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ESTATE OF MARION LEVINE, DECEASED, ROBERT L. LARSON, PERSONAL REPRESENTATIVE,
Petitioners,

ELECTRONICALLY FILED

v.

Docket No. 13370-13

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITIONER'S SERIATIM OPENING BRIEF

CERTIFICATE OF SERVICE

SERVED Feb 15 2018

UNITED STATES TAX COURT

ESTATE OF MARION LEVINE, DECEASED, ROBERT L. LARSON, PERSONAL REPRESENTATIVE,	)	
Petitioner,	)	
v.	)	Docket No. 13370-13
COMMISSIONER OF INTERNAL REVENUE,	)	Judge Holmes
Respondent.	)	Filed Electronically

OPENING BRIEF FOR PETITIONER

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PRELIMINARY STATEMENT

This is an estate tax case. The main issue to be decided is whether I.R.C. §§ 2035, 2036, 2038, or 2703 require the inclusion of $6,500,000 (the premiums paid) or $6,153,478 (the cash surrender value), of the split-dollar life insurance Transaction in the gross estate, as of the alternate valuation date, as Respondent contends. It is Petitioner's contention that the value of Decedent's interest in the split-dollar life insurance Transaction to be included in the gross estate is $2,282,195, as of the alternate valuation date. Respondent's notice of deficiency also asserts a 40% gross valuation understatement penalty, pursuant to I.R.C. § 6662(h), in the amount of $833,548, or, alternatively, a 20% accuracy related penalty, pursuant to I.R.C. § 6662(a).

This case was tried before the Honorable Mark V. Holmes on November 13 and November 14, 2017 in Washington, D.C. The evidence submitted at trial consists of a First, Second, and Third Stipulation of Facts, with accompanying exhibits, and a First, Second, and Third Stipulation of Settled Issues. At trial, Petitioner called M. Shane Swanson, Robert L. Larson, Nancy S. Saliterman, and Robert M. Levine as its witnesses.

Respondent called Patti Grauman and Howard Rubin as his witnesses.

The Court directed the parties to file seriatim briefs. Petitioner’s Opening Brief is due February 14, 2018; Respondent’s Answering Brief is due March 16, 2018; and Petitioner’s Reply Brief is due April 2, 2018.

QUESTIONS PRESENTED

1. Whether the fair market value of Schedule G, Item 23 (the two split-dollar arrangements) on the alternate valuation date was $6,500,000 (the premiums paid), or $6,153,478 (the cash surrender value), as Respondent contends, or $2,282,195,[1] as Petitioner contends?

2. Whether Petitioner is subject to a gross estate tax valuation understatement penalty, pursuant to I.R.C. § 6662(h) or, alternatively, a substantial estate tax valuation understatement penalty, pursuant to I.R.C. § 6662(g)?

[1] Petitioner reported the value of the split-dollar arrangements, as of the alternate valuation date, at $2,137,130 on the Estate Tax Return. The parties have stipulated that the alternate valuation date value shall be $2,282,195, per the Second Stipulation of Settled Issues, filed September, 11, 2017, if Respondent's primary and alternative arguments are not sustained.

POINTS RELIED UPON

1. The split-dollar Transaction was carefully structured to follow the express requirements of Treasury Regulation § 1.61-22.

2. The Transaction at issue was intended to fall under the economic benefit regime of Treasury Regulation § 1.61-22(c)(1)(ii)(A)(2). Under facts substantially similar to the facts in this case, *Estate of Morrissette v. Commissioner*, 146 T.C. 171 (2016), the Court found the split-dollar arrangements at issue to fall under the economic benefit regime for gift tax purposes. *Estate of Morrissette* made no determination of the split-dollar transaction for estate tax purposes.

3. I.R.C. § 2036(a) does not apply because Decedent did not make a transfer of property from her gross estate. Moreover, Decedent did not retain the possession or enjoyment of, or the right to the income from, the Life Insurance Policies acquired in the Transaction. Decedent did not have the right, either alone or in conjunction with another person, to designate the persons who shall possess or enjoy the assets or income therefrom during her lifetime.

4. Decedent did not deplete her gross estate by engaging in the Transaction because she retained interests in the Split-

Dollar Receivables during her lifetime, which ensured that she would recoup the funds she invested along with a minimum guaranteed return. Moreover, Decedent retained sufficient assets apart from the Transaction to more than support her needs for the rest of her life.

5. I.R.C. § 2036(a)(2) does not apply. Mr. Larson's purported ability to cancel the Split-Dollar Agreements during Decedent's lifetime does not require inclusion of the premiums paid or the cash surrender value in the gross estate. The Tax Court's holding in *Estate of Powell v. Commissioner*, 148 T.C. ___ (May 18, 2017) is inapplicable under the facts of this case because the fiduciary obligation Mr. Larson owed to Decedent was consistent and aligned with the fiduciary obligation he owed to the Beneficiaries of the Insurance Trust.

6. For the same reasons that I.R.C. § 2036 does not apply, I.R.C. §§ 2035 and 2038 do not apply.

7. The property to be valued for estate tax purposes is the Split-Dollar Receivables, not the cash surrender value of the Life Insurance Policies, because the Split-Dollar Receivables are the only property interest Decedent held at her death. Thus, under I.R.C. § 2703 and the holdings of *Estate of Strangi v. Commissioner*, 115 T.C. 478 (2000) and *Church v.*

United States, 85 AFTR 2d 2000-804, the asset to be included in the gross estate is the Split-Dollar Receivables.

8. The Transaction meets the bona fide sale for adequate and full consideration exceptions to I.R.C. §§ 2036, 2038 and 2703 and the holding of *Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005) because there were legitimate and significant nontax reasons for entering into the Transaction and the value of the Split-Dollar Receivables Decedent retained (the greater of the premiums paid or the cash surrender value), was proportionate to the value Decedent loaned the Insurance Trust.

9. There were several nontax reasons for the Transaction: (1) a long-term investment that provided Decedent a guaranteed growth on her investment; (2) a diversification of Decedent's asset portfolio, including the ability to pull equity out of Penn Lake Shopping Center; (3) life insurance protection for Decedent's children so their heirs would be able to pay their eventual estate tax without the need to sell the family's real estate assets.

10. While estate tax savings was one of the purposes of the Transaction, the Transaction was an income tax deferral provided for under the Code and regulations. In other words, while estate taxes were saved upon death, a commensurate amount

of additional income tax will be due upon the deaths of the Insureds when Petitioner receives the greater of the premiums paid or the cash surrender value.

11. Respondent has not met his burden of production for asserting the gross valuation understatement penalty, pursuant to I.R.C. § 6662(g), or the gross valuation misstatement related penalty, pursuant to I.R.C. § 6662(h), because he has not established his compliance with I.R.C. § 6651(b)(1), specifically that the revenue agent in this case made an initial determination of the penalty in this case and which was approved by his immediate supervisor.

12. Neither I.R.C. § 6662(g) nor I.R.C. § 6662(h) apply because the difference in value between the Split-Dollar Receivables reported on the Estate Tax Return and Respondent's argument that the premiums paid, $6,500,000, or the cash surrender value, $6,153,478, should be includible in the gross estate is not a valuation issue but based purely on Respondent's legal arguments.

13. The attorneys-in-fact provided all information regarding the Transaction to Mr. Swanson for purposes of implementing an estate plan for Decedent and for reporting the gift and estate tax consequences of the Transaction. Mr. Rubin

and Mr. Swanson recommended the Transaction. Both were experienced estate planners. Petitioner relied upon their advice.

14. Petitioner has reasonable cause defenses to any accuracy related penalties which may apply because it relied upon the advice of Mr. Swanson regarding the Transaction and the reporting of it for estate tax purposes. Petitioner acted in good faith in attempting to determine the correct tax consequences of the Transaction and reasonably relied upon Mr. Swanson's advice, and Mr. Siebrasse's value, for estate tax purposes.

15. Even if the Court determines that the gross valuation understatement or gross valuation misstatement penalty apply, Petitioner reasonably believed the estate tax reporting of the Transaction was accurate and there was substantial authority for the reporting positions taken on the Estate Tax Return.

REQUESTED FINDINGS OF FACT

The Petitioner is the Estate of Marion Levine, Deceased, Robert Larson, Personal Representative (hereinafter "Petitioner" or the "Estate").[2] At the time the Petition was filed, Petitioner had a mailing address at 5005 Old Cedar Lake Road, St. Louis Park, Minnesota, 55416.[3] An appeal of this case would lie in the United States Court of Appeals for the Eighth Circuit.[4]

Background

Marion Levine

Marion Levine ("Decedent") was born in 1920 in St. Paul, Minnesota.[5] Decedent grew up in St. Paul, Minnesota and she was one of nine children.[6] She graduated from St. Paul Central High School and she had some business school training after high school but she did not receive a college degree.[7] Decedent was an astute business woman and her children describe her as a

[2] Petition, filed June 12, 2013; Per the Court's Order dated December 13, 2017, the caption in this case was changed to "Estate of Marion Levine, Deceased, Robert L. Larson, Personal Representative, Petitioner, v. Commissioner of Internal Revenue, Respondent."
[3] Stip. ¶ 1.
[4] Stip. ¶ 2.
[5] Exs. 2-J & 4-J.
[6] Tr. 237: 9; Tr. 238: 4-5.
[7] Tr. 238: 19-23; Tr. 299: 8-9.

woman ahead of her time and a woman who broke the glass ceiling.[8] Decedent was married three times during her lifetime to George Levine ("George"), Henry Orenstein ("Mr. Orenstein") and Harold Frishberg ("Mr. Frishberg").[9] Decedent had two children with George: Nancy Sue Saliterman ("Ms. Saliterman"), age 72, and Robert Michael Levine ("Mr. Levine"), age 66.[10] George pre-deceased Decedent in 1974.[11] Decedent married Mr. Orenstein sometime between 1980 and 1990 and she was only married to him for a year before they divorced.[12]

Decedent married Mr. Frishberg in approximately 1990 and they remained married until his death in 2005.[13] Mr. Frishberg and Decedent had a prenuptial agreement and their marriage was one of convenience and companionship, not a financial arrangement.[14] In the late years of their marriage, Mr. Frishberg was verbally abusive to Decedent and she was afraid of him, which caused Decedent to withdraw and cower in his

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[8] Tr. 237: 13; Tr. 299: 6-8.
[9] Tr. 239: 4-5; Tr. 302: 8-9; Tr. 302: 15-16.
[10] Ex. 6-J, Bates pg. 297; Tr. 236: 12-13; Tr. 236: 15; Tr. 294: 11.
[11] Tr. 239: 8-10; Tr. 299: 13.
[12] Tr. 239: 10-15; Tr. 302: 8-9; Tr. 302: 11.
[13] Tr. 239: 4-5; Tr. 239: 22-24; Tr. 302: 15-16; Tr. 302: 19.
[14] Tr. 304: 3-7.

presence.[15] Ms. Saliterman and Mr. Levine did not like Mr. Frishberg or the way he treated Decedent.[16]

George and Decedent started a successful grocery store chain, Penny's Supermarkets ("Penny's"), in 1950 and she continued to operate Penny's after his death in 1974.[17] Decedent performed many duties for Penny's during the thirty-one years she owned the business, ranging from employee payroll, paying the company bills, human resources, running the main office and managing Penny's profit sharing plan.[18] Penny's was a successful chain and it was comprised of twenty-seven stores by the time it was sold.[19] Decedent sold Penny's in 1981 and her share of the sales proceeds was approximately $5,000,000.[20]

From 1981 until her death in 2009, Decedent increased her wealth from $5,000,000 to approximately $25,000,000 through a series of profitable business ventures and real estate investments.[21] Decedent's role in her real estate investments was predominantly that of a lender and Robert Larson ("Mr. Larson"), Ms. Saliterman's husband, Larry Saliterman ("Mr.

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[15] Tr. 240: 5-7; Tr. 241: 1; Tr. 24: 6-7; Tr. 305: 10-15; Tr. 354: 8-20.
[16] Tr. 240: 5-13; Tr. 354: 8-20.
[17] Tr. 299: 10-14.
[18] Tr. 241: 25 through Tr. 242: 5; Tr. 243: 4-7; Tr. 299: 17-24.
[19] Tr. 299: 10-12; Tr. 299: 22.
[20] Tr. 300: 6.
[21] Tr. 300: 5-10; Tr. 206: 6.

Saliterman") and Mr. Levine, managed the day-to-day businesses.[22] Decedent, Mr. Larson, Mr. Saliterman and Mr. Levine's real estate ventures were managed through companies called 5005 Properties and 5005 Finance.[23] Decedent's investments ranged from manufactured home communities (mobile home parks) to real estate partnerships, loans to real estate partnerships, her personal stock portfolio and interests in two renaissance fairs: Carolina Renaissance and Arizona Renaissance.[24] One of Decedent's assets was Penn Lake Shopping Center ("Penn Lake"), a shopping center she acquired with George in 1959.[25] By 2007, Penn Lake was owned outright by Decedent and it was generating approximately $200,000 per year in income.[26]

While Decedent was 61 years old when Penny's was sold in 1981, she remained very active in her real estate investments and she was responsible for increasing her wealth substantially.[27] Decedent met with Mr. Larson often to review the financial statements of her real estate investments and she

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[22] Tr. 300: 10 through 1; Tr. 301: 5-6.
[23] Tr. 179: 18-23; Tr. 180: 13-14.
[24] Tr. 38: 2-11; Tr. 39: 6-9; Tr. 39: 11-20; Tr. 182: Tr. 244: 4-7; Tr. 245: 1-4; Tr. 248: 1-6: Exs. 63-J & 64-J.
[25] Tr. 313: 24 through Tr. 314: 1.
[26] Tr. 314: 24 through Tr. 314: 3.
[27] Tr. 300: 5 through Tr. 301: 1.

came to the 5005 Properties office regularly to review profit statements and attend meetings until just before her death.[28]

In 2003, Decedent suffered a mini-stroke while staying at her Palm Springs home during the winter.[29] In 2003, Decedent was 83 years old and otherwise healthy, notwithstanding the mini-stroke.[30] After the mini-stroke in 2003, Mr. Larson, Ms. Saliterman and Mr. Levine noticed Decedent exhibit signs of temporary memory loss but Decedent remained very active in her business ventures until about six months before her death.[31] Decedent was never diagnosed with dementia or Alzheimer's during her lifetime.[32]

Decedent lost her driver's license in approximately 2004 after her family noticed that she and Mr. Frishberg appeared unsafe behind the wheel and the family recommended both have their driving skills tested.[33] While Mr. Frishberg passed the driving test and kept his license, Decedent's license was taken away and Decedent was angry about losing her driver's license.[34] After Mr. Frishberg died in 2005, Sandra Nelson ("Ms. Nelson"),

[28] Tr. 182: 19-23; Tr. 184: 2-5.
[29] Tr. 187: 19; Tr. 187: 21; Tr. 305: 20-24.
[30] Tr. 187: 22-24; Tr. 305: 20-24.
[31] Tr. 187: 19; Tr. 187: 21; Tr. 305: 20-24.
[32] Tr. 188: 1; Tr. 188: 12; Tr. 257: 7; Tr. 257: 9-12; Tr. 306: 17; Tr. 306: 21-25.
[33] Tr. 189: 6-9; Tr. 257: 1 through Tr. 258: 5.
[34] Tr. 189: 12; Tr. 258: 5-6. Tr. 258: 12; Tr. 306: 2-7.

Decedent's then-housekeeper, became a regular companion for Decedent, drove Decedent to appointments and spent time with her.[35] Ms. Nelson is not a trained nurse and Decedent did not require nursing care until the immediate months preceding her death.[36]

In the two years preceding her death, Decedent came into the 5005 Properties' offices approximately twice a week.[37] By late 2008 and when Decedent's health began to deteriorate, she stopped coming to the 5005 Properties' offices and Mr. Larson discussed her financial investments with her at her home.[38] It wasn't until the two to three months preceding Decedent's death that it became apparent to the attorneys-in-fact, and, ultimately, to Mr. Swanson, that Decedent was about to die.[39] In January, 2009, Decedent's health deteriorated rapidly, and it was clear to everyone that her death was imminent.[40] Decedent died on January 22, 2009 at the age of 88 of natural causes,

[35] Tr. 189: 16-18; Tr. 189: 22; Tr. 257: 1 through Tr. 258: 6; Tr. 259: 6-8; Tr. 260: 3-6; Tr. 306: 2-7.

[36] Tr. 260: 8; Tr. 260: 11-14.

[37] Tr. 191: 21; Tr. 191: 24-25.

[38] Tr. 189: 25 through Tr. 190: 7.

[39] Tr. 67: 16-21; Tr. 190: 10-17; Tr. 190: 20; Tr. 190: 22-23; Tr. 190: 25 through Tr. 191: 1; Tr. 261: 7-10; Tr. 306: 23-34; Tr. 307: 4-5.

[40] Tr. 67: 16-21; Tr. 190: 10-17; Tr. 190: 20; Tr. 190: 22-23; Tr. 190: 25 through Tr. 191: 1; Tr. 261: 7-10; Tr. 306: 23-34; Tr. 307: 4-5.

with underlying causes from hypertension, cerebrovascular disease and Alzheimer's.[41]

Robert Larson

Mr. Larson is the Personal Representative of Decedent's estate and was one of her attorneys-in-fact.[42] Mr. Larson attended the University of Minnesota from 1964 to 1965.[43] In 1966, he attended the Academy of Accountancy in Minnesota and received a degree in accounting.[44] He worked for G.B. Frederick in 1967 and then Continental Oil Conoco in 1968.[45]

Mr. Larson was hired by Decedent to work for Penny's in 1969.[46] Mr. Larson preformed tax, audit, financial and banking duties for Penny's as the company's controller.[47] After George died in 1974, Decedent began to rely more on Mr. Larson to manage Penny's and Mr. Larson's duties expanded to cover executive management, profit sharing trust oversight and help with all the stores' inventory.[48] Mr. Larson remained the company's controller until 1981 when Penny's was sold.[49]

[41] Stip. ¶s 3, 4 & 5, Ex. 4-J.
[42] Stip. ¶ 10.
[43] Tr. 172: 10-11.
[44] Tr. 172: 11-13.
[45] Tr. 173: 9-13.
[46] Tr. 173: 15-17; Tr. 174: 11-12.
[47] Tr. 174: 18-25.
[48] Tr. 175: 5-12.
[49] Tr. 175: 15-16.

In 1979, Mr. Larson introduced Decedent to her first manufactured home community investment, Dayton Park.[50] Other friends and family of Decedent's were also investors in Dayton Park, including Mr. Saliterman and Mr. Larson.[51] Currently, Mr. Larson is the President of 5005 Properties and 5005 Finance, which are the companies that oversee the tax, accounting, financial statements and management of the Levine family's real estate and financial assets.[52] Mr. Larson's duties for 5005 Properties and 5005 Finance require him to perform tax and accounting oversight and he signs most of the companies' tax returns.[53] Mr. Larson is not a certified public accountant and does not prepare tax returns.[54]

Mr. Larson remained very close to Decedent and worked with her professionally from 1969 until her death in 2009.[55] Ms. Saliterman and Mr. Levine have not always gotten along and Decedent trusted Mr. Larson to mediate in the event that the siblings could not agree.[56] Mr. Levine and Mr. Larson are

[50] Tr. 176: 1-5.
[51] Tr. 176: 24 through Tr. 177: 1.
[52] Tr. 179: 18-23; Tr. 182: 12.
[53] Tr. 182: 12-15.
[54] Tr. 172: 15; Tr. 182: 12-15.
[55] Tr. 251: 16-17; Tr. 303: 1-4.
[56] Tr. 185: 23-24; Tr. 251: 17-20; Tr. 303: 1-4.

current business partners and have worked with each other for over fifty years.[57]

Nancy Sue Saliterman

Ms. Saliterman is Decedent's daughter.[58] She was born in 1945.[59] Ms. Saliterman graduated from the University of Minnesota in 1967 with a major in English literature, humanities and art history.[60] Ms. Saliterman does not have an accounting or tax background.[61] Ms. Saliterman has worked in retail and for the family's business, Penny's, but her professional background is limited.[62] She was married to Larry Saliterman during the years at issue but they are now divorced.[63] Mr. Saliterman is a current business partner with Mr. Levine and Mr. Larson.[64]

Robert Michael Levine

Mr. Levine is Decedent's son.[65] He was born in 1951.[66] Mr. Levine joined the Minnesota National Guard after high school and in 1971 he attended the University of Pennsylvania, Wharton School of Business, where he graduated in 1974 with a Bachelor

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57 Tr. 303: 9-10.
58 Ex. 8-J; Tr. 157: 10-11.
59 Exs. 17-J & 18-J.
60 Tr. 235: 3-5; Tr. 235: 8-9.
61 Tr. 269: 1-2.
62 Tr. 235: 14-17; Tr. 235: 19.
63 Tr. 236: 1; Tr. 236: 3; Tr. 236: 6.
64 Tr. 180: 13-14.
65 Ex. 8-J; Tr. 157: 10-11.
66 Tr. 236: 12.

of Science degree in economics, majoring in accounting and finance.[67] In 1974, Mr. Levine attended the University of Colorado Law School, graduating in 1977 with a Juris Doctorate degree.[68] Mr. Levine is admitted to practice in Minnesota, however, he has not practiced as a lawyer since approximately 1985.[69] After graduating from the University of Colorado Law School in 1977, Mr. Levine joined the law firm Robins, Davis and Lyons in Minneapolis.[70] Mr. Levine practiced at Robins, Davis and Lyons (now Robins Kaplan, LLP), for two years, after which time he went to work for Penny's until 1981, when the company was sold. After the sale of Penny's, Mr. Levine started his own law firm, Stern, Levine, and Schwartz, where he practiced until approximately 1985.[71] Since 1985, Mr. Levine has owned and managed the Levine family's real estate investments.[72]

Mr. Levine's first real estate investment began in 1974, when he inherited Times Square Shopping Center, upon the death of his father, George.[73] Mr. Levine first started managing mobile home parks in 1979, and currently he owns interests in

[67] Tr. 294: 15-18.
[68] Tr. 294: 23-25.
[69] Tr. 295: 5; Tr. 295: 8-18.
[70] Tr. 295: 8-13.
[71] Tr. 295: 14-18.
[72] Tr. 295: 22 through Tr. 296: 4; Tr. 296: 7-10.
[73] Tr. 296: 7-10.

mobile home parks nationally.[74] Mr. Levine currently works for 5005 Properties, the property management company that oversees the management of the Levine family's various real estate interests, including the mobile home parks, shopping centers, and renaissance fairs.[75]

Shane Swanson

Mr. Swanson was the estate planning attorney for Decedent from 2007 until her death in January, 2009.[76] He is also the estate planning attorney for Ms. Saliterman, Mr. Levine and Mr. Larson.[77]

Mr. Swanson has two baccalaureate degrees from Texas Lutheran University in Spanish and Psychology and a Juris Doctorate degree from the University of Minnesota Law School.[78] Mr. Swanson took tax courses from the Carlson School of Management Masters of Business Tax Program.[79] Upon graduating from law school in 1998, Mr. Swanson began as a family law attorney but became a trusts and estates attorney, beginning in June, 2000.[80] Mr. Swanson started at the Parsinen law firm in

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74 Tr. 296: 13; Tr. 296: 21 through Tr. 297: 1.
75 Tr. 295: 21 through Tr. 296: 4.
76 Stip. ¶ 15-16.
77 Tr. 32: 9-12; Tr. 266: 8.
78 Tr. 22: 17-20.
79 Tr. 22: 22-24; Tr. 44: 24 to 45:8.
80 Tr. 23: 2-10.

