multi-billion dollar industry with a heavy institutional presence and a multitude of regulations in place. STOLI transactions have been widely criticized by the life-settlement industry, the insurance industry and regulators nationwide.

The consistent growth associated with life settlements over the course of the past year generated increased industry awareness and expanded the need for more uniform industry regulations that effectively address the issues associated with stranger-originated life insurance. While attempts have been made to enact such legislation with the introduction of both the National Association of Insurance Commissioners' (NAIC) Viatical Settlements Model Act and the National Conference of Insurance Legislators' (NCOIL) Model Act, the industry still has not reached a consensus regarding the regulation of life settlement transactions. Understanding the current regulatory atmosphere remains important for financial professionals, as more states introduce legislation and amend existing law aimed at standardizing the industry. It is also important to keep in mind those working in the life-settlement marketplace generally continue to push for the introduction of regulatory guidelines based on the NCOIL Model Act.

Recap of The Viatical Settlements Model Act

In June 2007, the NAIC introduced new amendments to the Viatical Settlements Model Act, setting out to regulate STOLI practices by establishing new guidelines affecting premium-financed policies. STOLI, the initiation of a life-insurance policy setting out to benefit a person or entity who has no insurable interest in the insured at the time of policy issuance, violates insurable interest laws and has caused increased confusion for those working with life settlements.

While the goal of the NAIC Model Act was to help prevent STOLI, some of the amendments—specifically the introduction of a five-year ban on settling life-insurance policies in the secondary market—spurred industry alarm. Consequently, regulatory organizations such as the National Conference of Insurance Legislators (NCOIL), the Life Insurance Finance Association (LIFA) and the Life Insurance Settlement Association (LISA®) released statements outlining significant issues with the NAIC Model Act amendments. To help provide more appropriate guidelines, NCOIL introduced and adopted its own Model Act. This version, which is more widely accepted and applauded by settlement industry professionals, includes a new STOLI definition that helps distinguish a life-settlement transaction from a STOLI transaction.

As more states have begun to introduce legislation based on the NAIC Model Act, industry professionals and organizations have also continued to speak out against the amendments, while calling for the states to enact laws that take the NCOIL Model Act into consideration. This has caused industry-wide attention, as each newly introduced piece of legislation could potentially affect the future of the industry.

The Regulatory Atmosphere

A number of bills seeking to enact legislation to regulate the life-settlement industry have been introduced this year, and despite industry organizations such as LISA outwardly supporting the NCOIL Model Act, some states have already introduced and passed legislation based on the NAIC model. Many industry professionals agree the NAIC-based legislation has the potential to negatively affect the industry, hindering both those working within the secondary market and the seniors who could benefit from life settlements. While the NCOIL and NAIC Model Acts share common characteristics, it is the differences that have continued to foster concern throughout the life-settlement industry. Significant differences found in the NAIC Model Act that create barriers for the life-settlement industry include:

- Prohibition on entering into life-settlement contracts prior to the issuance of a policy within a five-year time period;
- Surety bonds for licensing in the amount of $250,000, with no capacity to continue to transact business with a pending license application;

- Significant penalties for committing a violation under the Act including monetary fines, license revocation, and potential imprisonment; and
- Expanded time periods allowing for rescission of a settlement contract.

The NCOIL Model Act, in contrast, has been widely applauded by industry professionals because it more effectively addresses STOLI. The main provisions on the NCOIL Model Act include:

- The use of more commonly recognized terms such as "life-settlement contract," "broker" and "life-insurance producer;"
- Clear definition of and differentiation between STOLI and life settlements;
- Prohibition against engaging in STOLI transactions, defining them as "fraudulent life settlement acts;" and
- Establishing a required exchange of critical information between life insurers and seniors.

Current Legislation

Legislation has already begun to go into effect in some states, while a significant number of bills are still pending in others. The following highlights legislation that has passed and is based on the NAIC Model:

- Iowa Senate File 2392—goes into effect July 1, 2008;
- West Virginia SB 704—goes into effect May 29, 2008;
- Nebraska LB853—goes into effect July 1, 2008;
- North Dakota S 2268—already effective;
- Ohio HB 404—in committee; and
- Oklahoma SB 1980—in committee.

There have also been a number of bills introduced based on the NCOIL Model, including:

- Indiana HB 1379—goes into effect July 1, 2008, giving carriers two years to contest STOLI;
- Kentucky HB 348—goes into effect July 15, 2008. LISA and other trade association groups have publicly applauded this bill, as it is believed to properly address the needs of consumer protection;
- Maine LD 2091—goes into effect July 1, 2008 and addresses STOLI; and
- Kansas HB 2110—goes into effect July 1, 2008.

Controversy continues to surround the pending California SB 1224, due to the fact some financial professionals believe the proposed legislation does not include a strict enough definition of STOLI. Representatives from the life-settlement industry are looking to strengthen proposed STOLI guidelines included in the California legislation.

Looking Toward the Future

As the life-settlement industry continues to grow and the regulatory landscape is further evolved and developed, financial professionals can expect to see a continued push for more uniform standards that properly take into consideration the life-settlement transaction process and ways to stop STOLI, as well as the needs of consumers and those working in the secondary market for life insurance. Those working with life settlements can expect the regulatory trend to also evolve as changes to existing state law and new legislation introductions occur.