June, 2000, and remained there until January, 2009, when he joined Leonard Street and Deinard, (which is now named Stinson Leonard Street ("Stinson Leonard")).[81]

Mr. Swanson has substantial expertise as an estate and gift tax planning attorney and is highly recognized as a practitioner in his field.[82] He specializes in charitable and estate planning, generation skipping tax, wills and trusts, and estate administration.[83] Mr. Swanson has been practicing for almost 20 years and is admitted to practice in Minnesota, California and Texas.[84] In 2017, Mr. Swanson served as a member of the Professional Advisors Committee of the Minneapolis Foundation.[85] Mr. Swanson is a member of the Real Property Probate and Trust Law Section of the ABA, the Hennepin County Bar Association and the Minnesota State Bar Association.[86] Mr. Swanson has served as a Section Counsel member and the Legislative subcommittee of the Probate and Trust Law Section of the Minnesota State Bar Association.[87] Mr. Swanson is Vice Chair of the operating company and endowment boards for Planned Parenthood of

[81] Tr. 23: 2-10.
[82] Tr. 22: 9-14; Tr. 23: 2-10.
[83] Tr. 23: 16-18.
[84] Tr. 23: 12-14; Tr. 23: 2.
[85] Tr. 24: 2-4.
[86] Tr. 24: 4-7.
[87] Tr. 24: 8-11.

Minnesota, South Dakota and North Dakota.[88] He is on the board of Everwood Farmstead Foundation.[89] Currently, Mr. Swanson serves as Co-Chair of the Diversity Committee and is a member of the Nominating Committee for the Board of Directors of Stinson Leonard.[90] Additionally, Mr. Swanson has been professionally recognized by Super Lawyers and Best Lawyers.[91]

Decedent's Estate Planning

On May 13, 1988, Decedent created the Marion Levine Trust (the "Revocable Trust") and designated herself as trustee and Mr. Larson, Mr. Levine and Ms. Saliterman as her successor trustees.[92] Decedent's descendants, which included her children and grandchildren, were designated as beneficiaries of the Revocable Trust.[93] The Revocable Trust remained unchanged until May 17, 1996 when Decedent created the First Amendment to and Complete Restatement of Trust Agreement of Marion Levine ("First Amendment to Revocable Trust") and designated Mr. Larson and her children, Ms. Saliterman and Mr. Levine, to serve as co-trustees with her.[94] Also on May 17, 1996, Decedent created a Statutory

[88] Tr. 24: 14-19.
[89] Tr. 24: 19-20.
[90] Tr. 25: 6-10.
[91] Tr. 25: 1-3.
[92] Stip. ¶s 7 & 8, Ex. 6-J.
[93] Stip. ¶ 9, Ex. 6-J.
[94] Ex. 6-J.

Short Form Power of Attorney, Minnesota Statutes, Section 523.23 ("Power of Attorney"), designating Mr. Larson, Ms. Saliterman and Mr. Levine as her attorneys-in-fact, which allowed the attorneys-in-fact to engage in, among other things, real estate, financial, business and estate planning and litigation transactions on Decedent's behalf.[95] Mr. Larson was chosen to be one of Decedent's attorneys-in-fact as a trusted neutral party in the event that Mr. Levine and Ms. Saliterman did not agree and so that Mr. Larson would protect Ms. Saliterman's interests in the family business.[96] Mr. Frishberg, Decedent's then-husband, was intentionally not chosen as one of her attorneys-in-fact.[97] Notwithstanding the Power of Attorney, Decedent continued to manage her legal affairs until approximately six months before her death.[98]

Decedent executed second and third amendments to the Revocable Trust on August 30, 1999 and October 3, 2001, which were not material for purposes of the issues in this case.[99] On February 7, 2005, Decedent resigned as trustee of the Revocable

[95] Stip. ¶ 12; Joint Exhibit 9-J.
[96] Tr. 185: 23-24; Tr. 251: 16-20; Tr. 303: 1-4.
[97] Ex. 9-J; Tr. 303: 14-25.
[98] Tr. 187: 8; Tr. 304: 22.
[99] Exs. 7-J and 8-J.

Trust and named Mr. Larson, Ms. Saliterman and Mr. Levine as successor co-trustees.[100]

Bill Brody ("Mr. Brody") of the law firm Fredrickson & Byron, P.A., had been Decedent's estate planning lawyer for many years and he prepared Decedent's estate planning documents from 1996 until 2007.[101] However, by 2007, Decedent and her attorneys-in-fact grew dissatisfied with Mr. Brody's services, his excessive fees and his lack of responsiveness to telephone calls.[102] Thus, on November 19, 2007, the attorneys-in-fact retained the law firm Parsinen Kaplan Rosberg & Gotlieb, P.A. ("Parsinen") for purposes of implementing a comprehensive estate plan for Decedent.[103] Mr. Swanson, then an estate planning partner of Parsinen, was referred to the Levine family through Ms. Saliterman and Mr. Levine's aunt, Mitzi Diamond, who highly recommended his expertise and services.[104] Initially, Parsinen evaluated the estate planning strategies proposed by Mr. Brody.[105] Parsinen was retained to implement those strategies

[100] Stip. ¶ 13, Ex. 11-J.
[101] Exs. 6-J, 7-J, 8-J, 9-J & 10-J; Tr. 307: 24 through Tr. 308: 1; Tr. 309: 3-4.
[102] Tr. 261: 19-20; Tr. 261: 23-25; Tr. 273: 21 through Tr. 274: 1; Tr. 308: 1: 4.
[103] Ex. 78-J.
[104] Tr. 308: 4-6; Tr. 261: 21-23.
[105] Ex. 78-J; Tr. 28: 3-5; Tr. 28: 13-15.

and to consider others for a flat fee of $120,000.[106] Parsinen initially considered: (1) qualified personal residence trusts ("QPRTs") for Decedent's California and Minnesota homes; (2) a grantor retained annuity trust ("GRAT") for Decedent's interest in Dayton Park mobile home park; (3) gifts of Decedent's interests in Levine Investments, Levine Properties, Penn Lake and the Penny Building; and (4) intentionally defective grantor income trusts ("DIGITs") or loan transactions of Decedent's interests in various partnerships.[107] Howard Rubin ("Mr. Rubin"), a senior estate planning partner of Parsinen, negotiated the financial arrangement with the Levine family and he signed the engagement letter on behalf of the firm.[108] However, Mr. Swanson was the primary point of contact with Decedent's attorneys-in-fact and he conducted all the estate planning work for Decedent.[109]

The split-dollar life insurance transaction at issue in this case was not contemplated when Parsinen was first retained.[110] Mr. Swanson understood Decedent to be physically quite strong in 2007 and it was unknown how long she would

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[106] Ex. 78-J; Tr. 28: 6-10; Tr. 30: 9-14.
[107] Tr. 28: 13-16; Tr. 28: 21-23; Ex. 78-J.
[108] Ex. 78-J; Tr. 30: 19-24.
[109] Tr. 31: 22; Tr. 31: 24 to Tr. 32: 1; Tr. 383: 21-23; Tr. 385: 10-13; Tr. 381: 4-7.
[110] Ex. 78-J; Tr. 31: 3-4; Tr. 31: 6-13.

live.[111] While Decedent had issues with dementia and memory, Mr. Swanson understood that she was physically healthy at 87 years old.[112] The statutory estate planning techniques recommended by Parsinen, such as GRATs and QPRTs, would not have been undertaken in 2007 if the parties contemplated she would not live for at least two years following the implementation of the GRATs and QPRTs.[113] Both GRATs and QPRTs require the grantor to live beyond the selected term of the GRAT or QPRT (two years was selected for one of the QPRTs and three year was selected for the other QPRT), in order for those assets to be excluded from the gross estate.[114]

The majority of Decedent's assets in 2007 were real estate assets or loans to real estate partnerships.[115] In 2007, Decedent owned two homes outright: her home in Minneapolis and her Rancho Mirage home.[116] Decedent also held several interests in real estate partnerships, as well as interests in manufactured home communities and a brokerage account at Stifel

[111] Tr. 29: 10-12; Tr. 164: 5-6; Tr. 164: 19-21.
[112] Tr. 29: 25 through Tr. 30: 6; Ex. 4-J.
[113] Tr. 30: 4-6; Tr. 33: 9-12; Tr. 33: 25 to Tr. 34: 23; Tr. 35: 1-24.
[114] Tr. 33: 25 through Tr. 34: 21; Tr. 35: 1-24; Tr. Tr. 36: 6-10.
[115] Tr. 38: 6-8.
[116] Tr. 38: 2-3.

Nicolaus.[117] Decedent also held loans to several of her real estate partnerships and she also provided loans to the people who were purchasing homes in the manufactured home communities.[118] Additionally, Decedent's real estate portfolio included interests in two renaissance fairs: Arizona Renaissance and Carolina Renaissance.[119] Finally, Decedent owned an income producing shopping center, Penn Lake, outright.[120]

Decedent's net worth in 2007 and 2008 was $26,766,000 and $25,400,000, respectively.[121] Decedent's gross income was in excess of $1,000,000 in the four to five years preceding her death.[122] Decedent's gross income for 2007, 2008 and 2009 was $1,523,412, $1,067,616, and $102,343,[123] respectively.[124] Decedent had no personal debt in 2007 or 2008.[125]

Mr. Swanson understood from the attorneys-in-fact that Decedent was not interested in estate planning that involved her core capital, the money Decedent needed to sustain her current

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117 Tr. 38: 5-11.
118 Tr. 38: 7-10; Tr. 39: 11-20.
119 Tr. 39: 6-9.
120 Tr. 195: 24 through Tr. 196: 4; Tr. 196: 8-9.
121 Stip. ¶ 100; Tr. 37: 19-22; Tr. 313: 21; Tr. 206: 6; Exs. 57-J, 58-J, 63-J & 64-J.
122 Tr. 205: 11-13; Tr. 316: 12-13.
123 Decedent died on January 22, 2009, so her 2009 personal income tax return only contained 22 days of income.
124 Exs. 57-J, 58-J and 59-J. Tr. 38: 17-18; Tr. 316: 5-6.
125 Tr. 38: 21; Tr. 206: 18; Exs. 63-J & 64-J.

lifestyle for the rest of her life.[126] The family was interested in planning with Decedent's excess capital—assets she would not otherwise need during her lifetime, which the family intended to invest long-term while also minimizing estate taxes.[127] Ms. Saliterman and Mr. Levine had not done any estate planning of their own when Mr. Swanson was retained in 2007.[128] Because Decedent, Ms. Saliterman and Mr. Levine's assets were predominantly held in real estate, the goal was to keep those assets in each's estate to receive a stepped-up basis upon death.[129] Thus, life insurance would help pay the eventual estate taxes on the family's illiquid real estate assets upon death.[130] Accordingly, Mr. Swanson and Mr. Rubin suggested a split-dollar life insurance transaction because it provided Decedent with a market rate of return on her excess capital while at the same time providing tax-efficient estate planning for Decedent, Ms. Saliterman and Mr. Levine.[131]

After Mr. Swanson and Mr. Rubin had time to evaluate Decedent's estate planning goals and understand Ms. Saliterman and Mr. Levine's respective net worth, the two estate planners

[126] Tr. 29: 12-17.
[127] Tr. 29: 18-22.
[128] Tr. 43: 9-12.
[129] Tr. 42: 17-22.
[130] Tr. 42: 23 through Tr. 43: 6.
[131] Tr. 43: 6-12.

outlined the split-dollar life insurance transaction in detail to the family in a meeting sometime in late 2007 or early 2008.[132] Mr. Rubin and Mr. Swanson believed that the facts in this case were ideal for an intergenerational split-dollar life insurance estate planning technique.[133] For the split-dollar transaction to work, the estate planners opined that four factors were necessary: (1) Decedent had to have sufficient cash to buy the life insurance while also retaining sufficient assets to live on for the rest of her life; (2) Decedent had to have a large enough estate to need to reduce her estate tax; (3) Decedent's children, whose lives the life insurance was purchased on, had to have sufficient net worth of their own so that they would qualify for a high level of life insurance; and (4) the insureds had to be healthy so that they would pass the underwriting process.[134]

Mr. Swanson and Mr. Rubin met with the attorneys-in-fact at their office sometime in late 2007 or early 2008 to explain the intergenerational split-dollar insurance technique.[135] At the meeting, Mr. Swanson delivered a PowerPoint presentation he had prepared for the Levine family which explained how the split-

[132] Tr. 31: 6-13; Tr. 311: 1-4; Tr. 375: 23-25.
[133] Tr. 43: 2-12; Tr. 377: 11-13.
[134] Tr. 43: 24 through 44: 10; Tr. 384: 5-20.
[135] Tr. 193:9-12; Tr. 193: 24; Tr. 262: 20-24; Tr. 311: 1-4.

dollar arrangement would work for transfer tax purposes.[136] Mr. Rubin and Mr. Swanson gave copies of their PowerPoint slides to the attorneys-in-fact at that meeting.[137]

There were many purposes for the intergenerational split-dollar transaction. From Mr. Swanson's perspective, the transaction served many purposes. First, the split-dollar loan provided Decedent with a market rate of return on her excess capital.[138] Second, the split-dollar life insurance transaction was a way to plan for Decedent's legacy.[139] Decedent and her children had amassed significant real estate assets and the life insurance would allow the family to keep the real estate assets, because assets would not need to be sold to pay eventual estate taxes.[140] Third, the split-dollar life insurance transaction not only provided a guaranteed rate of return for Decedent, but it also provided an additional economic benefit upon the deaths of the insureds with the death benefit.[141] Fourth, the split-dollar transaction enabled Decedent to diversify her assets.[142] Finally, while the split-dollar life insurance loans had the

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[136] Tr. 48: 11-14; Tr. 48: 19-21; Tr. 263: 15-16, Tr. 311: 1-4; Ex, 14-J.
[137] Tr. 48: 11-14; Tr. 48: 16-17; Tr. 263: 15-16.
[138] Tr. 43: 6-9; Tr. 44: 24 through 45: 1.
[139] Tr. 43: 9-12; Tr. 45: 1-3.
[140] Tr. 45: 3-8.
[141] Tr. 43: 6-12; Tr. 44: 24-25; Tr. 45:8-13.
[142] Tr. 50: 15-24.

effect of reducing Decedent's estate tax, the Decedent's basis in the loans was also correspondingly reduced.[143] As a result, the split-dollar loans created a significant future income tax obligation that would be paid upon the deaths of the insureds.[144]

From the perspective of the attorneys-in-fact, the split-dollar life insurance transaction served many purposes. Decedent was carrying significant loans to real estate partnerships in 2007 and she owned several real estate assets.[145] Penn Lake, which had been in the family since 1959, was generating approximately $200,000 in income per year and there was zero debt on the property.[146] Thus, the split-dollar life insurance was a way to monetize Decedent's equity in Penn Lake and invest it in an asset that provided guaranteed growth for Decedent, while also providing tax-efficient estate planning for Decedent and her children.[147] The Split-Dollar Receivable provided diversification of Decedent's real estate asset portfolio with a guaranteed growth on her investment on an income tax deferred basis.[148] Finally, the split-dollar life

[143] Tr. 46: 1-3.
[144] Tr. 46: 1-8.
[145] Tr. 42: 8-14; Tr. 265: 12-20.
[146] Tr. 343: 21-24.
[147] Tr. 265: 12-20; Tr. 318: 21-25; Tr. 343: 21-24; Tr. 351: 8-15.
[148] Tr. 265: 12-20; Tr. 311: 11 through Tr. 313: 3; Tr. 318: 21-

insurance transaction not only provided estate planning for Decedent, it also provided life insurance protection for her children for their own estate planning.[149]

In January, 2008, Mr. Swanson sent a detailed letter to the attorneys-in-fact regarding the legal and tax effects of the split-dollar life insurance transaction.[150] Mr. Swanson's letter, dated January 7, 2008, was sent in response to a December 1, 2007 email sent by Mark Saliterman, Ms. Saliterman's brother-in-law and accountant.[151] The January 7, 2008 letter outlined the proposed transaction, assuming a $10,000,000 life insurance premium on the lives of Ms. Saliterman and Mr. Levine, for illustration purposes.[152] Mr. Swanson detailed the income, gift and estate tax consequences of the transaction and included the applicable Treasury Regulations and analytical tax journal articles regarding intergenerational split-dollar life insurance as attachments to his letter.[153] Mr. Swanson's illustration of the tax and legal effects of the proposed split-dollar

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25; Tr. 351: 13-15; Tr. 352: 12-17.

[149] Tr. 265: 12-20; Tr. 312: 14-21; Tr. 318: 21-25.

[150] Ex. 13-P.

[151] Ex. 13-P, Exhibit 1 at Bates pg. 370 (The December 1, 2007 email from Mark Saliterman is not admitted into evidence for the truth of the matter asserted and is only allowable for its effect on Mr. Swanson); Tr. 52: 17-20; Tr. 52: 22-25.

[152] Ex. 13 P at Bates pg. 361.

[153] Ex. 13-P at Exhibits 2 & 3.

transaction were for instructional purposes only because it was uncertain in January, 2008 how long Decedent would live, what amount of life insurance would ultimately be purchased, what the insureds' life expectancies would be and what discounts would be applicable to the transaction upon Decedent's death.[154] While the attorneys-in-fact received a copy of the letter, each testified they understood the transaction from discussions with Mr. Swanson more than from the written legal advice he provided to them.[155]

In January, 2008, the attorneys-in-fact discussed the split-dollar transaction amongst themselves and with Decedent.[156] Decedent approved the transaction, but limited the total amount of premium to $6,500,000.[157] Thereafter, the attorneys-in-fact contacted Mr. Swanson and told him to prepare the necessary transactional documents.[158]

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[154] Tr. 58: 6-8; Tr. 64: 8-20; Tr. 64: 22-25; Tr. 67: 6-11.

[155] Tr. 221: 16; 224: 7; Tr. 264: 10-15; Tr. Tr. 281: 4-6; Tr. 318: 1; Tr. 318: 14.

[156] Tr. 206: 23 through Tr. 207: 4; Tr. 280: 12-15; Tr. 280: 23 through Tr. 281: 1; Tr. 313: 12; Tr. 320: 19.

[157] Tr. 207: 11-14; Tr. 207: 16; Tr. 267: 13-15; Tr. 320: 21 through Tr. 321: 2.

[158] Tr. 68: 6-11; Tr. 280: 10-15; Tr. 280: 23 through Tr. 281: 1; Tr. 320: 19; Tr. 339: 1.

Life Insurance Trust

Mr. Swanson drafted the Marion Levine 2008 Irrevocable Trust ("Insurance Trust"), which was signed by the attorneys-in-fact and South Dakota Trust Company, LLC ("South Dakota Trust"), the independent trustee of the Insurance Trust, on January 31, 2008.[159] The purpose of the Insurance Trust was for it to own the split-dollar life insurance policies but Mr. Swanson also intended for Mr. Levine and Mr. and Ms. Saliterman to use the Insurance Trust for their own estate planning.[160] The beneficiaries of the Insurance Trust were Decedent's children and grandchildren (the "Beneficiaries").[161]

In fifteen years from the inception of the Insurance Trust, the Insurance Trust shall be divided and continue, including all undistributed income and principal, into equal shares for the benefit of Decedent's children and it shall continue to be held in a Generation Skipping Tax ("GST") trust for the benefit of Mr. Levine and Ms. Saliterman.[162] Thus, in fifteen years from the inception of the trust, the Insurance Trust does not terminate completely but is split between Mr. Levine and Ms. Saliterman into GST trusts so that they could continue to plan

[159] Stip. ¶ 17; Ex. 15-J.
[160] Tr. 71: 22 through Tr. 72: 2.
[161] Stip. ¶ 19; Ex. 15-J, Article 4.1, Bates pg. 488.
[162] Ex. 15-J, Article 4.2, Bates pgs. 488-499.

with the corpus of the sub-trusts for their own estate planning purposes.[163]

South Dakota Trust Company LLC ("South Dakota Trust") was chosen to be the independent trustee of the Insurance Trust for several reasons. First, South Dakota Trust is a directed trustee, which means the trust company will not agree to direct the investments of any trust for which they serve as trustee.[164] Second, a trust sitused in South Dakota would enable the trust to take advantage of the favorable tax and estate planning laws South Dakota offered.[165] Third, there is no Rule Against Perpetuities in South Dakota.[166] Fourth, there is no state income tax in South Dakota.[167] Finally, the premium tax in South Dakota is more favorable for trusts than in other states.[168] Patti Grauman, a trust officer at South Dakota Trust, has served as the independent trustee of the Life Insurance Trust since January 31, 2008.[169]

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[163] Ex. 15-J, Article 4.2.

[164] Tr. 72: 12-14; Tr. 357: 10-14; Ex. 15-J, Article 7.2, Bates pgs. 492-493; Article 7.3, Bates pgs. 493-502; Article 7.4, Bates pgs. 502-504.

[165] Tr. 79: 4-11; Tr. 79: 15-18; Tr. 321: 16-22; Tr. 382: 3-5; Tr. 382: 11-14.

[166] Tr. 79: 7-8; Tr. 321: 18-20; Tr. 382: 3-5; Tr. 382: 11-14.

[167] Tr. 79: 7-8.

[168] Tr. 79: 16-18.

[169] Stip. ¶s 20 & 21; Ex. 15-J; Tr. 78: 17-22; Tr. 321: 7; Tr. 356: 22; Tr. 356: 25.

Mr. Larson has been the sole member of the Investment Committee of the Insurance Trust since its inception.[170] Mr. Larson was chosen for this role because Mr. Levine and Ms. Saliterman do not get along and Decedent wanted someone neutral to mediate any disputes between the two siblings.[171] Moreover, Mr. Larson was someone the entire family trusted and he could manage the dynamics between Mr. Levine and Ms. Saliterman.[172]

As the sole member of the Investment Committee of the Insurance Trust, Mr. Larson has several fiduciary obligations to the beneficiaries of the trust.[173] Mr. Larson is responsible for directing the trustee as to all investments of the Insurance Trust.[174] Mr. Larson is responsible for directing the trustee as to what money market accounts would hold the cash of the trust.[175] Mr. Larson directed the acquisition of the split-dollar life insurance policies.[176] Upon the payout of the life insurance policies, it is Mr. Larson's fiduciary obligation to direct the investment of the life insurance proceeds received by

170 Stip. ¶ 23; Ex. 15-J, Article 7.5(1), Bates pg. 504.
171 Tr. 73: 1-11; Tr. 73: 13-19.
172 Tr. 73: 1-11; Tr. 200: 25 through Tr. 201: 2.
173 Ex. 15-J, Article 7.5.
174 Tr. 73: 22-23; Ex. 15-J, Article 7.5, Bates pgs. 505-507.
175 Tr. 73: 24-25; Ex. 15-J, Article 7.5, Bates pgs. 505-507.
176 Tr. 73: 25 through Tr. 74: 1; Exs. 54-J & 55-J.

the Insurance Trust.[177] Mr. Larson is charged with monitoring the Insurance Trust's investments, filing the Insurance Trust's income tax returns and ensuring the split-dollar investment is operating the way it was intended.[178]

Paragraph 7.5 of the Life Insurance Trust provides, among other things, that the Trustee is required to follow the written instructions of the Investment Committee with respect to the retention, purchase, sale or encumbrance of the trust property and the investment and reinvestment of principal and income held thereunder.[179] Mr. Larson's duties as the sole member of the Investment Committee are exercisable only in a fiduciary capacity under South Dakota law.[180] Mr. Swanson explained the aforementioned duties required under the terms of the Insurance Trust to Mr. Larson and Mr. Larson understood his fiduciary obligations.[181]

Mr. Swanson did not believe Mr. Larson's role as one of Decedent's attorneys-in-fact and as the sole member of the Investment Committee of the Insurance Trust was a conflict of

[177] Tr. 74: 1-5.
[178] Tr. 75: 3-9.
[179] Stip. ¶ 22; Ex. 15-J.
[180] Ex. 15-J, Article 7.5(1)(g), Bates pg. 506.
[181] Tr. 76: 5-13; Tr. 200: 13-17; Tr. 200: 20; Tr. 200: 22.

interest.[182] Mr. Larson was chosen as the sole member of the Investment Committee of the Insurance Trust because the entire family trusted him to make decisions regarding the trust if there were disagreements among the beneficiaries, and, specifically, Decedent's children.[183] Respondent has argued that Mr. Larson's sole ability to surrender the split-dollar life insurance policies and his role as one of Decedent's attorneys-in-fact creates a conflict of interest.[184] However, Decedent had sufficient assets and income such that she would never need the funds from the Split-Dollar Receivables during her lifetime.[185] Moreover, had someone requested that Mr. Larson cancel the split-dollar policies, it would have been impossible for Mr. Larson to fulfill his fiduciary duty to Decedent under the terms of the Power of Attorney and to the beneficiaries of the Insurance Trust.[186] Mr. Swanson would have advised Mr. Larson to step down as the sole member of the Investment Committee of the Insurance Trust in this instance.[187] Regardless, it was (and still is) everyone's intention that the split-dollar life

[182] Tr. 78: 3-5.
[183] Tr. 77: 17-24; Tr. 200: 25 through Tr. 201: 2.
[184] Respondent's Pre-Trial Memorandum, dated October 16, 2017.
[185] Stip. ¶ 100; Tr. 37: 19-22; Tr. 313: 21; Tr. 206: 6; Exs. 57-J, 58-J, 63-J & 64-J; Tr. 205: 11-13; Tr. 316: 12-13.
[186] Tr. 78: 11-15.
[187] Tr. 78: 11-15.

insurance policies stay intact until the deaths of the insureds under the policies.[188]

Acquisition of Life Insurance Policies

After creating the Insurance Trust on January 31, 2008, the attorneys-in-fact and Mr. Swanson undertook a series of steps to acquire two separate life insurance policies on the lives of Mr. and Ms. Saliterman (the "Insureds").[189] The parties determined that the life insurance policies would be purchased on the lives of Mr. and Ms. Saliterman because Mr. Levine was uninsurable at a competitive price given his pre-existing medical health.[190] Mr. Levine has long been a diabetic and the cost of life insurance for him would have been prohibitively expensive.[191]

Mr. Swanson worked with insurance broker, Jason Prather, to assist him in finding insurance companies for the split-dollar transaction.[192] Met Life, Pacific Life and John Hancock insurance companies were considered but ultimately the parties settled on purchasing the two life insurance policies with John Hancock and Pacific Life.[193] John Hancock and Pacific Life were

[188] Tr. 201: 5-6; Tr. 269: 5; Tr. 269: 10-14; Tr. 326: 25 through Tr. 327: 1.
[189] Stip. ¶ 24.
[190] Tr. 58: 22 through Tr. 59: 2; Tr. 267: 7-8.
[191] Tr. 58: 23-24; Tr. 267: 7-8; Tr. 312: 20-22.
[192] Tr. 83: 3-5; Ex. 16-R.
[193] Tr. 83: 17-19; Exs. 30-J & 31-J.

chosen because the two companies provided the best rate of return (consistent with treasury bonds) and had less counterparty risk and the two companies were financially solid with good credit ratings.[194] Last-to-die insurance policies were chosen because the insurance premiums were cheaper.[195] The policies were purchased on the lives of Mr. and Ms. Saliterman, because it was unnecessary to have liquidity upon the first of them to die since they would have the benefit of the unlimited marital deduction.[196] Moreover, it was expected that Mr. and Ms. Saliterman would pre-decease Mr. Levine, so there would be liquidity from the death benefit of the policies before Mr. Levine's death.[197] John Hancock and Pacific Life insurance companies provided the lowest and most competitive rates.[198] Accordingly, Mr. and Ms. Saliterman prepared and submitted applications for life insurance to Pacific Life and John Hancock in April, 2008.[199]

[194] Tr. 83: 25 through 84: 8.
[195] Tr. 58: 24 through 59: 2; Tr. 85: 8-15.
[196] Tr. 85: 8-15.
[197] Tr. 59: 2-6; Tr. 85: 8-15.
[198] Tr. 84: 9-11.
[199] Exs. 17-J & 18-J.

Funding the Life Insurance Policies

Between April, 2008 and August, 2008, the parties undertook steps to raise cash for the insurance policies.[200] While Decedent had assets and a net worth in excess of $25,000,000 in 2008, the parties chose to fund the life insurance premiums with short-term loans to save premium at an earlier age for Mr. and Ms. Saliterman and to lock in the insurance premium amounts.[201] It was the parties' intention to borrow the funds for the John Hancock and Pacific Life insurance policies and repay only the short-term loans (and not the Central Bank Loan, explained below), once assets were sold and Decedent's existing loans to partnerships were repaid.[202] The parties anticipated selling Decedent's interest in the Arizona Renaissance at the time the John Hancock and Pacific Life insurance policies were funded, and, ultimately, sold Decedent's interest in the Arizona Renaissance for $850,000 shortly thereafter.[203]

Central Bank Loan

On June 10, 2008, Mr. Levine, in his capacity as the Chief Manager of Penn Lake Shopping Center, LLC, an entity in which

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[200] Stip. ¶ 24.
[201] Stip. ¶ 100; Tr. 68: 13-17; Tr. 68: 20 through Tr. 69: 3; Tr. 319: 6-16.
[202] Tr. 66: 20 through Tr. 69: 3. Tr. 69: 7-12; Tr. 195: 19-21; Tr. 319: 6-16.
[203] Tr. 70: 3-7; Tr. 203: 17 through Tr. 204: 1; Tr. 314: 17-21.

Decedent owned 100% of the outstanding membership interests, entered into a $3,800,000 *Promissory Note* with Central Bank (the "Central Bank Loan").[204] The *Promissory Note* provides that interest would accrue at an annual rate of 6.35% and Penn Lake Shopping Center, LLC was required to make 60 equal monthly payments until July 1, 2013.[205] Mr. Levine and Central Bank also entered into a *Mortgage and Security Agreement and Fixture Finance Statement* which pledged various property owned by Penn Lake Shopping Center, LLC as collateral in exchange for the $3,800,000 loan.[206] No interest in either the John Hancock or Pacific Life insurance policies was pledged as collateral for the Central Bank Loan.[207]

It was the parties' intention *not* to repay the Central Bank Loan on the Penn Lake Shopping Center on a short-term basis so that the annual interest paid on this loan would continue to be accrued to increase Decedent's basis in the Split-Dollar Receivables.[208] Mr. Swanson advised the attorneys-in-fact that all interest paid on loans for the split-dollar transaction

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[204] Stip. ¶ 24 (a); Ex. 22-J.
[205] Stip. ¶ 24 (a); Ex. 22-J.
[206] Stip. ¶ 24 (a); Ex. 23-J.
[207] Stip. ¶ 96.
[208] Tr. 195: 19-21; Tr. 195: 24 through Tr. 196: 4; Tr. 351: 8-15; Tr. 351: 18 through Tr. 352: 8.

would not be currently deductible under I.R.C. § 264.[209] In other words, it was the intention to leverage the equity of Penn Lake, of approximately $3,800,000, and repay the Central Bank Loan annually, plus interest, and accrue the interest paid on the Central Bank Loan over the course of loan and add it to Decedent's basis in the Split-Dollar Receivable.[210] Upon the deaths of the Insureds, Decedent's basis in the Split-Dollar Receivable would be increased for the interest paid to Central Bank, which would create an income tax savings to Decedent.[211] Thus, not only did the equity taken out of Penn Lake create a diversification of Decedent's portfolio (because she acquired a Split-Dollar Receivable), the Central Bank Loan created income tax savings to Decedent by increasing her basis in the Split-Dollar Receivable upon the deaths of the Insureds.[212]

On June 13, 2008, Penn Lake Shopping Center, LLC wired $4,000,000 to the Pacific Life Insurance Company.[213] Of this amount, $3,730,000 was derived from the $3,800,000 Central Bank Loan and $270,000 was derived from funds from Penn Lake Shopping

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[209] Tr. 71: 3; Tr. 351: 10-13: Ex. 13-P, Bates pg. 363.
[210] Tr. 351: 8-15; Tr. 351: 18 through Tr. 352: 17.
[211] Tr. 351: 8-15; Tr. 351: 18 through Tr. 352: 8.
[212] Tr. 351: 8-15; Tr. 351: 18 through Tr. 352: 8.
[213] Stip. ¶ 27; Ex. 25-J.

Center, LLC's savings account.[214] In exchange for the $4,000,000 premium payment, the Pacific Life Insurance Company issued a last-to-die life insurance policy on the lives of Mr. and Ms. Saliterman (the "Pacific Life Policy").[215] The Pacific Life Policy was issued policy number VF51523670 and had an effective date of March 22, 2008.[216] The Pacific Life Policy has a face amount of $10,750,000 (i.e. the Pacific Life Insurance Company will pay $10,750,000 upon the death of the last to die of Mr. and Ms. Saliterman).[217] The Pacific Life policy is a whole life insurance policy.[218]

From July 1, 2008 until July 1, 2013, Penn Lake Shopping Center, LLC made interest and principal payments as required by the Central Bank Loan agreement.[219] On July 1, 2013, the Central Bank Loan had an outstanding principal balance of $2,484,541.63 and Penn Lake Shopping Center, LLC renewed the loan until October 1, 2013.[220] On October 1, 2013, the Central Bank Loan had an outstanding principal balance of $2,471,715.53 and it was renewed again until June 1, 2015 at a lower annual rate of

[214] Stip. ¶ 27; Tr. 202: 12-14.
[215] Stip. ¶ 28; Ex. 30-J.
[216] Stip. ¶ 28; Ex. 30-J.
[217] Stip. ¶ 29; Ex. 30-J.
[218] Stip. ¶ 37.
[219] Stip. ¶ 96.
[220] Stip. ¶ 96.

5.00%.[221] On June 1, 2015, the Central Bank Loan had an outstanding principal balance of $1,809,097.06 and was renewed again at a lower annual rate of 4.25%.[222] As of June 5, 2017, the loan had an outstanding principal balance of $1,691,008.04.[223]

Private Bank Line of Credit

On July 16, 2008, Mr. Larson, Mr. Levine and Ms. Saliterman, as the attorneys-in-fact for Decedent, entered into a *Personal Line of Credit Agreement and Disclosure* with Private Bank Minnesota (the "Private Bank Line of Credit").[224] The Private Bank Line of Credit provided Decedent with a $2,000,000 line of credit for a term of one year.[225] The Private Bank Line of Credit agreement provided that the annual percentage rate for any funds advanced would be fixed at 5.25% during this term and that the outstanding balance of the credit line was due and payable in a single balloon payment on July 16, 2009.[226] On July 16, 2008, Decedent's attorneys-in-fact also entered into two *Consumer Security Agreements* and four *Commercial Pledge Agreements* which pledged various properties

[221] Stip. ¶ 96.
[222] Stip. ¶ 96.
[223] Stip. ¶ 96.
[224] Stip. ¶ 24(b); Ex. 32-J.
[225] Stip. ¶ 24(b); Ex. 32-J.
[226] Stip. ¶ 24(b); Ex. 32-J.

and assets owned by Levine Investments and 5005 Properties, Inc., d.b.a. 5005 Properties Finances and 5005 Finance Company, as collateral in exchange for the $2,000,000 line of credit.[227] No interest in either the John Hancock or the Pacific Life policies was pledged as collateral for the Private Bank Line of Credit.[228] On May 28, 2009, the Estate paid off the then-outstanding $1,992,078.32 principal balance on the Private Bank Line of Credit.[229]

On July 18, 2008, Private Bank Minnesota wired $2,000,000 to the John Hancock Life Insurance Company.[230] This amount was derived from the *Personal Line of Credit Agreement and Disclosure* that Mr. Larson, Mr. Levine and Ms. Saliterman, as the attorneys-in-fact for Decedent, entered into with Private Bank Minnesota on July 16, 2008.[231]

Business Bank Loan

On August 8, 2008, Ms. Saliterman and Mr. Larson, in their capacities as the co-trustees of the Revocable Trust, entered into a $516,000 *Loan Agreement* with The Business Bank (the

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227 Stip. ¶ 24(b); Exs. 34-J, 35-J, 36-J, 38-J & 39-J.
228 Stip. ¶ 97.
229 Stip. ¶s 97 & 99.
230 Stip. ¶ 30; Exs. 40-J & 41-J.
231 Stip. ¶ 30.

"Business Bank Loan").[232] As collateral for the Business Bank Loan, the Revocable Trust pledged its interest in various installment sales contracts and leases identified in Schedule 1 of the *Security Agreement*.[233] No interest in either the John Hancock or the Pacific Life policies was pledged as collateral for the Business Bank Loan.[234] The Business Bank *Loan Agreement* provides that interest would accrue at an annual rate of 6.9%, and the Revocable Trust was required to make monthly payments in the amount of $4,000 for five years and then one installment of the entire remaining unpaid principle balance plus all accrued and unpaid interest exactly five years after the execution of the Loan Agreement.[235] Ms. Saliterman and Mr. Larson also executed personal guarantees on behalf of Decedent and Levine Properties in furtherance of obtaining the $516,000 loan from The Business Bank.[236]

On August 11, 2008, The Business Bank wired $500,000 to the John Hancock Life Insurance Company.[237] This amount was derived from the Business Bank Loan.[238]

[232] Stip. ¶ 24(c); Ex. 43-J.
[233] Stip. ¶ 98; Ex. 43-J.
[234] Stip. ¶ 98; Ex. 43-J.
[235] Stip. ¶ 24(c); Ex. 43-J.
[236] Stip. ¶ 24(c); Ex. 43-J; Bates pgs. 768-785.
[237] Stip. ¶ 31.
[238] Stip. ¶ 31.

The wire transfers from Private Bank Minnesota on July 18, 2008, in the amount of $2,000,000, and Business Bank on August 11, 2008, in the amount of $500,000, to John Hancock Life Insurance Company comprised the full premium amount, $2,500,000, on the John Hancock policy.[239] In exchange for the $2,500,000 in premium payments, the John Hancock Life insurance Company issued a last-to-die life insurance policy on the lives of Ms. Saliterman and Mr. Saliterman (the "John Hancock Policy," together with the Pacific Life Policy, the "Life Insurance Policies").[240] This policy was assigned Policy Number 93986016 and had an official issuance date of July 9, 2008 and an effective date of March 23, 2008.[241] The John Hancock policy has a face amount of $6,496,877 (i.e. the John Hancock Life Insurance Company will pay $6,496,877 upon the death of the last to die of Mr. and Ms. Saliterman).[242] The John Hancock policy also contained an additional four year term death benefit in the amount of $7,940,640, through March 23, 2012.[243] The John Hancock policy is a whole life insurance policy.[244]

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[239] Stip. ¶s 30, 31 & 32.
[240] Stip. ¶ 32; Ex. 31-J.
[241] Stip. ¶ 32; Ex. 31-J.
[242] Stip. ¶ 33; Ex. 31-J.
[243] Stip. ¶ 33; Ex. 31-J.
[244] Stip. ¶ 37.

On July 16, 2014, the Estate paid off the then outstanding $214,927.93 principal balance due on The Business Bank Loan.[245]

Split-Dollar Agreements

Between June 1, 2008 and August 8, 2008, Mr. Larson, Mr. Levine and Ms. Saliterman, as the attorneys-in-fact for Decedent and as the Co-Trustees of the Revocable Trust, entered into two Split-Dollar Agreements (the "Split-Dollar Agreements") with the Insurance Trust for each of the John Hancock and Pacific Life insurance policies (collectively, the "Transaction").[246] The Split-Dollar Agreements include the following terms: (1) the Insurance Trust will purchase the insurance policies on the lives of the Insureds, Nancy and Larry Saliterman, and assign the policies to the Revocable Trust as collateral to secure the repayment of the amounts that the Revocable Trust would pay towards the premiums on the policies; (2) the Revocable Trust was responsible for paying all premiums on the policies; and (3) in exchange for paying the premiums on the policies, the Revocable Trust would receive, upon death of the last surviving Insured or the termination of the policies, the greater of (a) the total amount of premiums paid, or (b) the current cash surrender value ("CSV") of the policies (the

[245] Stip. ¶s 98-99.
[246] Stip. ¶ 25; Exs. 26-J & 28-J.