Industry associations and professionals will continue to press for legislation based on the NCOIL Model Act. It is believed states including provisions based on this act will better protect seniors and others in the marketplaces from STOLI and fraud, while setting forth laws that properly take into consideration the needs and structure of the industry. Such legislation will also keep seniors better informed of their insurability while protecting consumer needs. Because the NCOIL Model Act is believed to be more targeted and effective, it has the basis to make STOLI practices illegal without hampering the life-settlement industry.

STOLI is not to be confused with life settlements, which have grown into a multi-billion dollar industry with a heavy institutional presence and a multitude of regulations in place.

Life Settlement Awareness Month

Financial professionals interested in learning more about life settlements, the NCOIL and NAIC Model Acts, and current legislation can visit the numerous industry-related Web sites, including LISA's Web site, which provides an entire section on STOLI and its impact on the industry. Those looking to increase knowledge of the secondary market are also invited to take part in the third annual Life Settlement Awareness Month™, kicking off June 1, 2008. This year's event includes fundamental and advanced strategies webinars, panel discussions featuring marketplace experts, an investor geared session, and access to a certified continuing-education course. Those who are interested in signing up or finding out more about Life Settlement Awareness Month events can visit *www.lifesettlementawarenessmonth.com*. ✦

Decline Due To Market Conditions

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companying the Revenue Act of 1935 (P.L. 74-407) (79 Cong. Rec. 14632 (1935)), to counter the effects of "the hardships which were experienced after 1929 when market values decreased very materially between the period from the date of death and the date of distribution to the beneficiaries. " When the predecessor section was recodified as Code Sec. 2032, Congress restated its position that the alternate valuation date election was enacted during the 1930s because, due to the substantial decline in property values, the payment of the estate tax could result in the total depletion of an estate's value.

Faced with whether an estate could value property on the alternate valuation date when a trustee's actions caused the decline in the value of the estate's property, the court in *A. Flanders,* DC Calif., 72-2 USTC ¶12,881, 347 FSupp 95, concluded that the election was available only when the reduction in value was due to market conditions and not a voluntary act. In *Flanders,* the decedent's trust held his undivided one-half interest in a cattle ranch. After the decedent's death and before the valuation date, the trustee entered into a land conservation agreement with the state of California. As a result of the conservation agreement, the fair market value of the cattle ranch was substantially reduced. On the decedent's federal estate tax return, the trustee valued the decedent's one-half interest in the cattle ranch on the alternate valuation date to take advantage of the reduction in value due to the conservation agreement. The estate's valuation was rejected because the reduction in value was solely attributable to the trustee's actions. The court explained that it was clearly Congress's intent that the character of the property was established on the date of death and that the election was available only when the reduction in value was caused by unfavorable market conditions.

On the other hand, the Tax Court held in *H. Kohler, et al.,* 92 TCM 48, CCH Dec. 56,573(M), TC Memo. 2006-152 (Nonacq.), that an estate's closely held stock was correctly valued on the alternate valuation date, including discounts for transfer restrictions and a purchase option. After the decedent's death, the company underwent a tax-free reorganization. The estate exchanged the decedent's stock for stock that was subject to the transfer restrictions. Concluding that the reorganization was not a disposition or sale for purposes of Code Sec. 2032(a)(1), the court held that the estate's election to use the alternate valuation date to value the closely held stock was appropriate. In Nonacquiescence Announcement, IRB 2008-9, March 3, 2008, the IRS announced that it would not follow the *Kohler* decision, explaining its rationale for not acquiescing in an accompanying Action on Decision (AOD-2008-01, March 3, 2008). (See *Brief Ideas, Nonacquiescence in H. Kohler, et al.*, ESTATE PLANNING REVIEW, March 20, 2008, page 24). Citing *A. Flanders,* the IRS argued that the value of a decedent's property is established on the date of death and the use of the alternate valuation date election is limited to circumstances where market conditions, not voluntary actions, have caused a decrease in the fair market value of the estate's property.

Market Conditions Rule

In response to the conflicting court opinions, the proposed amendments to Reg. §20.2032-1 reiterate the IRS's position taken in the *Kohler* nonacquiescence. A new subparagraph is added that would restrict the availability of the alternate valuation date election to those circumstances where market conditions caused the decline in the property's value. The term "market conditions" is defined as "events outside of the control of the decedent (or the decedent's executor or trustee) or other persons whose property is being valued that affect the fair market value of the property being valued" (Proposed Reg. §20.2032-1(f)(1)). Changes that are the result of a mere lapse of time or other post-death events not related to market conditions would not be relevant in determining the value of the decedent's gross estate under the alternate valuation date method.

Any interest in property affected by post-death events other than market conditions is included in a decedent's gross estate under the alternate valuation date method, except an adjustment would be made for any change in value that is due to market conditions (Proposed Reg. §20.2032-1(f)(3)). The amendments provide a non-exclusive list of events that would be considered "post-death events," which include a reorganization of an entity in which the estate holds an interest, a distribution of cash or other property to the estate from such entity, or one or more distributions by the estate of a fractional interest in such entity. Examples, including one with a fact scenario very similar to that presented in *Kohler,* are also provided that illustrate what is considered a post-death event. When adopted as final regulations, the proposed amendments would generally be applicable to estates of decedents dying on or after April 25, 2008. ✦