"Split-Dollar Receivables").[247] The Insurance Trust retained all other ownership rights in the policies.[248]

The Insurance Trust did not have access to, or any current or future interest in, the CSV of the policies.[249] Neither Decedent nor the Revocable Trust had any right, power or duty that is an "incident of ownership", as defined under I.R.C. §§ 2035 and 2042, in the Life Insurance Policies at the time of Decedent's death.[250] If the Split-Dollar Agreements were terminated during the lifetime of either Insured, the Insurance Trust had the right, within sixty-days of such termination, to the Life Insurance Policies if it satisfied its obligation to the Revocable Trust by paying the Revocable Trust the greater of the then existing CSV of the policies or the total premiums paid.[251]

Per the recitals in the Split-Dollar Agreements, the Insurance Trust, the beneficiaries of the Insurance Trust and the Insureds did not have access to, or any current or future interest in, the CSVs of the John Hancock or Pacific Life Insurance policies in accordance with Treasury Regulation §

[247] Stip. ¶ 26, Exs. 26-J & 28-J.
[248] Stip. ¶ 26, Exs. 26-J & 28-J.
[249] Stip. ¶ 103; Exs. 26-J & 28-J.
[250] Exs. 26-J, Bates pgs. 592-593 & 28-J, Bates pgs. 606-607.
[251] Exs. 26-J, 27-J, 28-J, & 29-J.

1.61-22(d)(4), the economic benefit regime.[252] Mr. Swanson analyzed the loan and economic benefit regimes under the split-dollar regulations and determined that it would be advantageous for gift tax purposes for the Transaction to fall under the economic benefit regime.[253] Moreover, per recitals in the Split-Dollar Agreements, it was the intention of the parties that the Collateral Assignments convey no right, power, or duty that is an incident of ownership, as such phrase is defined under I.R.C. §§ 2035 and 2042 and Treasury Regulation §20.2042-1(c) to Decedent or the Revocable Trust.[254]

The Split-Dollar Agreements are loan agreements which set forth the terms of the loans made from Decedent's Revocable Trust to the Insurance Trust for the purchase of the Life Insurance Policies.[255] The Split-Dollar Agreements for the Pacific Life and John Hancock policies were prepared by Mr. Swanson with the assistance of his partners at Parsinen.[256] Mr. Swanson explained the terms of the Split-Dollar Agreements to the attorneys-in-fact, specifically that Decedent would be making a long-term loan to the Insurance Trust and she would

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[252] Exs. 26-J & 28-J.
[253] Tr. 90: 5-15.
[254] Exs. 26-J & 28-J.
[255] Tr. 87: 22-23.
[256] Tr. 88: 1; Tr. 88: 4-8.

retain the right to the greater of the premiums paid or the CSV as measured at the moment before the later of Mr. and Ms. Saliterman's deaths.[257] Mr. Swanson also explained the Split-Dollar Agreements to Patti Grauman because, as trust officer of South Dakota Trust, she would need to review the agreements and sign them on behalf of the Insurance Trust.[258]

Collateral Assignments

On June 19, 2008, the Revocable Trust and the Insurance Trust entered into Collateral Assignments for the Pacific Life and John Hancock policies.[259] The Collateral Assignments assigned collateral rights in the John Hancock and Pacific Life policies to the Revocable Trust to secure the payment of the amounts owed to the Revocable Trust pursuant to the Split-Dollar Agreements, which consisted solely of the right to be repaid the greater of the CSV of the policies or the total premiums paid upon the earlier of the surrender of the policies, termination of the Split-Dollar Agreements, or the death of the last surviving Insured.[260] Neither the Revocable Trust nor the Insurance Trust retained the right to borrow against the

[257] Tr. 88: 14-15; Tr. 89: 11-20.
[258] Tr. 88: 15-17; Tr. 89: 4-7.
[259] Stip. ¶ 35; Exs. 27-J & 29-J.
[260] Exs. 27-J & 29-J.

policies.[261] The Collateral Assignments were signed by Patti Grauman, as trust officer of the Revocable Trust, the attorneys-in-fact, as trustees of the Revocable Trust and by representatives of each John Hancock and Pacific Life insurance companies.[262] The purpose of the Collateral Assignments was to not only secure the Revocable Trust's interest in the loans for the life insurance policies, but also to put both John Hancock and Pacific Life on notice that the death benefit of the two policies cannot be paid to the Insurance Trust until Decedent was repaid the greater of the premiums paid or the then-existing CSV of the policies.[263]

Mr. Swanson prepared the two Collateral Assignment agreements and explained their meaning to the attorneys-in-fact, Mr. Prather and South Dakota Trust Company.[264]

Direction Letters

In June, 2008, Mr. Larson, in his capacity as the sole member of the Investment Committee of the Insurance Trusts, signed two Direction Letters to South Dakota Trust Company.[265] The Direction Letters directed Ms. Grauman, as trustee of the

[261] Ex. 27-J, Section I, Bates pg. 602; Ex. 29-J, Section I, Bates pg. 616.
[262] Exs. 27-J & 29-J.
[263] Tr. 91: 11-16; Exs. 27-J & 29-J.
[264] Tr. 91: 19-24.
[265] Exs. 54-J & 55-J.

Insurance Trust, to acquire the John Hancock and the Pacific Life policies.[266]

Mr. Swanson's Legal Advice

Mr. Swanson researched the Transaction before recommending it to the attorneys-in-fact for Decedent in late 2007 and early 2008.[267] He researched the split-dollar Treasury Regulations under § 1.61-22 and he considered the Internal Revenue Code Sections at issue in the present case, I.R.C. §§ 2035 through 2042.[268] Mr. Swanson researched the special valuation rules under I.R.C. §§ 2701 through 2704 and Treasury Regulation § 1.7872, regarding the tax treatment of loans with below market interest rates, in consideration of the economic benefit and loan regimes.[269] Mr. Swanson considered *Estate of Strangi v. Commissioner*,[270] and *Church v. United States*,[271] particularly on the issue of whether the Transaction only involve Decedent's excess capital—assets she would not otherwise need during her

[266] Exs. 54-J & 55-J; Tr. 92: 25 through Tr. 93: 6.
[267] Tr. 61: 12-13; Tr. 61: 20; Tr. 61: 22; Exs. 13-P & 14-J.
[268] Tr. 59: 12-15.
[269] Tr. 59: 15-20.
[270] 115 T.C. 478 (2000), *aff'd in part, rev'd in part on other grounds*, 293 F.3d 279 (5th Cir. 2002).
[271] 85 AFTR 2d 2000-804, (W.D. Tex. 2000), *aff'd without pub. opinion*, 268 F.3d 1063 (5th Cir. 2001).

lifetime—while considering a possible I.R.C. § 2036 attack by the Internal Revenue Service.[272]

Mr. Swanson communicated with the attorneys-in-fact, predominantly verbally (by phone or in person), since the attorneys-in-fact typically did not communicate by email.[273] While Mr. Swanson provided written legal advice to the attorneys-in-fact, he communicated with them also by telephone and in person to deliver his legal advice throughout the course of his engagement and in connection with the Transaction.[274] Mr. Swanson believed the attorneys-in-fact understood his legal advice regarding the Transaction.[275]

Likewise, the attorneys-in-fact testified that they relied upon Mr. Swanson to provide them with legal advice regarding the Transaction.[276] Though Mark Saliterman, Ms. Saliterman's then brother-in-law and accountant, was also provided with Mr. Swanson's legal advice, none of the attorneys-in-fact relied upon Mark Saliterman to provide them with legal advice regarding

[272] Tr. 59: 21 through Tr. 60: 1; Tr. 60: 20-25.
[273] Tr. 40: 22-24; Tr. 65: 16; Tr. 76: 21-24; Tr. 264: 13-15; Tr. 318: 11; Tr. 318: 14.
[274] Tr. 62: 23 through Tr. 63: 11; Tr. 76: 20-24; Tr. 194: 17.
[275] Tr. 62: 13; Tr. 64: 1.
[276] Tr. 194: 23; Tr. 219: 8; Tr. 232: 8; Tr. 264: 21-25; Tr. 318: 4.

the Transaction.[277] The attorneys-in-fact trusted Mr. Swanson's advice and his estate planning expertise.[278]

Split-Dollar Life Insurance Policies Currently

The Split-Dollar Receivables had a guaranteed rate of return of 3% from their inception.[279] However, the growth on the receivables has actually been in excess of the 3% guaranteed rate of return, with a range of 4.3% to 5.45% rate of return.[280] The credited increases to and the CSVs of the John Hancock and Pacific Life policies from 2008 through 2017 are as follows:[281]

Year	Pacific Life Credited Increase	Pacific Life CSV as of March 21 of each year	John Hancock Credited Increase	John Hancock CSV as of March 22 of each year
2008	5.45%	n/a	4.8%	n/a
2009	5.45%	$3,703,497.80	4.8%	$2,227,386.49
2010	5.43%	$3,890,284.34	4.6%	$2,333,968.57
2011	5.35%	$4,071,138.72	4.5%	$2,439,934.84
2012	5.31%	$4,247,549.08	4.5%	$2,546,333.64
2013	5.07%	$4,410,174.03	4.5%	$2,664,708.53
2014	5.33%	$4,579,098.35	4.3%	$2,781,004.59

277 Ex. 13-P; Tr. 226: 21; Tr. 226: 23; Tr. 232: 10-11; Tr. 277: 23-24.
278 Tr. 219: 12; Tr. 264: 21-24; Tr. 318: 6-8.
279 Stip. ¶ 38.
280 Ex. 76-J & 77-J.
281 Stip. ¶ 102; Exs. 76-J & 77-J.

Year	Pacific Life Credited Increase	Pacific Life CSV as of March 21 of each year	John Hancock Credited Increase	John Hancock CSV as of March 22 of each year
2015	5.12%	$4,734,380.12	4.3%	$2,898,921.67
2016	4.92%	$4,875,161.37	4.3%	$3,019,008.89
2017	4.67%	$4,997,880.68	4.3%	$3,140,257.67

The attorneys-in-fact intend to keep the Transaction in place until the deaths of Mr. and Ms. Saliterman.[282]

Gift Tax Reporting

Mr. Swanson advised the attorneys-in-fact to report the economic benefit conferred to the beneficiaries of the Insurance Trust by Decedent for gift tax purposes, as is required under the split-dollar regulations.[283] Accordingly, Forms 709 "United States Gift (and Generation-Skipping Transfer) Tax Return," for 2008 and 2009 were filed by Decedent reporting the economic benefit conferred to the beneficiaries in each year on Schedule A (the "Gift Tax Returns").[284] The Gift Tax Returns were prepared by Mr. Swanson.[285]

[282] Tr. 104: 12-17; Tr. 210: 15; Tr. 210: 17; Tr. 269: 8; Tr. 269: 10-14; Tr. 326: 25 through Tr. 327: 1; Tr. 327: 3-5.
[283] Tr. 62: 2-5; Tr. 93: 21 through Tr. 94: 2.
[284] Exs. 1-J & 95-J.
[285] Ex. 1-J & 95-J.

Estate Tax Reporting

The Form 706 "United States Gift (and Generation-Skipping Transfer) Tax Return" (the "Estate Tax Return") for Decedent's estate was prepared by Mr. Swanson.[286] The Split-Dollar Receivables, as owned by Decedent's Revocable Trust, were reported on Schedule G, line 23 as of the alternate valuation date at $2,137,130 on the Estate Tax Return.[287] Attached to the Estate Tax Return, as pertinent to the Transaction, was the valuation appraisal of the Split-Dollar Receivables, the Insurance Trust, the Revocable Trust (and all amendments thereto), the Collateral Assignments for the John Hancock and Pacific Life Insurance policies and the Split-Dollar Agreements for the John Hancock and Pacific Life Insurance policies.[288]

The appraisal of the Split-Dollar Receivables for estate tax purposes was prepared by Paul Siebrasse, Managing Director of RSM McGladrey.[289] Mr. Siebrasse's expert valuation report of the Split-Dollar Receivables was attached to the Estate Tax

[286] Ex. 2-J.

[287] Ex. 2-J, Bates pg. 18; Tr. 95: 12-17. The parties have stipulated that the fair market value of the Split-Dollar Receivables, if Petitioner prevails at trial, will now be $2,282,195, as of the alternate valuation date (Second Stipulation of Settled Issues).

[288] Ex. 2-J; Tr. 96: 5-23.

[289] Ex. 2-J, Bates pg. 82 through Bates pg. 167 (without attachments).

Return.[290] Mr. Siebrasse was recommended to the attorneys-in-fact by Mr. Swanson based upon his experience and credentials and questions Mr. Swanson asked of him on a telephone call before he was retained.[291] Mr. Swanson believed Mr. Siebrasse had the requisite education and appraisal expertise to prepare a valuation report of the Split-Dollar Receivables for estate tax purposes.[292] The attorneys-in-fact relied upon Mr. Swanson's recommendation to retain Mr. Siebrasse to value the Split-Dollar Receivables for estate tax purposes.[293]

On September 15, 2009, Mr. Siebrasse was the Director of RSM McGladrey's business valuation and litigation support group.[294] As of the date of his valuation report, he had over 14 years of experience in business valuation and economic analysis and was accredited a Senior Appraiser as a business valuation expert by the American Society of Appraisers.[295] Mr. Siebrasse has a Masters in Science and a B.S. in business from Montana State University.[296]

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[290] Ex. 2-J, Bates pg. 82 through Bates pg. 167 (without attachments).
[291] Tr. 97: 16-24: Tr. 101: 25 through Tr. 102: 4.
[292] Tr. 291: 16-24.
[293] Tr. 98: 6-10; Tr. 208: 21 through Tr. 210: 9; Tr. 323: 5-23.
[294] Ex. 2-J, Bates pg. 103.
[295] Ex. 2-J, Bates pg. 103.
[296] Ex. 2-J, Bates pg. 103.

To prepare his valuation report, Mr. Siebrasse reviewed for each of the Pacific Life and John Hancock policies, the following information: (1) annual statements for the Insurance Trusts; (2) the Insurance Trust; (3) the Split-Dollar Agreements; (4) the Collateral Assignments; and (5) life expectancy tables, dated 2004.[297] Mr. Swanson provided all the source information to Mr. Siebrasse to prepare his valuation report, with the exception of the life expectancy tables which Mr. Siebrasse gathered from research databases.[298] Mr. Siebrasse used 6.05% as the applicable discount rate for the Split-Dollar Receivable attributable to the Pacific Life Policy and 5.65% as the applicable discount rate for the Split-Dollar Receivable attributable to the John Hancock Policy.[299]

Procedural Background

On April 19, 2013, Respondent issued a Notice of Deficiency with respect to the Estate Tax Return, in the amount of $3,018,759.00 and he asserted the gross estate tax valuation understatement penalty, pursuant to I.R.C. § 6662(h), in the amount of $833,548.00 (the "Estate Tax Notice of Deficiency").[300]

[297] Ex. 2-J, Bates pg. 104.
[298] Tr. 98: 13-16; Tr. 101: 10-19.
[299] Ex. 2-J, Bates pg. 99.
[300] Petition for Redetermination filed June 12, 2013, Docket No. 13370-13.

On June 12, 2013, Petitioner filed a Petition for Redetermination of Deficiency with respect to the Estate Tax Notice of Deficiency.[301] Respondent filed an Answer to the Estate Tax Petition on August 12, 2013 and contested all items raised in the Petition.[302] Respondent's Answer, filed August 12, 2013, did not allege that Respondent met his burden of production under I.R.C. § 6751(b)(1) to show that the "initial determination" of the assertion of the gross valuation misstatement penalty was personally approved by the immediate supervisor making the determination.[303]

On February 24, 2015, the IRS issued a Notice of Deficiency with respect to Decedent's 2008 Gift Tax Return, asserting a deficiency in the amount of $2,920,205 (the "Gift Tax Notice of Deficiency").[304] On April 7, 2015, Petitioner filed a Petition for Redetermination of Deficiency with respect to the Gift Tax Notice of Deficiency.[305] On September 15, 2015, Petitioner filed

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[301] Petition for Redetermination filed June 12, 2013, Docket No. 13370-13.

[302] Answer, filed August 12, 2013, Docket No. 13370-13.

[303] Answer filed August 12, 2013. An Amended Petition was filed May 27, 2014 and the Respondent filed an Answer to Amended Petition on July 24, 2014. Respondent did not allege his compliance with I.R.C. § 6751(b)(1) in the Answer to Amended Petition either.

[304] Petition for Redetermination filed June 12, 2013, Docket No. 13370-13, Exhibit A.

[305] Petition for Redetermination filed April 15, 2015, Docket No.

a Motion for Summary Judgement because the Gift Tax Notice of Deficiency was issued after the expiration of the applicable three-year statute of limitations under I.R.C. § 6501(a).[306] Respondent argued that there was an omitted gift equal to the value of the premiums paid for the Life Insurance Policies and, therefore under I.R.C. § 6501(c)(9), there was an indefinite period with which to assess gift tax.[307] On June 23, 2016, the Court heard oral argument on Petitioner's Motion for Summary Judgement. During oral argument, Petitioner argued that the gift was adequately reported on the 2008 Gift Tax Return and that the Tax Court's recent decision in *Estate of Morrissette v. Commissioner,*[308] controlled. Respondent agreed that *Estate of Morrissette* controlled, but disagreed with the holding in *Estate of Morrissette*. On July 13, 2016, the Court issued an order granting Petitioner's Motion for Summary Judgement. Thus, the Gift Tax Notice of Deficiency is not at issue in the instant case.

9345-15.

306 Motion for Summary Judgement filed September 15, 2015, Docket No. 9345-15.

307 Order, filed July 13, 2016, Docket No. 9345-15.

308 146 T.C. 171 (2016).

Respondent's Penalty Approval Form

On February 26, 2013, Estate and Gift Tax Attorney Nicole Bard, the Acting Group Manager and immediate supervisor for Estate and Gift Tax Attorney Scott Ratke, approved Mr. Ratke's assertion of the Gross Valuation Misstatement Penalty with respect to Schedule G, item 23 of Decedent's Estate Tax Return via the form identified as Exhibit 53-R (the "Penalty Approval Form").[309]

Respondent's Penalty Approval Form checked the box "yes" for the Gross Valuation Misstatement Penalty, pursuant to I.R.C. § 6662(h), but all other penalty boxes were checked "no."[310] The explanation for the gross valuation misstatement penalty on the Penalty Approval Form states the following:

> There is an [sic] gross understatement [sic] of Schedule G, Item 23. It was returned at $1,432,131[311] [sic] and the corrected value is $6,767,950; therefore under I.R.C. 6662(h)(2)(c), a 40% penalty is applied to the estate tax attributable to this asset. There is not 'reasonable cause' to abate this penalty. It was applied in another stat notice case in another territory and Area Counsel supports the assertion of this penalty.[312]

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309 Stip.¶ 127.
310 Ex. 53-R.
311 The value of the Split-Dollar Receivables reported on the Form 706 Federal Estate Tax Return at Schedule G, Item 23 was $2,137,130.17 and not $1,432,131, as the Penalty Approval Form alleges. See Ex. 2, Bates pgs. 17-18.
312 Ex. 53-R.

No analysis of the basis for asserting the gross valuation misstatement penalty was included with the Penalty Approval Form (or introduced at trial) and, thus, there is no evidence of Mr. Ratke's purported "initial determination," pursuant to I.R.C. § 6751(b)(1) in the record.[313] Moreover, the sole basis for asserting the gross valuation misstatement penalty in the present case was because it was purportedly applied in another "stat notice case in another territory."[314] The Penalty Approval Form does not identify: (1) the other statutory notice case Respondent relied upon; (2) what the facts and legal issues are in that case; (3) who made the "initial determination" in the other case; or (4) whether Area Counsel purportedly approved, in writing, the "initial determination" of the penalty in the other unidentified case.[315] Finally, though the Penalty Approval Form states that reasonable cause defenses to the penalty are not applicable, it states no basis for this assertion nor is there any indication that the Estate and Gift Tax Attorney or his immediate supervisor considered any of Petitioner's defenses to the penalty before completing the Penalty Approval Form.[316]

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[313] Entire record.
[314] Ex. 53-R
[315] Ex. 53-R.
[316] Ex. 53-R.

ULTIMATE FINDINGS OF FACT

1. There were substantial business and other nontax reasons for the Transaction, which included: (1) diversifying Decedent's asset portfolio; (2) obtaining a minimum guaranteed return of 3% per year (and potentially much greater) on her excess capital, and (3) helping to preserve the family's real estate business by providing life insurance protection for Decedent's children. Entire record.

2. Decedent did not own the Life Insurance Policies and her only interest in the policies was a security interest through the Collateral Assignments, which ensured repayment of the Split-Dollar Receivables. Exs. 26-J, 27-J, 28-J & 29-J.

3. The Insurance Trust owned the Life Insurance Policies. Exs. 15-J, 26-J, 27-J, 28-J & 29-J.

4. Decedent did not retain the possession or enjoyment of, or the right to the income from, the Life Insurance Policies acquired in the Transaction. Entire record.

5. Decedent did not retain the right, either alone or in conjunction with Mr. Larson (or any other person), to designate the persons who could possess or enjoy the Life Insurance Policies or income therefrom during her lifetime because Mr. Larson was obligated by his fiduciary duties to the

Beneficiaries and to Decedent to keep the policies in place. Entire record.

6. There was no implied agreement between Decedent and any other person to cancel the Split-Dollar Agreements or the Life Insurance Policies. Entire record.

7. Decedent had more than sufficient assets and income apart from the $6,500,000 used to fund the Transaction to sustain her living expenses for the rest of her life. Entire record.

8. Decedent received full and adequate consideration for engaging in the Transaction by virtue of the value she received in the Split-Dollar Receivables. Entire record.

9. Petitioner relied on the tax and legal expertise of Mr. Swanson in reporting the Transaction on the Estate Tax Return and Petitioner’s reliance was reasonable given Mr. Swanson’s extensive tax and estate planning expertise. Entire record.

10. Mr. Swanson was qualified to advise on the tax and estate tax reporting of the Transaction and was provided with all relevant and necessary information regarding the Transaction. Entire record.

ARGUMENT

I. THE VALUE OF THE SPLIT-DOLLAR RECEIVABLES, AS OF THE ALTERNATE VALUATION DATE, IS $2,282,195

A. Overview of Split-Dollar Agreements And Treasury Regulation § 1.61-22

Treasury Regulation § 1.61-22 (the "Split-Dollar Regulations") governs all split-dollar life insurance arrangements entered into or materially modified after September 17, 2003.[317] Treasury Regulation § 1.61-22(b)(1) defines a split-dollar life insurance arrangement as:

> any arrangement between an owner and a non-owner of a life insurance contract that satisfies the following criteria—
>
> (i) Either party to the arrangement pays, directly or indirectly, all or any portion of the premiums on the life insurance contract, including a payment by means of a loan to the other party that is secured by the life insurance contract;
>
> (ii) At least one of the parties to the arrangement paying premiums under paragraph (b)(1)(i) of this section is entitled to recover (either conditionally or unconditionally) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract; and
>
> (iii) The arrangement is not part of a group-term life insurance plan described in section 79 unless the group-term life insurance plan provides permanent benefits to employees (as defined in §1.79-0).

[317] Treas. Reg. §§ 1.61-22(j)(1) & (2).

The Split-Dollar Agreements in the instant case are governed by the Split-Dollar Regulations because they meet the above specified requirements. The Split-Dollar Agreements were entered into after September 17, 2003, as they are dated in 2008. The Split-Dollar Agreements are arrangements between an owner (Decedent through her Revocable Trust)[318] and a non-owner (the Insurance Trust), as defined in Treasury Regulation § 1.61-22(c)(1), where Decedent has paid all of the premiums under the Life Insurances Policies and Decedent is entitled to recover, via the Split-Dollar Receivables, the greater of the total premiums paid or the CSV of the Life Insurance Policies. Decedent's right to recovery is secured by the proceeds of the policies through the Collateral Assignments.

Under Treasury Regulation § 1.61-22(b)(3)(i) there are two mutually exclusive regimes, either the economic benefit regime or the loan regime, that govern the income and gift tax consequences of split-dollar life insurance arrangements entered

[318] Per the Court's July 13, 2016 Order and concession by Respondent, *Estate of Morrissette v. Commissioner,* 146 T.C. 171 (2016), governs the Transaction and the *Morrissette* Court held, under nearly identical facts as the present case, that the donor in that case (the Clara M. Morrissette Trust) was the owner of the split-dollar life insurance arrangement under the Split-Dollar Regulations for gift tax purposes, not estate tax purposes.

into (or materially modified) after September 17, 2003.[319]

Treasury Regulation § 1.61-22(b)(3)(i) provides:

> Except as provided in paragraph (b)(3)(ii) of this section, paragraphs (d) through (g) of this section do not apply to any split-dollar loan as defined in §1.7872-15(b)(1). Section 1.7872-15 applies to any such loan. See paragraph (b)(5) of this section for the treatment of a payment made by a non-owner under a split-dollar life insurance arrangement if the payment is not a split-dollar loan.

Treasury Regulation § 1.61-22(b)(3)(ii) provides:

> *Paragraphs (d) through (g) of this section apply (and §1.7872-15 does not apply) to any split-dollar life insurance arrangement if—*
>
> > (A) The arrangement is entered into in connection with the performance of services, and the employer or service recipient is the owner of the life insurance contract (or is treated as the owner of the contract under paragraph (c)(1)(ii)(A)(1) of this section); or
> >
> > *(B) The arrangement is entered into between a donor and a donee (for example, a life insurance trust) and the donor is the owner of the life insurance contract (or is treated as the owner of the contract under paragraph (c)(1)(ii)(A)(2) of this section).* (emphasis added).

Generally, the person named as the owner in the insurance contract is treated as the owner of the contract.[320] A non-owner is any person other than the owner who has any direct or indirect interest in the contract.[321] However, there is an

[319] Treas. Reg. §§ 1.61-22(a)(1) & 1.61-22(j).
[320] Treas. Reg. § 1.61-22(c)(1).
[321] Treas. Reg. § 1.61-22(c)(2).

exception to this general rule under Treasury Regulation § 1.61-22(c)(1)(ii)(A)(2), which provides (notwithstanding Treasury Regulation § 1.61-22(c)(1)(i)):

> A donor is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into between a donor and a donee (for example, a life insurance trust) if, at all times, the only economic benefit that will be provided under the arrangement is current life insurance protection as described in paragraph (d)(3) of this section.

Therefore, under this exception, if the only economic benefit provided under the Split-Dollar Agreements to the Insurance Trust is current life insurance protection, then Decedent will be the deemed owner of the Life Insurance Policies and the economic benefit regime will apply irrespective of actual policy ownership.[322] However, if the Insurance Trust receives any additional economic benefit other than current life insurance protection, then the Insurance Trust will be considered the owner and the loan regime will apply.[323]

Thus, the critical inquiry in determining whether the loan or economic benefit regime applies is whether the Insurance Trust received any additional economic benefit, other than current life insurance protection. In *Estate of Morrissette v.*

[322] Treas. Reg. § 1.61-22(c)(1)(ii)(A)(2).
[323] *Id*; Treas. Reg. § 1.61-22(b)(3).

Commissioner,[324] the Tax Court considered and answered this same question for split-dollar arrangements that are almost identical to the Transaction at issue in this case. In *Estate of Morrissette v. Commissioner,* the Tax Court determined the split-dollar arrangements at issue to fall under the economic benefit regime for gift tax purposes.[325] *Estate of Morrissette* made no determination of the transaction for estate tax purposes.[326]

B. **The Court's Decision in *Estate of Morrissette* Provides Guidance For Split-Dollar Transactions For Gift Tax Purposes Not Estate Tax Purposes**

In *Estate of Morrissette v. Commissioner*, the Court held that the economic benefit regime under the Split-Dollar Regulations applied to several split-dollar arrangements entered into between Mrs. Morrissette's trust, the Clara M. Morrissette Trust (the "CMM Trust"), and three dynasty trusts set up for the benefit of Mrs. Morrissette's three sons, the Kenneth Morrissette Dynasty Trust, the Donald J. Morrissette Dynasty Trust, and the Arthur E. Morrissette, Jr. Dynasty Trust (collectively, the "Dynasty Trusts").[327] The CMM Trust and Dynasty Trusts entered into two split-dollar arrangements where the CMM Trust contributed a total of approximately $10,000,000

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[324] 146 T.C. 171 (2016).
[325] *Id.* at 186.
[326] *Id.* at 172, footnote 2.
[327] *Id.*

to each of the Dynasty Trusts, which the Dynasty Trusts used to acquire universal life insurance protection on the lives of each of Mrs. Morrissette's three children.[328] In exchange for advancing a total of $29,900,000 to the Dynasty Trusts, the CMM Trust was entitled to repayment of the greater of the total premiums paid for the life insurance policies ($29,900,000) or the cash surrender values of the life insurance policies at the time the insureds died or the policies were surrendered.[329]

The sole issue decided by the Court in *Estate of Morrissette* was, for gift tax valuation purposes, whether the split-dollar arrangements were governed by the economic benefit regime under the Split-Dollar Regulations.[330] In *Estate of Morrissette,* the Court stated that it was "not deciding whether the estate's valuation of the receivables (the portion of the cash value of each policy the CMM Trust was entitled to receive) in the gross estate is correct."[331] After analyzing the Split-Dollar Regulations, the Court determined that the special ownership rule, under Treasury Regulation § 1.61-22(c)(1)(ii)(A)(2), applied for gift tax purposes because the Dynasty Trusts had no right to any portion of the cash values of

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[328] *Id.* at 173-176.
[329] *Id.*
[330] *Id.* at 172, footnote 2.
[331] *Id.*

the life insurance policies and the only economic benefit provided by CMM Trust to the Dynasty Trusts was current life insurance protection.[332] Therefore, the Court held, pursuant to Treasury Regulation § 1.61-22(c)(1)(ii)(A)(2), the CMM Trust was deemed to be the owner of the life insurance contracts and, as a result, the economic benefit regime rather than the loan regime governed the split-dollar arrangements for gift tax purposes.[333]

However, the implication of *Estate of Morrissette v. Commissioner*, if any, with respect to the estate tax issues in the instant case, is unclear.

Treasury Regulation § 1.61-22(a)(1) states:

> This section provides rules for the taxation of a split-dollar life insurance arrangement for purposes of the income tax, the gift tax, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), and the Self-Employment Contributions Act of 1954 (SECA).

Therefore, Treasury Regulation § 1.61-22(a)(1) does not direct the estate tax consequences of a split-dollar arrangement. The only reference the Split-Dollar Regulations make regarding the estate tax consequences of a split-dollar arrangement is in the preamble, which states: "For estate tax purposes, regardless of who is treated as the owner of a life insurance contract under

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[332] *Id.* at 179.
[333] *Id.* at 186.

the final regulations, the inclusion of the policy proceeds in a decedent's gross estate will continue to be determined under section 2042."[334] By its express terms, I.R.C. § 2042 only governs the estate tax consequences of life insurance policies on a decedent's own life, not the split-dollar arrangements which are at issue here where the life insurance policy is on the lives of others, Decedent's children. Thus, the estate tax consequences of the Transaction in the instant case is presumably limited to the value of the Split-Dollar Receivables owned by Decedent as of the date of death.

Accordingly, the Court's holding in *Estate of Morrissette* is solely limited to the determination of whether the economic benefit regime or loan regime applies for gift tax valuation purposes. Moreover, the Split-Dollar Regulations do not govern the estate consequences of split-dollar arrangements. Nevertheless, *Estate of Morrissette* may be relevant because gift and estate taxes are considered *in pari materia* and must be construed together.[335]

[334] T.D. 9092, sec. 5, Gift Tax Treatment of Split-Dollar Life Insurance Arrangements, 2003-2 C.B. 1055.
[335] *See, e.g.*, *Merrill v. Fahs*, 324 US 308, 310-11 (1945); *Estate of Magnin v. Commissioner*, 184 F.3d 1074, 1078 (9th Cir. 1999).

C. Estate Tax in General

I.R.C. § 2001(a) imposes a tax "on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." I.R.C. § 2051 defines the taxable estate as "the value of the gross estate," less applicable deductions. Under I.R.C. § 2031(a), the gross estate of a decedent includes, to the extent provided for in I.R.C. §§ 2031 through 2046, "the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated."

I.R.C. §§ 2035 through 2039 include in a decedent's gross estate the value of property the decedent transferred during his life when specified conditions are met. For example, as explained in more detail below, I.R.C. § 2036 includes the value of transferred property in the decedent's gross estate if, after the transfer, the decedent retained for life the right to the income from the property or the right to designate the beneficiary of the property or the income therefrom. I.R.C. § 2038 includes the value of transferred property in a decedent's gross estate if the decedent retained at death the right to alter, amend, revoke, or terminate the transferee's enjoyment of the property. I.R.C. § 2703 provides a special valuation rule for gift, estate, and generation-skipping transfer tax purposes where property, under certain circumstances, must be valued without regard to an option or agreement to acquire the property for less than fair market value and without regard to any restriction on the right to sell or use the property.

At the time of Decedent's death, the only asset Decedent owned after the Transaction was the right under the Split-Dollar Agreements to receive the greater of: (1) the total amount of premiums paid; or (2) the current CSV of the policies upon the earlier of the death of the last surviving Insured, the termination of the Split-Dollar Agreements, or the surrender of the Life Insurance Policies. The Decedent did not own, or have any other ownership interest in, the Life Insurance Policies because they were owned by the Insurance Trust.

Since Decedent did not own the Life Insurance Policies, Respondent relies on legal theories under I.R.C. §§ 2035, 2036, 2038, and 2703 in an attempt to tax Decedent's estate on something other than the rights she held at the time of her death. In the event the Respondent's arguments fail, the Parties have stipulated that the fair market value of Decedent's interest in the Split-Dollar Agreements was $2,282,195, as of the alternate valuation date.

D. I.R.C. § 2036(a) Does Not Apply

I.R.C. § 2036(a)(1) includes in the gross estate, any assets transferred by a decedent, whether in trust or otherwise, where the decedent retained the possession or enjoyment of, or the right to the income from, the assets so transferred.[336] Treasury Regulation § 20.2036-1(b)(2) states that "the 'use, possession, right to the income, or other enjoyment of the transferred property' is considered as having been retained by, or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit."

I.R.C. § 2036(a)(2) includes in the gross estate any assets transferred by the decedent, whether in trust or otherwise, where the decedent retained the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the assets or the income therefrom during the decedent's lifetime.[337]

[336] *See Estate of Bigelow v. Commissioner*, T.C. Memo. 2005-65, *aff'd*, 503 F.3d 955 (9th Cir. 2007).

[337] *See Estate of Strangi v. Commissioner*, 417 F.3d 468 (5th Cir. 2005).

Treasury Regulation § 20.2036-1(b)(3) further states:

> The phrase "right... to designate the person or persons who shall possess or enjoy the transferred property or the income therefrom" includes a reserved power to designate the person or persons to receive the income from the transferred property, or to possess or enjoy nonincome-producing property, during the decedent's life or during any other period described in paragraph (a) of this section. With respect to such a power, it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e.g., the death of another person during the decedent's lifetime).

Treasury Regulation § 20.2036-1(c)(1) states that "An interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express, or implied, that the interest or right would later be conferred." The existence or nonexistence of such an understanding is determined from all of the facts and circumstances surrounding both the transfer itself and the subsequent use of the property.[338]

[338] *Estate of Harper v. Commissioner*, T.C. Memo. 2002-121.

1. **There has been no transfer of property**

In order for I.R.C. § 2036(a) to apply, there must be a transfer.[339] The IRS has argued that split-dollar transactions deplete the gross estate, and, thus, the depletion is the "transfer" for purposes of I.R.C. § 2036. However, the Estate has not been depleted as there has not been a transfer of assets from Decedent's gross estate. The Transaction in this case was carefully structured under Treasury Regulation § 1.61-22, which necessitates the irrevocable payment of $6,500,000 of premiums to John Hancock and Pacific Life in exchange for the Split-Dollar Receivables. Since the Revocable Trust never owned the Life Insurance Policies, there was no transfer of the Life Insurance Policies' ownership rights from the Revocable Trust to the Insurance Trust. After the completion of the Transaction, Decedent (through her Revocable Trust) maintained her interests in the Split-Dollar Receivables and they have been unaltered since the day she received them. Thus, there has been no transfer of any rights with respect to the Split-Dollar Receivables, and I.R.C. §§ 2036(a)(1) and (a)(2) by their express terms do not apply.

[339] *See, e.g.*, *Shafer v. Commissioner*, 749 F2d 1216 (6th Cir. 1984); *National City Bank of Cleveland v. United States*, 371 F2d 13 (6th Cir. 1966).

2. I.R.C. § 2036(a)(1) does not apply because Decedent did not retain possession, enjoyment or the right to income from the $6,500,000

a. The $6,500,000 was permanently and irrevocably reconstituted into Decedent's rights under the Split-Dollar Agreements and Receivables

I.R.C. § 2036(a)(1) cannot apply to require the inclusion of the $6,500,000 of premiums paid to acquire the Life Insurance Policies because Decedent irrevocably exchanged this property with the third-party insurance companies for the rights under the Split-Dollar Agreements. Once the Life Insurance Policies were purchased and the period for returning the policies ended (10 days after inception for the John Hancock Policy and 20 days after inception for the Pacific Life Policy), neither Decedent, the Revocable Trust nor the Insurance Trust had any legal rights to the $6,500,000 of premiums paid. Thus, there is no conceivable scenario where Decedent could have retained possession, enjoyment, or the right to income from the $6,500,000 because the $6,500,000 was permanently reconstituted into the contractual rights under the Life Insurance Policies with John Hancock and Pacific Life.

Respondent has argued that Decedent "made an inter vivos transfer of $6,500,000 to or for the benefit of the trusts," and that I.R.C. § 2036(a)(1) applies because "Decedent has retained a right to the income on the $6,500,000 for a period that extended beyond her life."[340] For the reasons stated above, Respondent's argument has no merit because Decedent retained no right with respect to the $6,500,000 paid to purchase life insurance from John Hancock and Pacific Life.

b. None of the factors courts consider to determine whether I.R.C. § 2036(a) applies are present in the instant case

Petitioner can find no legal authority where I.R.C. § 2036(a) has been applied to a split-dollar arrangement for estate tax purposes. The legal authority regarding application of I.R.C. § 2036(a) to assets owned by a decedent at death is predominantly in the context of family limited partnerships.

Courts consider several factors to determine whether a decedent's ties to the property transferred to a family limited partnership have been sufficiently severed to avoid estate tax inclusion under I.R.C. §§ 2036(a)(1) and (2).[341] These factors include: (1) whether the decedent's relationship with the assets changed after the transfer; (2) whether the formalities of the

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[340] Respondent's Pre-Trial Memorandum, dated October 16, 2017, pg. 13.

[341] *See, e.g.*, *Estate of Bigelow v. Commissioner*, T.C. Memo. 2005-65, *aff'd*, 503 F.3d 955 (9th Cir. 2007); *Estate of Bongard v. Commissioner*, 124 T.C. 95, 112 (2005); *Estate of Reichardt v. Commissioner*, 114 T.C. 144 (2000); *Estate of Schauerhamer v. Commissioner*, T.C. Memo. 1997-242.

entity's separate legal existence were respected; (3) the amount of assets held the by the decedent outside the family limited partnership; and (4) whether there was a nontax reason for forming the family limited partnership.[342]

The Transaction in this case is fundamentally different from a family limited partnership because Decedent's $6,500,000 was permanently exchanged by the Insurance Trust for the Life Insurance Policies. In some testamentary family limited partnerships, however, the decedents continued to use the assets the same after purportedly transferring them to the partnership and, in that instance, courts have found the family limited partnership to be nothing more than a "partnership wrapper."[343] Nevertheless, the factors courts analyze when applying I.R.C. § 2036(a) to family limited partnerships are relevant to determine whether I.R.C. § 2036(a) should apply in this case.

i. Decedent's relationship with the $6,500,000 permanently changed

A critical factor courts consider in determining whether I.R.C. § 2036(a) applies, is a decedent's relationship with the

[342] *Estate of Harper v. Commissioner*, T.C. Memo. 2002-121.

[343] *See, e.g., Estate of Bigelow v. Commissioner*, T.C. Memo. 2005-65, *aff'd*, 503 F.3d 955 (9th Cir. 2007); *Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005); *Estate of Reichardt v. Commissioner*, 114 T.C. 144 (2000); *Estate of Schauerhamer v. Commissioner*, T.C. Memo. 1997-242.

assets before and after the transfer to a family limited partnership. In *Estate of Reichardt v. Commissioner*, the decedent formed a family limited partnership and transferred his residence and all of his other property (other than his car, personal effects, and a small amount of cash), to the partnership.[344] The decedent also served as a co-trustee of the revocable trust, which was the general partner of the partnership.[345] After forming the partnership, the decedent transferred limited partnership interests to his children but deposited partnership income in his personal account, used the partnership checking account as his personal account, and continued to live at the residence without paying rent to the partnership.[346] The Court concluded nothing but legal title had changed in the decedent's relationship to the assets he purportedly transferred to the partnership and, accordingly, I.R.C. § 2036(a) required the value of the assets transferred to the partnership to be included in the gross estate.

In the instant case, however, Decedent's relationship with the $6,500,000 used to fund the Life Insurance Policies has fundamentally and permanently changed. Not only has the

[344] 114 T.C. 144, 148 (2000).
[345] *Id.* at 152.
[346] *Id.* at 152-153, 158.

$6,500,000 been permanently reconstituted into the Life Insurance Policies but Decedent also gave up the right to be repaid under the Split-Dollar Receivables until such time that the last surviving Insured dies, the Split-Dollar Agreements are terminated, or the policies are surrendered. Moreover, each of the attorneys-in-fact testified that none of them had any intention of canceling the Life Insurance Policies. Indeed, it was everyone's intention to keep the policies in place to ensure life insurance protection until the death of the last surviving Insured. Furthermore, as discussed below, Decedent did not need the cash for any foreseeable obligation in the future. The instant case is fundamentally different from the line of family limited partnership cases where a decedent has transferred his or her assets to the partnership but continued to use them in the same manner until his or her death.[347] Thus, Decedent did not retain possession, enjoyment, or the right to income from the policies.

[347] *See, e.g., Estate of Bigelow v. Commissioner*, T.C. Memo. 2005-65; *Estate of Bongard v. Commissioner*, 124 T.C. 95, 112 (2005); *Estate of Reichardt v. Commissioner*, 114 T.C. 144 (2000); *Estate of Schauerhamer v. Commissioner*, T.C. Memo. 1997-242.

ii. The parties have respected the formalities of the Split-Dollar Agreements

Courts also consider whether the members of a family limited partnership observe and respect the formalities of the entity's separate legal existence.[348] In *Estate of Harper v. Commissioner*, the Court held that I.R.C. § 2036(a) required the inclusion of assets the decedent transferred to a family limited partnership because the decedent commingled partnership funds, did not transfer assets that were purportedly owned by the partnership until several months after the formation of the partnership, and generally did not respect the separate legal existence of the partnership.[349] Instead, the decedent's executor attempted to manipulate the accounting between decedent's trust and the partnership post-mortem in order to separate the decedent's personal funds from partnership funds.[350] The Court in *Estate of Harper* found the decedent's disregard of the partnership form to be equally egregious as the decedent in *Estate of Reichardt v. Commissioner* and it concluded that I.R.C. § 2036(a) applied.[351]

[348] *See, e.g.*, *Estate of Harper v. Commissioner*, T.C. Memo. 2002-121.
[349] *Id.*
[350] *Id.*
[351] *Id.*

In contrast, every aspect of the Transaction in this case has been followed according to its form, since 2008. Formalities the parties have adhered to in the instant case include: (1) the formation of the Insurance Trust; (2) the applications for the Life Insurance Policies; (3) the execution of the Split-Dollar Agreements; (4) the recording of the Collateral Assignments with the life insurance companies; and (5) the reporting of the Transaction for gift and estate tax purposes. Moreover, third parties, such as John Hancock and Pacific Life insurance companies, the lenders and South Dakota Trust, have all required the formalities of the Transaction to be respected since inception. Lastly, Mr. Swanson strictly followed the Split-Dollar Regulations in order to effectuate the Transaction.

Moreover, there has been no commingling of Decedent’s own funds with the funds she advanced to the Insurance Trust so the trust could acquire the policies. Mr. Larson understood his duties as the sole member of the Investment Committee of the Insurance Trust and he has continued to respect the fiduciary obligation his position entails. These facts demonstrate that the parties have respected the form of the Transaction since its inception, have continued to do so after Decedent’s death, and have unequivocally stated their intent to do so until the deaths of the Insureds.

iii. Decedent held significant assets apart from the Split-Dollar Receivables and was earning income substantially in excess of her personal expenses

One of the most important factors courts consider in applying I.R.C. § 2036(a) is the amount of assets a decedent held outside the family limited partnership and whether those assets were sufficient to support the decedent's financial needs for the rest or his or her life.[352] In *Estate of Bigelow v. Commissioner*,[353] the Court found that there was an implied agreement that the Ms. Bigelow retained the right to income from a rental property she transferred to a family limited partnership because, after the partnership was formed, she used $2,000 of the $2,150 monthly net income generated by the rental property to make payments on her personal debts. No other partners of Ms. Bigelow's partnership received distributions before her death.[354]

[352] *See, e.g., Estate of Reichardt v. Commissioner*, 114 T.C. 144, 151 (2000); *Estate of Thompson v. Commissioner*, 382 F.3d 367 (3d Cir. 2004); *Estate of Strangi (II) v. Commissioner,* T.C. Memo. 2003-145; *Church v. United States,* 85 AFTR 2d 2000-804.
[353] T.C. Memo. 2005-65.
[354] *Id.*

In the instant case, however, Decedent's net worth was in excess of $26,000,000 when the Transaction was effected. Decedent also had annual income in excess of a $1,000,000 in the four to five years preceding her death and no personal debt or mortgages on her homes in 2007 or 2008. While Decedent borrowed $6,500,000 to fund the Life Insurance Policies, the loans to fund the policies were taken to save age on Mr. and Ms. Saliterman's lives and were intended to be repaid on a short-term basis, with the exception of the loan on Penn Lake. The loan on Penn Lake was planned to diversify Decedent's asset portfolio and to monetize Decedent's equity in Penn Lake. Moreover, the parties anticipated the sale of Decedent's interest in the Arizona Renaissance and intended to use those funds to repay the loans. As the evidence at trial established, the plan was to borrow on a short-term basis (other than the Central Bank Loan) to save age on the Life Insurance Policies and pay off the loans with the sales proceeds from Decedent's assets. Decedent was earning income significantly in excess of the interest payable on the loans. Notwithstanding the nontax reasons for the loans to fund the Life Insurance Policies, the evidence at trial established that Decedent had sufficient personal assets to fund the Transaction without the need to borrow.

This case is markedly different from the line of family limited partnership cases where decedents transferred substantially all of their assets to the partnerships and were left with insufficient assets to pay their personal expenses for life.[355] In the instant case, Decedent was able to provide for her own personal expenses for the rest of her life. Mr. Swanson understood Decedent was only interested in planning with her excess capital, capital that was in excess of what she needed to maintain her lifestyle for the rest of her life. Finally, at the time the Transaction was planned, Mr. Swanson specifically considered I.R.C. § 2036(a) cases, which required the funds used for the Transaction to not be needed by Decedent for the rest of her life.

iv. There were significant nontax reasons for entering into the Transaction

Finally, courts also consider whether there were "significant and legitimate nontax reasons" for forming a family limited partnership.[356] In *Estate of Bongard v. Commissioner,*

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[355] *See, e.g., Estate of Schauerhamer v. Commissioner*, T.C. Memo. 1997-242; *Estate of Lillie Rosen v. Commissioner*, T.C. Memo. 2006-115; *Liljestrand v. Commissioner*, T.C. Memo. 2011-259.
[356] *See, e.g., Estate of Bongard v. Commissioner*, 124 T.C. 95,

the Court held "the bona fide sale for adequate and full consideration exception is met where: (1) the record establishes the existence of a legitimate and significant nontax reason for creating the FLP; and (2) the transferors received partnership interests proportionate to the value of the property transferred."[357] The *Estate of Bongard* Court applied this test to find that Mr. Bongard's transfer of Empak, Inc. stock to WCB Holdings, LLC qualified for the bona fide sale for adequate and full consideration exception, but that his transfer of membership units in WCB Holdings, LLC to the Bongard Family Limited Partnership, did not.[358] The Court found that there were legitimate and significant nontax reasons for Mr. Bongard's transfer of Empak, Inc. stock to WCB Holdings, LLC, because Empak's board of directors determined that pooling the Empak, Inc. stock owned by Mr. Bongard and the Wayne C. Bongard Irrevocable Stock Accumulation Trust into a single entity would advantageously position Empak for a corporate liquidity event.[359] Prior to the transfer to WCB Holdings, LLC, Empak's stock was held 86.39% by Mr. Bongard and 13.61% by the Wayne C. Bongard

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118 (2005); *Estate of Bigelow v. Commissioner,* T.C. Memo. 2005-65, *aff'd*, 503 F.3d 955 (9th Cir. 2007).

[357] 124 T.C. 95, 118 (2005).

[358] *Id.*

[359] *Id.*

Irrevocable Stock Accumulation Trust.[360] The Court also found that Mr. Bongard received an interest in WCB Holdings, LLC that was proportionate to the value of the Empak shares he contributed (even though he did not receive a control premium), because he retained effective control over Empak through his 86.31% interest in WCB Holdings, LLC.[361]

In the present case, there were several significant nontax reasons for the Transaction. First, the Split-Dollar Receivables were a long-term investment that provided a minimum (and potentially much greater) guaranteed growth on Decedent's $6,500,000 investment. The Transaction also diversified Decedent's portfolio of assets, which was heavily invested in real estate. Additionally, the Transaction provided life insurance protection for Decedent's children so their children could pay their eventual estate tax without the need sell the family's real estate assets.

The Transaction also satisfies the second requirement of the *Estate of Bongard* test that "the transferors received partnership interests proportionate to the value of the property transferred"[362] because Decedent received the Split-Dollar

[360] *Id.*
[361] *Id.*
[362] *Id.*

Receivables which entitled her to a minimum return on her investment. As it currently stands, the CSV of the two policies exceeds $8,138,138, which represents a total growth of more than $1,638,138 over the original $6,500,000 in premiums paid by Decedent in 2008. Therefore, if the Insureds died tomorrow, Decedent would be entitled to an additional $1,638,138 return over the $6,500,000 return of principal under the Split-Dollar Receivables. The significant growth in the Split-Dollar Receivables demonstrates the nontax reason for the Transaction and that Decedent received a property interest proportionate to the value of property she transferred.

Finally, it is hard to conceive how a transaction can lack significant and legitimate nontax reasons when it is specifically provided for under the Internal Revenue Code and the Split-Dollar Regulations.

c. Decedent did not retain possession, enjoyment or the current right to income from the $6,500,000 of premiums paid

As the Supreme Court held in *U.S. v. Byrum*, "it is well settled that the terms 'enjoy' and 'enjoyment,' as used in various estate tax statutes, 'are not terms of art, *but connote substantial present economic benefit* rather than technical vesting of title or estates.'"[363] "Speculative and contingent benefit[s] which may or may not be realized" are also not included in the term "enjoy."[364] The Supreme Court's interpretation of "enjoy" and "enjoyment" imply that I.R.C. § 2036(a)(1) only applies to present or current possessory interests in property, not future interests.

Decedent did not retain the right to possess, enjoy or use the income from the $6,500,000 of premiums paid to John Hancock and Pacific Life during her lifetime because these funds were irrevocably loaned to the Insurance Trust in order to finance the acquisition of the policies. At the time of Decedent's death, the only property interest she held after the Transaction was the Split-Dollar Receivables. Thus, Decedent had no present economic benefit from the $6,500,000 of funds used to acquire the Life Insurance Policies because she was not entitled to repayment of these funds, or any interest thereon, until the death of the last surviving Insured.

As the Court noted in *McNichol's Estate v. Commissioner*, "if…the most valuable property attribute of stocks is their income, it is no less true that one of the most valuable

[363] 408 U.S. 125, 145 (quoting *Commissioner v. Estate of Holmes*, 326 U.S. 480) (emphasis added).
[364] *Id.* at 150.

incidents of income-producing real estate is the rent which it yields. He who receives the rent in fact enjoys the property."[365] Contrary to Respondent's assertion, Decedent did not have the right to access or receive any of the CSV or growth of the Life Insurance Policies at any point during the period in which the Life Insurance Policies were in place because the Insurance Trust held the sole right to surrender the policies. Decedent was not entitled to receive the greater of the premiums paid or the CSV of the Life Insurance Policies until such time that the policies were surrendered, the Split-Dollar Agreements were terminated, or the death of the last surviving Insured. Moreover, one of the purposes for engaging in the Transaction, to provide life insurance protection for Decedent's children, required that the Life Insurance Policies remain in place until the death of the last surviving Insured. Per the express terms of the Transaction, Decedent was not entitled to receive repayment of interest or principal on the Split-Dollar Receivables for an estimated 26 years (the projected joint life expectancy of the Insureds). Thus, Decedent did not enjoy any income from the Split-Dollar Receivables, or have the present right to their increase in value, during her lifetime.

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[365] 265 F.2d 667 (3rd Cir. 1959).

The Split-Dollar Receivables are, in fact, a $6,500,000 term loan. The only difference between a generic term loan and the loan to the Insurance Trust is the term of the loan in the present case is measured on the joint life expectancy of the Insureds. The Transaction followed the Split-Dollar Regulations, which provide for the purchase of life insurance on the life of another on an income tax deferred basis. Under the express terms of the Transaction (and the Split-Dollar Regulations), Decedent gave up possession, enjoyment, and the right to the income from the loan principal for the term of the loan because Decedent was not entitled to repayment of the loan principal or the CSV until such time that the last surviving Insured died, the Split-Dollar Agreements were terminated, or the policies were surrendered.

d. Revenue Ruling 2008-35 is distinguishable from the present case

Respondent cites Revenue Ruling 2008-35 (the "Ruling") for the proposition that the right to receive income from property under I.R.C. § 2036(a)(1) must be broadly interpreted because it specifically includes investment income accruing for the benefit of the taxpayer, even if the taxpayer's current access to the asset is limited.[366] Notwithstanding Respondent's assertion,[367] the Ruling fails to provide any specific legal authority for the contention that I.R.C. § 2036(a)(1) applies, even if a decedent does not have a current right to income from the property. Moreover, the facts of the Ruling are significantly different from the facts in this case.

In the Ruling, taxpayer "A" deposited assets into a restricted management account ("RMA") with Bank M. Pursuant to the terms of the RMA, A gave Bank M complete discretion over the investment of the assets held in the RMA and agreed to forgo the right to withdraw the assets from the RMA for five years in exchange for a reduced investment management fee from the bank. Nevertheless, A retained the property rights to the assets held in the RMA under applicable law and Bank M had no property rights in the assets in the RMA. After five years, the restrictions under the RMA would end and A would be free to access and withdraw the assets from the RMA. In the second year after opening the RMA, A assigned a 1/6th interest in the RMA to A's child, B, at which point the fair market value of the assets

[366] Respondent's Pre-Trial Memorandum, dated October 16, 2017, pg. 15, footnote 4.

[367] "A revenue ruling, without more, of course, is simply the contention of one of the parties to the litigation, and is entitled to no greater weight." *Estate of Lang v. Commissioner*, 64 T.C. 404, 407 (1975).

in the RMA was $60. In the fourth year after opening the RMA, A died, at which point the fair market value of the assets in the RMA was $55.

The Ruling concluded that the fair market value of an interest in an RMA for gift and estate tax purposes is determined based on the fair market value of the assets held in the RMA without any reduction or discount to reflect restrictions imposed by the RMA agreement on the transfer of any part or all of the RMA or on the use of the assets held in the RMA. Thus, there was a $10 gift in year two to B and the amount to be included in A's estate was $55. The Ruling based its conclusion on the fact that "A at all times retain[ed] a property interest under applicable law in the assets in the RMA" and "A ha[d] not changed the nature of A's property by entering into the RMA agreement." Moreover, "A remain[ed] the sole and outright owner of the assets in the RMA and the income from those assets," for the entire time that A owned the RMA.

In the present case, Decedent did not retain any interest in, or rights to, the $6,500,000 of premiums paid or the Life Insurance Policies because, per the express terms of the Split-Dollar Agreements, the Insurance Trust is the owner of the policies. While Decedent was entitled to receive the greater of: (1) the total amount of premiums paid, or (2) the current CSV of the policies at the time of the last surviving Insured's death or earlier termination of the Split-Dollar Agreements, or surrender of the policies, Decedent did not own an interest in the underlying Life Insurance Policies. The Decedent's rights in the Split-Dollar Receivables are only security interests in the policies to protect Decedent's advancement of the $6,500,000. Upon the termination of the Split-Dollar Agreements, the Life Insurance Policies are not required to be surrendered or transferred to Decedent. Instead, the Insurance Trust has a sixty-day option to purchase Decedent's rights under the Split-Dollar Receivables by paying an amount equal to the greater of the total premiums paid by Decedent or the CSVs of the policies. This means the Insurance Trust can retain the Life Insurance Policies, even if the Split-Dollar Agreements are cancelled, as long as the obligation to repay Decedent is satisfied.

The instant case is distinguishable from Revenue Ruling 2008-35 because Decedent does not own the Life Insurance Policies; she has a security interest in them ensuring her right to be repaid under the Split-Dollar Receivables. In the Ruling, however, A (the decedent) at all times owned the underlying property held in the RMA. In contrast, Decedent is not entitled to 100% of the assets. Any amount in excess of the CSV of the policies is payable to the Insurance Trust, not Decedent. The instant case is also distinguishable from the Ruling because the RMA agreement limited A's ability to assign its interest in the RMA (subject to Bank M's approval) to a spouse, parent, descendent, or a trust for the benefit of these permitted transferees. Decedent, by contrast, is free to assign, sell, or otherwise dispose of the Split-Dollar Receivables in any manner she chooses. Moreover, the terms of the RMA agreement were only agreed to in order to provide A with a lower management fee. Per the express terms of the Split-Dollar Agreements, Decedent's inability to access the CSV of the policies was necessary to effectuate the purposes of the Transaction. Finally, the RMA transaction at issue in Revenue Ruling 2008-35 was not provided for by the Code and Treasury Regulations. Split-dollar arrangements, however, are.

e. Respondent's interpretation of I.R.C. § 2036(a)(1) is inconsistent with Treasury Regulation § 20.2031-4

If the Court were to adopt Respondent's interpretation of I.R.C. § 2036(a)(1), then every estate that owned a loan, note receivable, or bond, would be required to include the full amount of loaned principal (or proceeds used to acquire the bond), regardless of whether the loan or bond would be repaid. In every loan (other than zero interest gift loans) the lender earns interest for foregoing the current right to use the principal. Respondent's application of I.R.C. § 2036 to the Split-Dollar Receivables is also inconsistent with Treasury Regulation § 20.2031-4, which contemplates discounts on the valuation of notes based on the interest rate, date of maturity, and solvency of the borrower. Interpreting I.R.C. § 2036(a)(1) to require the inclusion of the full amount of loan principal rather than the fair market value of the right to receive such principal, i.e. the promissory note, would effectively preclude the use of valuation discounts because in every case where the fair market value of the promissory note was less than its face value, Respondent could argue that I.R.C. § 2036(a)(1) required inclusion of the loan principal.

f. There is no authority for Respondent's interpretation of I.R.C. § 2036(a)(1) in the context of intra-family loans

Finally, Petitioner is unable to find any authority where I.R.C. § 2036(a)(1) was applied in the context of an intra-family loan to require an estate to report, for estate tax purposes, the amount of loan proceeds rather than the fair market value of the loan. Respondent recognized this shortfall in his Pre-Trial Memorandum.[368] The general purpose of I.R.C. § 2036 is to "include in a decedent's gross estate transfers that are essentially testamentary—i.e., transfers which leave the transferor a significant interest in or control over the property transferred during his lifetime."[369] In the instant case, Decedent parted with all of her interest in, and control of, the $6,500,000 until the deaths of the Insureds. The instant case is not like the "partnership wrapper" family limited partnership cases which require inclusion of transferred assets under I.R.C. § 2036.[370] Indeed, Decedent gave up the possession, use, and the current right to income from the $6,500,000 while the Split-Dollar Agreements are in place. There is no authority for Respondent's interpretation of I.R.C. § 2036(a)(1) in the context of intra-family loans.

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368 Respondent's Pre-Trial Memorandum, dated October 16, 2017, pg. 12.

369 *United States v. Estate of Grace*, 395 U.S. 316, 320 (1969).

370 *See, e.g.*, *Estate of Bigelow v. Commissioner*, T.C. Memo. 2005-65, *aff'd*, 503 F.3d 955 (9th Cir. 2007); *Estate of Bongard v. Commissioner*, 124 T.C. 95, 112 (2005); *Estate of Reichardt v. Commissioner*, 114 T.C. 144 (2000); *Estate of Schauerhamer v. Commissioner*, T.C. Memo. 1997-242.

3. **I.R.C. § 2036(a)(2) does not apply**

Respondent has argued that I.R.C. § 2036(a)(2) and the Tax Court's holdings in *Estate of Strangi (II)*[371] and *Estate of Powell*,[372] require Decedent to include the CSV of the Life Insurance Policies in her gross estate because one of Decedent's attorneys-in-fact, Mr. Larson, served as the sole member of the Investment Committee of the Insurance Trust and, therefore, could have exercised his power to cancel the Split-Dollar Agreements. This argument fails to consider the fiduciary obligation that Mr. Larson owes to the Beneficiaries of the Insurance Trust, which, as a matter of law, prevented him from canceling the Transaction. Under paragraph 7.5(g) of the Insurance Trust agreement and South Dakota State law,[373] the rights granted to the Investment Committee are only exercisable in a fiduciary capacity. The argument that Mr. Larson could have cancelled the Life Insurance Policies fails to consider that he would have breached his fiduciary duty to the Beneficiaries, as they stand to gain $17,000,000 less the CSV of

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[371] T.C. Memo. 2003-145.
[372] 148 T.C. ___ (May 18, 2017).
[373] *E.g.,* Trustee's obligation of good faith required by South Dakota Codified Laws § 59.0106. In all matters connected with his trust a trustee is bound to act in the highest good faith toward his beneficiary and may not obtain any advantage therein over the latter by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind.

the policies upon the death of the last surviving Insured, as opposed to nothing if the policies were terminated before the deaths of the Insureds.

In *Estate of Strangi (II)*, the Court held that the decedent was required to include the value of property contributed to the Strangi Family Limited Partnership ("SFLP") under I.R.C. § 2036(a)(2) because the decedent, acting in conjunction with others, could dissolve the partnership and because the decedent, through his son-in-law and attorney-in-fact, had the right to determine the amount and timing of partnership distributions.[374] The *Estate of Strangi (II)*[375] Court rejected the estate's arguments that the son-in-law's fiduciary duties to the other members of the SFLP were insufficient under *United States v. Byrum*[376] to trigger the application of I.R.C. § 2036(a)(2). The Court rejected this argument because it found that in exercising his duties to the SFLP, the son-in-law would not "disregard his pre-existing obligation to decedent" and, therefore, the son-in-law's duties to manage the partnership were duties he owed "essentially to himself."[377]

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374 T.C. Memo. 2003-145.
375 *Id.*
376 408 U.S. 125 (1972).
377 T.C. Memo. 2003-145.

This case is distinguishable from *Estate of Strangi (II)*[378] and *Estate of Powell*,[379] for many reasons. First, Mr. Larson was not a member of Decedent's family and he is unrelated to the Beneficiaries. Therefore, the fiduciary obligation he owes to the Beneficiaries is not to members of his own family, but to unrelated third parties. Second, dissolving a partnership has significantly different economic consequences than surrendering the Life Insurance Policies before the death of the last surviving Insured. Unlike the minority partners in the family limited partnerships at issue in *Estate of Strangi (II)*[380] and *Estate of Powell*[381] (who would have been entitled to any distributions or liquidation proceeds based on their ownership interests in the partnerships), if the Split-Dollar Agreements are terminated, *the Beneficiaries of the Insurance Trust would receive absolutely nothing*. Termination of the Split-Dollar Agreements would be far more detrimental to the Beneficiaries than the minority partners in *Estate of Strangi (II)*[382] and *Estate of Powell*[383] and, thus, in violation of Mr. Larson's fiduciary duty under the Insurance Trust agreement. Mr.

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378 *Id.*
379 148 T.C. ___ (May 18, 2017).
380 T.C. Memo. 2003-145.
381 148 T.C. ___ (May 18, 2017).
382 T.C. Memo. 2003-145.
383 148 T.C. ___ (May 18, 2017).

Larson's fiduciary obligation to the Beneficiaries is more significant and constraining than the "illusory" duties the Courts found sufficient to require the application of I.R.C. § 2036(a)(2) in *Estate of Strangi (II)*[384] and *Estate of Powell*[385] and, thus, warrants a different result in this case.

Termination of the Split-Dollar Agreements would also defeat one of the underlying purposes for entering into the Transaction: to provide liquidity to Decedent's children on the death of the last surviving Insured and a long-term income tax deferred investment for Decedent. Therefore, it was in neither Decedent's nor the Insurance Trust's interest to cancel the Life Insurance Policies because doing so would result in a loss of insurance protection for Decedent's children and would prevent the Revocable Trust from recognizing long-term growth on its investment. The attorneys-in-fact and Mr. Swanson testified that it was everyone's intention, including Decedent's, that the Split-Dollar Agreements stay in place until the deaths of the Insureds.

If Mr. Larson were to cancel the Insurance Policies before the death of the last surviving Insured, he would not only be violating his fiduciary duty to the Beneficiaries but he would

[384] T.C. Memo. 2003-145.
[385] 148 T.C. ___ (May 18, 2017).

also be in violation of the fiduciary duty he owed to Decedent under the terms of the Power of Attorney. In other words, it was in the mutual interest of both Decedent and the Beneficiaries for the Policies to remain in place. If the Court were to disregard Mr. Larson's fiduciary obligation to the Beneficiaries by reason of his pre-existing fiduciary obligation to Decedent as her attorney-in-fact, Mr. Larson's fiduciary obligation to Decedent *alone* prevents him from canceling the Life Insurance Policies. Mr. Swanson testified that it would be a conflict of interest for Mr. Larson to continue as the sole member of the Investment Committee *if* he was requested to cancel the Transaction during Decedent's lifetime.

Moreover, there is no evidence in the record that would indicate that Mr. Larson would need to cancel the Life Insurance Policies during Decedent's lifetime. The Decedent's net worth in 2008 was in excess of $26,000,000 and her annual earnings were in excess of $1,500,000. Decedent had sufficient assets and income to maintain her lifestyle without the necessity of Mr. Larson canceling the Life Insurance Policies during her lifetime. The evidence at trial established that there was no conceivable scenario that Decedent would need the funds from the Split-Dollar Receivables during her lifetime.

4. **Even if I.R.C. § 2036 applies, the Transaction meets the bona fide sale for adequate and full consideration exception**

Even if the Court were to find that I.R.C. § 2036 required the inclusion of CSV of the Life Insurance Policies rather than the fair market value of the Split-Dollar Receivables in the gross estate, the exception for bona fide sales for adequate and full consideration, per I.R.C. § 2036, precludes the CSV of the Life Insurance Policies from being brought into Decedent's gross estate.

I.R.C. § 2036 does not include in the gross estate transfers a decedent makes prior to his or her death if the transfer is "a bona fide sale for an adequate and full consideration in money or money's worth" (the "bona fide sale exception"). The prevailing Eight Circuit case which interprets the bona fide sale exception is *Estate of Korby v. Commissioner.*[386] *Estate of Korby* held:

> The transaction must "be made in good faith" which requires an examination as to whether there was "some potential for benefit other than the potential estate tax advantages that might result from holding assets in the partnership form." *Thompson*, 382 F.3d at 383. "[I]f there is no discernible purpose or benefit for the transfer other than estate tax savings, the sale is not 'bona fide' within the meaning of § 2036." *Id.*; see also *Strangi*, 417 F.3d at 479 ("[A] sale is 'bona fide' if, as an objective matter, it serves a

[386] 471 F.3d 848 (8th Cir. 2006).

> 'substantial business [or] other non-tax' purpose." (quoting *Kimbell v. United States*, 371 F.3d 257 [93 AFTR 2d 2004-2400], 267 (5th Cir. 2004)).[387]

The Tax Court has interpreted the bona fide sale exception to require an estate to establish both the nontax bona fides of the transaction and the existence of full and adequate consideration.[388] The Tax Court also considers whether a transfer depletes a decedent's estate when determining whether full and adequate consideration is present.[389] However, the Tax Court, Ninth Circuit, and Fifth Circuit have rejected the argument that valuation discounts necessitate a finding against full and adequate consideration, recognizing that there is an exception to the depletion rule in the context of family limited partnerships where the value of a partnership interest received by a decedent is less than the value of the assets transferred to the partnership because lack of control and lack of marketability discounts apply to the partnership interest, if the partnership was created for a legitimate and significant nontax reason.[390]

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[387] Id. at 853-54.
[388] *See Estate of Bigelow v. Commissioner*, 503 F.3d 955, 969 (9th Cir. 2007).
[389] *See Estate of Powell,* 148 T.C. ___ (May 18, 2017).
[390] *See, e.g., Estate of Harper v. Commissioner,* T.C. Memo. 2002-121; *Estate of Powell,* 148 T.C. 18 (2017); *Estate of Bigelow v. Commissioner*, 503 F.3d 955, 969 (9th Cir. 2007), *aff'g* T.C.

a. The Transaction was motivated by several nontax business reasons

The Split-Dollar Receivables received pursuant to the Split-Dollar Agreements meet the bona fide sale exception because the Transaction was undertaken for legitimate nontax business reasons: (1) as a long-term investment for Decedent to recognize guaranteed growth on the $6,500,000 of premiums paid with deferred income tax consequences; (2) to diversify Decedent's assets; and (3) to provide life insurance protection for Decedent's children in order to help them pay their eventual estate tax liabilities without having to sell their interests in the family real estate businesses. While estate tax savings was also a purpose for the Transaction, the Transaction was provided for in the Split-Dollar Regulations and was carefully structured to follow the requirements under the regulations.

Per the express terms of the Split-Dollar Agreements, the Revocable Trust was entitled to a guaranteed rate of return equal to at least 3% per year. The rate of return, however, has actually ranged from 5.45% to 4.67% for the Pacific Life Policy and 4.8% to 4.3% for the John Hancock Policy. As a result, the CSV of the two policies exceeds $8,138,138, which represents a

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Memo. 2005-65; *Kimbell v. United States*, 371 F.3d 257, 267 (5th Cir. 2004).

total growth of more than $1,638,138 over the original $6,500,000 in premiums paid by Decedent in 2008. Thus, as it currently stands, the Estate is not only entitled to a return of its investment, but also substantial growth on the funds Decedent loaned to the Insurance Trust.

b. Any potential tax savings resulting from the Transaction are speculative because the Transaction is an income tax deferral

Upon the death of the last surviving Insured, the Revocable Trust will have to recognize income in an amount equal to *at least $5,855,943*—the CSV of the two policies as of March 21, 2017 less its $2,282,195 basis (the fair market value of the Split-Dollar Receivables as agreed to between the Parties in the Second Stipulation of Settled Issues). If, however, the Estate is required to report the fair market value of the Split-Dollar Receivables at $6,500,000 on Decedent's Estate Tax Return as Respondent contends, the Revocable Trust will receive a $6,500,000 basis in the Split-Dollar Receivables and will instead recognize income equal to $1,638,138, if the policies were surrendered for their March 21, 2017 CSV. While taking the lower $2,282,195 basis in exchange for reporting an additional $4,217,805 of income could result in overall net tax savings (taking into consideration both the income and estate tax consequences of the Transaction), it is substantially less tax savings than Respondent has argued because the Estate will have to recognize at least an additional $4,217,805 of income upon the death of the last surviving Insured. Therefore, the potential tax savings resulting from the Transaction are speculative and are not the substantial tax savings that Respondent has argued.

Instead, the Transaction is an income tax deferral, which is provided for under I.R.C. § 72 and Treasury Regulation § 1.61-22. Therefore, it is difficult to understand how a transaction that is specifically contemplated and sanctioned by the Code and Treasury Regulations could be viewed as lacking a bona fide component, particularly where Decedent and the Insurance Trust structured the Transaction exactly as is provided for under the Code and regulations.

c. The Transaction did not deplete the Estate

There has been no depletion of Decedent's gross estate by virtue of the Transaction, contrary to what Respondent has argued. Decedent purchased split-dollar life insurance in exchange for the Split-Dollar Receivables, retaining the right to receive the greater of: (1) the premiums paid or (2) the CSV of the Life Insurance Policies. Thus, Decedent was not only entitled to 100% of the premiums paid but also a guaranteed and competitive return on her investment. Therefore, as long as the Life Insurance Policies grew in value (which they were guaranteed to do at a rate equal to at least 3% per year), Decedent would receive a return of, and growth on, her investment.

While it is true that the $6,153,478 CSV of the two Life Insurance Policies at the onset of the Transaction was less than the $6,500,000 of premiums paid, this was a result of the immediate transaction costs for underwriting the policies and providing current term life insurance on the Insureds. By 2011 for the Pacific Life Policy and 2012 for the John Hancock Policy, the CSV of each policy had increased above the initial $4,000,000 and $2,500,000 of premiums paid for each policy, respectively. Furthermore, the current CSV of the Life Insurance Policies today exceeds $8,138,138. Therefore, the Estate is not only entitled to receive a return of Decedent's initial investment but it also stands to receive an additional $1,638,138 over the original $6,500,000 in premiums Decedent paid in 2008. Because Decedent was entitled to receive an amount greater than $6,500,000, she has not depleted her gross estate, nor has she transferred an asset within the meaning of I.R.C. § 2036.

d. Even if there was a reduction in the value of the Split-Dollar Receivables by reason of Decedent's inability to access the CSV of the Life Insurance Policies, this diminution must be disregarded under *Estate of Harper* and *Kimbell v. United States*

Courts have recognized that although some transfers result in depletion of the estate (for example, because of restrictions on marketability and control resulting from the transfer of assets to a family limited partnership), there can be intangible benefits that result from a genuine pooling of assets such that the transfer still qualifies as full and adequate consideration for purposes of the bona fide sale exception.[391] The Eighth Circuit in *Estate of Korby v. Commissioner,* recognizes that the "good faith" requirement "requires an examination as to whether there was some potential for benefit other than the potential estate tax advantages that might result from holding assets in the partnership form."[392] *Estate of Korby* also cites *Kimbell v.*

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[391] *See, e.g., Estate of Harper v. Commissioner,* T.C. Memo. 2002-121; *Estate of Powell,* 148 T.C. 18 (2017); *Estate of Bigelow v. Commissioner*, 503 F.3d 955, 969 (9th Cir. 2007), *aff'g* T.C. Memo. 2005-65; *Kimbell v. United States*, 371 F.3d 257, 267 (5th Cir. 2004).
[392] 471 F.3d 848, 853 (8th Cir. 2006).

United States, whose rationale is particularly applicable to the instant case.[393]

In *Kimbell v. United States*, the Fifth Circuit explained the rationale behind this exception to the full and adequate consideration requirement:

> The business decision to exchange cash or other assets for a transfer-restricted, non-managerial interest in a limited partnership involves financial considerations other than the purchaser's ability to turn right around and sell the newly acquired limited partnership interest for 100 cents on the dollar. Investors who acquire such interests do so with the expectation of realizing benefits such as management expertise, security and preservation of assets, capital appreciation and avoidance of personal liability. Thus there is nothing inconsistent in acknowledging, on the one hand, that the investor's dollars have acquired a limited partnership interest at arm's length for adequate and full consideration and, on the other hand, that the asset thus acquired has a present fair market value, i.e., immediate sale potential, of substantially less than the dollars just paid — a classic informed trade-off.[394]

The discrepancy between the value of the Split-Dollar Receivables as reported on Decedent's Estate Tax Return and the amount of premiums paid is primarily due to the fact that neither Decedent nor the Revocable Trust had the right to cancel the Life Insurance Policies. The discount resulting from Decedent's current inability to access the CSV of the Life

[393] *Id.*
[394] *Kimbell v. United States*, 371 F.3d 257, 266 (5th Cir. 2004).

Insurances Policies should be treated no differently than the lack of control or lack of marketability discounts applicable to partnership interests because this was necessary to ensure life insurance coverage for Decedent's children. The lack of Decedent's current right to receive payment under the Split-Dollar Receivables is no different than liquidation and distribution restrictions in a partnership agreement. Both are necessary and inherent features of the underlying property interest. Without termination restrictions in a partnership agreement, the partners in a partnership could terminate the partnership at will. Likewise, if Decedent had the current right to access the CSV of the Life Insurance Policies, there would be no guarantee that Decedent's children would receive the death benefit under the Life Insurance Policies.

In addition, Decedent received intangible benefits from the Transaction that were not reflected in its value. The Transaction diversified Decedent's portfolio and provided her a guaranteed return of 3% per year on her $6,500,000 investment with the potential to earn significantly in excess of 3%. In fact, the Life Insurance Policies have credited between 4.3% and 5.45% since the completion of the Transaction. Moreover, it is possible that Decedent could earn in excess of the 6.05% and

5.65% discount rates used by Mr. Siebrasse in his valuation of the Split-Dollar Receivables, in which case there would be no depletion of the Estate at all.

As the *Kimbell* Court recognized, there are financial considerations such as the expectation of capital appreciation and preservation of assets which explain why an arm's length investor might purchase a limited partnership interest that has a present fair market value of substantially less than the dollars just paid for it.[395] In the present case, Decedent and the attorneys-in-fact decided to pursue the Transaction for exactly the same reasons as *Kimbell* identified[396]: (1) to diversify Decedent's portfolio; (2) to provide Decedent with a guaranteed return on her excess capital; and (3) to provide for the long-term preservation of the family's real estate business by planning for estate taxes of future generations. In almost every instance after the formation of a limited partnership, the partners receive something that is initially worth less than the assets exchanged for such interest by reason of the termination and transferability restrictions that are present in almost all partnership agreements. *Kimbell* recognized that these investment decisions are a classic informed trade-off and

[395] 371 F.3d 257, 266 (5th Cir. 2004).
[396] *Id* at 266, 268.

specifically rejected the argument that the immediate loss in value resulting therefrom necessitates a finding against full and adequate consideration.[397] Here, the decision Decedent made to engage in the Transaction is no different. Thus, despite the fact that the Split-Dollar Receivable was worth less than the premiums Decedent paid in the hands of a third-party buyer immediately after the Transaction was completed, the value of the Split-Dollar Receivable was full and adequate.

E. For The Same Reasons I.R.C. § 2036 Does Not Apply, I.R.C. § 2038 Does Not Apply to The Split-Dollar Agreements

Under I.R.C. § 2038, the value of all interests in property of which a decedent has at any time made a transfer, by trust or otherwise, is included in the gross estate if the enjoyment of the transferred interests were subject at the date of the decedent's death to any change through the exercise of a power (in whatever capacity exercisable) 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), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death. While I.R.C. §§ 2036 and 2038 are

[397] *Id.*

not exactly the same, there is substantial similarity between the rights and powers that trigger one or both of these Code sections to require inclusion in the gross estate. In addition, I.R.C. § 2038 contains exception for "a bona fide sale for an adequate and full consideration in money or money's worth" that is identical to the bona fide sale exception in I.R.C. § 2036. Therefore, the same arguments discussed, herein, regarding the inapplicability of I.R.C. § 2036 (including the arguments with respect to the bona fide sale exception) apply equally to any potential arguments under I.R.C. § 2038. Thus, for the same reasons as discussed above in section I.D., I.R.C. § 2038 does not apply to the Split-Dollar Agreements or the Split-Dollar Receivables.

F. I.R.C. § 2035 Does Not Apply to The Split-Dollar Agreements Because There Has Not Been a Transfer of Property And I.R.C. §§ 2036, 2037, 2038 And 2042 Are Inapplicable

I.R.C. § 2035(a) requires an estate to include the value of any property, if a decedent transfers or relinquishes any power with respect to such property during the three year period ending on the date of the decedent's death, and the value of such property would have been included in the gross estate under I.R.C. §§ 2036, 2037, 2038, or 2042, had the transferred interest or relinquished power been retained by the decedent on the date of death.

As discussed above in section I.D., I.R.C. § 2035(a) does not apply because Decedent has not transferred the Split-Dollar Receivables or relinquished any power or rights with respect thereto. Even if the Court were to find that the Decedent transferred an interest or relinquished a power with respect to the Life Insurance Policies, I.R.C. § 2035 would only apply if the interest or power would have been included in the Decedent's gross estate under I.R.C. §§ 2036, 2037, 2038, or 2042. Therefore, the same arguments discussed, herein, regarding the inapplicability of I.R.C. §§ 2036 and 2038 (including the arguments with respect to the bona fide sale exception) apply equally here.

I.R.C. § 2042 only applies to life insurance policies of which the estate is a beneficiary or of which the decedent possesses an "incident of ownership." As previously discussed, the Insurance Trust, not Decedent, was the beneficiary and owner of the Life Insurance Policies. Neither Decedent nor the Revocable Trust possessed any "incidents of ownership" or rights with respect to the Life Insurance Policies other than a collateral interest in the policies which ensured the right to be repaid the greater of the premiums paid or the CSV of the Life Insurance Policies. Accordingly, I.R.C. § 2042 is inapplicable.

I.R.C. § 2037 includes in the gross estate the value of any property transferred by the decedent if possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and the decedent retained a reversionary interest in the property. I.R.C. § 2037 does not apply because this Code section requires a transfer by Decedent, and, as discussed above, there has been no transfer of the Split-Dollar Receivables. Moreover, even if the Court were to conclude that there was a transfer of the premiums paid or the Life Insurance Policies to the Insurance Trust, there is no requirement that the Insurance Trust or the Beneficiaries survive Decedent in order to possess or enjoy the Life Insurance Policies. Rather, the Insurance Trust owns the Life Insurance Policies and its entitlement to the death benefits payable under the policies pursuant to the Split-Dollar Agreements is not conditioned on anyone surviving Decedent.

Thus I.R.C. § 2035 does not apply to the Split-Dollar Agreements or the Split-Dollar Receivables.

G. The Property Interest to be Valued For Purposes of Applying I.R.C. § 2703 is The Split-Dollar Receivables

1. I.R.C. § 2703 cannot apply to the Life Insurances Policies or their CSVs because Decedent has no ownership rights in either

Respondent argued that the combined CSV of the Life Insurance Policies ($6,153,478) is includable in the Estate, because "this is the amount that Decedent's attorneys-in-fact would have received on the alternate valuation date had they unwound the arrangements on that date."[398] This argument must be rejected because Decedent did not own the Life Insurance Policies, nor did she have any right to the CSV of the policies at any time. Respondent acknowledges this shortcoming by stating that the Transaction would need to be unwound in order for Decedent to realize the CSV. Respondent's hypothetical recast of the Transaction assumes away the heart of the issue. Decedent could not unwind the Transaction because she had no right to surrender the Life Insurance Policies or terminate the Split-Dollar Agreements. Therefore, when considering the application of I.R.C. § 2703, the Court must look solely to the property interest held by Decedent at the time of her death, which indisputably is Decedent's rights under the Split-Dollar

[398] Respondent's Pre-Trial Memorandum, dated October 16, 2017, pgs. 18-19.

Agreements. The Tax Court has rejected other attempts by the Internal Revenue Service to apply I.R.C. § 2703 to something other than the property interest held by a decedent at the time of his or her death.[399]

For example, in *Estate of Strangi (I) v. Commissioner*, the Tax Court rejected Respondent's argument that I.R.C. § 2703 required the Court to ignore the existence of the family limited partnership, stating that I.R.C. §§ 2703 and 2704:

> [W]ere intended to be a targeted substitute for the complexity, breadth, and vagueness of prior section 2036(c); and Congress wanted to value property interests more accurately when they were transferred, instead of including previously transferred property in the transferor's gross estate.[400]

Therefore, the *Estate of Strangi (I)* Court concluded:

> Congress did not intend, by the enactment of section 2703, to treat partnership assets as if they were assets of the estate where the legal interest owned by the decedent at the time of death was a limited partnership or corporate interest.[401]

In *Church v. United States*, the Court also rejected Respondent's argument that the term "property" in I.R.C. § 2703 referred to the assets the decedent transferred to the partnership prior to death, rather than her partnership

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[399] See *Estate of Strangi (I) v. Commissioner,* 115 T.C. 478 (2000).

[400] *Id* at 488-489.

[401] *Id* (emphasis added).

interest, finding that there "is no statutory basis for this contention."[402] The Court also rejected Respondent's alternative argument that in the event that I.R.C. § 2703 required taxation of the decedent's partnership interest, I.R.C. § 2703 allowed any term restriction or restrictions on sale in the partnership agreement that served to reduce its market value to be disregarded, stating:

> No case supports the Government's position, and nothing in the legislative history, or the regulations adopted by the IRS itself, convince this Court to read into Section 2703 something that is not there. By its very nature, a partnership is voluntary association of those who wish to engage in business together, and upon whom the law imposes fiduciary duties. *Term restrictions, or those on the sale or assignment of a partnership interest that preclude partnership status for a buyer, are part and parcel of the property interest created by state law.* These are not the agreements or restrictions Congress intended to reach in passing I.R.C. § section 2703.[403]

Under the holdings of *Estate of Strangi (I)*[404] and *Church*,[405] the assets to be included in Decedent's gross estate are the Split-Dollar Receivables and not the underlying Life Insurance Policies because Decedent did not own the Life Insurance Policies at the time of her death. Under the express terms of the Split-Dollar Agreements, the only right Decedent held was

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402 85 AFTR 2d 2000-804.
403 *Id* (emphasis added).
404 115 T.C. 478 (2000).
405 85 AFTR 2d 2000-804.

the right to receive the greater of: (1) the total amount of premiums paid; or (2) the current CSV of the policies—the Split-Dollar Receivables. Per the express terms of the Split-Dollar Agreements, the Insurance Trust was the owner of the policies and retained all other ownership rights in the policies, including the sole right to cancel or surrender the policies prior to the death of the last surviving Insured.

2. <u>There are no restrictions on the Split-Dollar Receivables and the terms of the Split-Dollar Agreements are "part and parcel" of the property interest</u>

The Split-Dollar Agreements contain no restrictions on Decedent's or the Revocable Trust's rights with respect to the Split-Dollar Receivables. Therefore, the Revocable Trust is free to sell, assign, encumber and use the Split-Dollar Receivables in any manner it desires. The only "restriction" in the Split-Dollar Agreements is that the Revocable Trust does not have the right to surrender the Life Insurance Policies or receive repayment under the Split-Dollar Receivables at any time. Instead, it must wait until the death of the last surviving Insured or the surrender of the policies. However, this restriction is not a restriction on the Split-Dollar Receivables; it is a restriction on the underlying Life Insurance Policies and Decedent and the Revocable Trust did not own the actual Life Insurance Policies at the time of Decedent's death. The Policies were owned by the Insurance Trust.

Respondent argues that the Revocable Trust's inability to unilaterally terminate the Split-Dollar Agreements is analogous to a closely-held company with bylaws that allow shareholders to veto all sales of stock (a restriction, Respondent asserts, which I.R.C. § 2703 somehow applies to).[406] However, Respondent's characterization is fundamentally false. There are no restrictions on Decedent's rights or use of the Split-Dollar Receivables. Moreover, unlike a shareholder in a company, Decedent has no rights to the underlying Life Insurance Policies (other than a collateral interest ensuring repayment of the Split-Dollar Receivables), even upon the death of the last surviving Insured or the termination of the Split-Dollar Agreements. Decedent is merely owed an amount equal to the greater of the total premiums paid or CSV of the policies. In contrast, shareholders of a company are entitled to the underlying assets upon the liquidation of the company. The distinction between holding a security interest (such as in the case of a lender), versus owning the property subject to a loan or mortgage, is critical, because as long as the Split-Dollar

[406] Respondent's Pre-Trial Memorandum, dated October 16, 2017, pg. 20.

Receivables are repaid, Decedent never can own the Life Insurance Policies.

In this case, Decedent's rights with respect to the Life Insurance Policies are the same as a lender with a security interest because the Split-Dollar Receivables are no different economically than a promissory note received pursuant to a term loan. Decedent is entitled to the greater of the premiums paid (the principal) or the CSV, and the CSV of the policies is guaranteed to grow at a minimum of 3% per year (the interest on the principal). The only difference is the Split-Dollar Receivables are measured by the joint lives of the Insureds rather than by a fixed period of time.

The Split-Dollar Receivables should not be subject to I.R.C. § 2703 any more than the partnership interests at issue in *Church* are, because the terms contained in the Split-Dollar Receivables are "part and parcel" of the property interest created by the Transaction.[407] To hold otherwise would make every loan subject to I.R.C. § 2703 because a lender in a term loan necessarily incurs a "restriction" on the right to collect the principal during the term of the loan in exchange for interest payments and a later repayment of principal. Forgoing

[407] 85 AFTR 2d 2000-804.

the right to be repaid principal for the term of the loan is an inherent aspect of a loan. Likewise, the Revocable Trust has forgone the right to be repaid under the Split-Dollar Receivables, until the death of the last surviving Insured, in order to ensure Decedent's children do not lose the certainty of their life insurance protection.

3. **Revenue Ruling 2008-35 is distinguishable**

Revenue Ruling 2008-35 held that I.R.C. § 2703(a)(2) applied to disregard the restrictions on the sale or use of the property held by A in the RMA for federal transfer tax valuation purposes. As discussed, above, in section I.D.2.(d), Revenue Ruling 2008-35 is distinguishable from the present case because Decedent does not own the underlying property subject to the Split-Dollar Agreements.

4. **Even if I.R.C. § 2703 were to apply, the transaction meets the bona fide sale exception**

I.R.C. § 2703(b) contains a substantially similar bona fide sale exception to those in I.R.C. §§ 2036 and 2038. The exception in I.R.C. § 2703(b) also requires that the terms of any option, agreement, right, or restriction to be "comparable to similar arrangements entered into by persons in an arms' length transaction." The same arguments discussed above regarding the applicability of the I.R.C. §§ 2036 and 2038 bona fide sale exception apply equally to any potential arguments under I.R.C. § 2703(b). Therefore, for the same reasons as discussed, above, in section I.D.4., even if the Court were to find that I.R.C. § 2703 does apply, the Transaction meets the bona fide sale exception under I.R.C. § 2703(b).

II. PETITIONER IS NOT LIABLE FOR ACCURACY RELATED PENALTIES, PURSUANT TO I.R.C. §§ 6662(h) OR 6662(g)

A. Respondent Has Not Met His Burden of Production For The Assertion of The Gross And Substantial Valuation Misstatement Penalties Under I.R.C. § 6751(b)(1)

I.R.C. § 6751(b)(1) provides: "No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate." The penalties at issue herein, I.R.C. §§ 6662(h) and 6662(g), require managerial approval, in writing, of the "initial determination" made of the individual asserting such penalty.[408] Under I.R.C. § 7491(c), Respondent bears the burden of production with respect to the liability for any penalty. Respondent must present sufficient evidence to show that it is

[408] I.R.C. § 6751(b)(1).

appropriate to impose a penalty in the absence of available defenses.[409]

In *Graev v. Commissioner* (*Graev II*),[410] the Tax Court held that compliance with I.R.C. § 6751(b)(1) is not ripe for review in a deficiency case because the penalty has not yet been assessed until after the conclusion of the Tax Court case. However, within a few months after *Graev II* was decided, the Second Circuit in *Chai v. Commissioner*,[411] rejected the holding in in *Graev II.* In *Chai*, the Second Circuit held that the Commissioner must show that he complied with I.R.C. § 6751(b)(1) as part of his burdens of production *and proof* in deficiency cases before the notice of deficiency is issued (or the Commissioner files his Answer or Amended Answer).[412] The Tax Court subsequently adopted the holding of *Chai* in *Graev III.*[413]

Graev III, and the concurring opinions thereto, raised many questions regarding what is required of the Commissioner in a deficiency case where certain penalties are at issue. Specifically, the Court struggled with *Chai's* holding that the Commissioner must now have supervisory approval of the "initial

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[409] *See Higabee v. Commissioner*, 116 T.C. 438, 446 (2001).
[410] *Graev v. Commissioner*, 147 T.C. __, __ (November 30, 2016).
[411] *Chai v. Commissioner*, 851F. 3d 190, 216-223 (2nd Cir. 2017), *aff'g in part, rev'g in part* 109 T.C.M. 1206.
[412] *Id* at 223.
[413] *Graev v. Commissioner*, 149 T.C. ___ (December 20, 2017).

determination of such assessment" which, per the majority of *Graev III,* refers to the action of the IRS official who first proposes the penalty to be asserted and which must also be approved by his or her immediate supervisor.[414] The question that remained unanswered in *Graev III* is whether the Commissioner bears not only the burden of production but also the burden of proof of some penalties, as *Chai* held.[415]

The Penalty Approval Form in the instant case identifies Scott Ratke as the subordinate who made the "initial determination" of the I.R.C. § 6662(h) gross valuation misstatement penalty at issue.[416] Nicole Bard, Group Manager and Mr. Ratke's acting supervisor, signed the Penalty Approval Form.[417] However, the Penalty Approval Form itself states the basis for the I.R.C. § 6662(h) penalty solely because "It was applied in another stat. notice case in another territory and Area Counsel supports the assertion of this penalty." The other statutory notice of deficiency case, the person who made the "initial determination" of the penalty in that unidentified case

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[414] *Graev III*, 149 T.C. at__ (slip. op. at 74-81).
[415] *Chai v. Commissioner*, 851 F.3d 190, 221 "…[W]e further hold that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which the penalty is asserted."
[416] Ex. 53-R.
[417] Stip. ¶ 93.

and the identity of the Area Counsel (or whether he or she approved such a penalty in writing), is missing from the Penalty Approval Form *in this case*. Thus, there can be no "initial determination" of the I.R.C. § 6662(h) gross valuation misstatement penalty by Scott Ratke in this case because the basis for assertion the penalty *was in another case* and *not in this case.*

While the *Graev III* Court has not smoothed out all the "initial determination" wrinkles, it is uncontroverted that the supervisor's written approval must be of the "initial determination" made by the same subordinate who *actually made* the "initial determination."[418] Thus, per the express terms of the Penalty Approval Form, Respondent has failed to meet his burden of production in this case by demonstrating that the subordinate who made the "initial determination" of the penalty was approved by his or her immediate supervisor in writing. Mr. Ratke and Ms. Bard's reliance on the penalty assertion in another statutory notice of deficiency case does not meet the express requirements of I.R.C. § 6751(b)(5) and *Graev III*. For this reason alone, the accuracy related penalties at issue, pursuant to I.R.C. §§ 6662(h) and 6662(g), should be abated.

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[418] *Graev III*, 149 T.C. at __ (slip. op. at 74-81).

B. **The Gross And Substantial Valuation Misstatement Penalties Under I.R.C. §§ 6662(g) And 6662(h)(2) do Not Apply**

I.R.C. § 6662(a) imposes an accuracy-related penalty on an underpayment of tax equal to 20% of any underpayment attributable to any substantial estate or gift tax valuation understatement. According to I.R.C. § 6662(g), there is a substantial estate or gift tax valuation understatement if the value of property reported on an estate or gift tax return is 65% or less of its correct value and the underpayment attributable to such valuation understatement exceeds $5,000. The penalty imposed under I.R.C. § 6662 is increased from 20% to 40% where there is a gross valuation misstatement.[419] A gross valuation misstatement occurs where the property is reported at a value less than 40% of its correct value.[420]

In the Estate Tax Notice of Deficiency, Respondent determined that there was a gross valuation misstatement pursuant to I.R.C. § 6662(h) and he asserted a penalty equal to 40% of the understatement. In the alternative, Respondent has asserted a 20% substantial valuation understatement penalty under I.R.C. § 6662(g). Per the Second Stipulation of Settled Issues, the parties have stipulated that the value of the split-

[419] I.R.C. § 6662(h)(1).
[420] I.R.C. § 6662(h)(2)(C).

dollar receivables as of the alternate valuation date will now be $2,282,195. Thus, if Petitioner prevails in overcoming all of Respondent's legal arguments, there will be no substantial or gross valuation misstatement with respect to the Split-Dollar Receivables because Petitioner reported the value at $2,137,130 on the Estate Tax Return.

Respondent's arguments that the $6,500,000 of premiums paid, or the $6,153,478 CSV of the Life Insurance Policies, should be includable in the gross estate are based purely on legal theories under I.R.C. §§ 2035, 2036, 2038 and/or 2703. In the event these legal theories are not sustained, Respondent has stipulated that the value to be determined under I.R.C. §§ 2031, 2032, 2033 and Treasury Regulation § 20.2031-4 is $2,282,195. Accordingly, the difference in Respondent's value to be includable in the gross estate and Petitioner's value reported on the Estate Tax Return is not a valuation misstatement but is based solely on Respondent's legal theories. The valuation issues have been fully stipulated between the parties. Thus, there can be no valuation misstatement in this case for that reason alone.

1. <u>Petitioner has reasonable cause defenses to the accuracy related penalties</u>

Per I.R.C. § 6664(c), no accuracy-related penalty will be applied when a taxpayer can demonstrate that the taxpayer: (i) had reasonable cause for the underpayment and (ii) acted in good faith with respect to the underpayment. A taxpayer can establish reasonable cause where he or she exercised ordinary business care and prudence.[421] The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all relevant facts and circumstances.[422] Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability.[423] Depending on the taxpayer's knowledge, education and experience, an honest misunderstanding of a fact or the law may constitute reasonable cause.[424]

Reliance upon the advice of a tax professional or appraiser may establish reasonable cause and good faith.[425] The Tax Court has stated that reasonable cause and good faith are present where the taxpayer establishes by a preponderance of evidence that: (i) the taxpayer reasonably believed that the professional

[421] *U.S. v. Boyle*, 469 U.S. 241 (1985).
[422] Treas. Reg. § 1.6664-4(b)(1).
[423] Treas. Reg. § 1.6664-4(b)(1).
[424] Treas. Reg. § 1.6664-4(b)(1).
[425] *U.S. v. Boyle*, 469 U.S. 241 (1985).

upon whom the reliance is placed was a competent tax adviser who has sufficient expertise to justify reliance; (ii) the taxpayer provided necessary and accurate information to the adviser; and (iii) the taxpayer actually relied in good faith on the adviser's judgment in order for such reliance to demonstrate reasonable cause.[426]

Petitioner has reasonable cause defenses to any gross valuation misstatement or negligence penalties. The evidence at trial established that the attorneys-in-fact relied upon the advice of Mr. Swanson, Decedent's trusted tax and estate planning attorney, with respect to the tax treatment of the Transaction. Mr. Swanson and Mr. Rubin introduced the Transaction to the attorneys-in-fact and Decedent. Mr. Swanson advised the attorneys-in-fact with respect to the gift, income, and estate tax treatment of the Transaction after he conducted due diligence into the facts and reviewed the law. Mr. Swanson reviewed the Split-Dollar Regulations and applicable Internal Revenue Code sections and considered potential challenges to the transaction by the IRS, none of which had appeared in any published legal authority at the time of the Transaction (or, as of the time the Estate Tax Return was prepared and filed). Mr.

[426] *Neonatology Assocs., P.A. v. Commissioner*, 115 T.C. 43 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

Swanson provided his advice to the attorneys-in-fact before, during and after the Transaction was completed. Mr. Swanson's advice was delivered to the attorneys-in-fact in writing with a PowerPoint presentation and in the detailed January 7, 2008 letter, which outlined the tax and legal effects of the Transaction. Mr. Swanson and the attorneys-in-fact each testified that Mr. Swanson provided legal advice regarding the Transaction to them in meetings and by telephone since the attorneys-in-fact do not typically communicate by email.

The attorneys-in-fact did not have the requisite education or expertise to structure the Transaction or to provide legal advice with respect to the tax treatment of the Transaction. While Mr. Larson has limited accounting expertise, he is not a tax or legal advisor, nor is he a certified public accountant. Ms. Saliterman has no professional experience with respect to tax or estate planning. Though Mr. Levine attended law school, he has not practiced law since 1985 and he has never practiced tax or estate planning. Thus, each of the attorneys-in-fact relied upon Mr. Swanson's tax and legal experience. Moreover, it was prudent for them to rely upon Mr. Swanson given his extensive tax and estate planning expertise.

Mr. Swanson has significant expertise in the areas of federal gift and estate tax as a practicing estate planning attorney for more than 18 years. Mr. Swanson testified regarding his professional expertise, the advice he gave with respect to the Transaction and that he had complete knowledge of the facts at the time his advice was rendered. It was reasonable for Petitioner to rely upon his advice on the tax treatment of the Transaction and Petitioner followed Mr. Swanson's advice.

Additionally, Mr. Swanson and Petitioner retained Mr. Siebrasse to prepare an appraisal of the Split-Dollar Receivables for the Estate Tax Return. Mr. Siebrasse is a managing director at RSM McGladrey and had more than 14 years of professional experience in business valuation and economic analysis at the time he was retained by the Estate. Mr. Siebrasse was provided with all the facts and documents underlying the Transaction at the time his appraisal was prepared. Petitioner relied upon Mr. Siebrasse's value of the Split-Dollar Receivables for estate tax purposes and his determined value of Decedent's interest in the Split-Dollar Receivables was reported on the Estate Tax Return.

Accordingly, Petitioner had reasonable cause and good faith defenses to the valuation misstatement penalties, within the meaning of I.R.C. § 6664, when it reported the value of Decedent's interests in the Split-Dollar Receivables. Thus, neither the substantial valuation misstatement nor the gross valuation misstatement penalty applies.

2. **Petitioner had a reasonable basis for the reporting position taken on the Estate Tax Return**

An accuracy related penalty does not apply if the taxpayer has a reasonable basis for his position.[427] A taxpayer can generally establish that he has a reasonable basis for a return position where it is reasonably based on one or more authorities constituting "substantial authority."[428] The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities identified in Treas. Reg. § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in Treas.

[427] Treas. Reg. § 1.6662-3(b)(1).
[428] Treas. Reg. §§ 1.6662-4(d)(3) and 1.6662-3(b)(3).

Reg. § 1.6662-4(d)(2).[429] As shown above in Sections I.D. through I.G., Petitioner had substantial authority for entering into the Transaction, and therefore, had a reasonable basis for the position reported on the Estate Tax Return.

Substantial authority for a particular tax treatment exists when the weight of the authorities supporting the treatment is substantial in relation to the weight of the authorities supporting contrary positions.[430] The substantial authority standard is less stringent than the more-likely-than-not standard (met only when the likelihood of a position's being upheld is greater than 50%) but is more stringent than the reasonable basis standard."[431]

"The standard of 'substantial authority' requires that, when the facts and authorities are analyzed with respect to the taxpayer's case, the weight of the authorities that support the taxpayer's position should be substantial when compared with those supporting the contrary position."[432] To determine whether substantial authority exists, all relevant authorities,

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429 Treas. Reg. § 1.6662-3(b)(3).
430 *See Curcio v. Commissioner*, 689 F.3d at 224-225; *Norgaard v. Commissioner*, 939 F.2d 874, 880 (9th Cir. 1991), *aff'g in part, rev'g in part on another ground* T.C. Memo. 1989-390; Treas. Reg § 1.6662-4(d)(3)(i).
431 Treas. Reg. §1.6662-4(d)(2).
432 *Schirmer v. Commissioner*, 89 T.C. 277, 283 (1987).

including those pointing to a contrary result, are taken into account.[433] Examples of relevant authority include statutory and regulatory provisions, caselaw, legislative history, and administrative interpretations by the Commissioner.[434]

A taxpayer may have substantial authority for a position that is unlikely to prevail, as long as the weight of the authorities in support of the taxpayer's position is substantial in relation to the weight of any contrary authorities.[435] The substantial authority regulations further provide:

> The weight accorded an authority depends on its relevance and persuasiveness, and the type of document providing the authority. For example, a case or revenue ruling having some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is otherwise inapplicable to the tax treatment at issue.[436]

The determination of whether a taxpayer's position has substantial authority is made as of the last day of the taxable year to which the return relates and at the time that return is filed.[437]

Petitioner has substantial authority because Decedent and Petitioner complied with the Split-Dollar Regulations when the

[433] Treas. Reg. § 1.6662-4(d)(3)(i).
[434] Treas. Reg. § 1.6662-4(d)(3)(iii).
[435] Treas. Reg. § 1.6662-4(d)(2).
[436] Treas. Reg. § 1.6662-4(d)(3)(ii).
[437] Treas. Reg. § 1.6662-4(d)(3)(iv)(C).

Transaction was structured and considered all applicable estate tax authority when the Transaction was reported for estate tax purposes. The Transaction was designed to fall under the economic benefit regime of the Split-Dollar Regulations and the terms of the Split-Dollar Agreements were drafted to accomplish this. Although the Split-Dollar Regulations do not provide specific guidance on the estate tax reporting of split-dollar arrangements, the preamble of the Split-Dollar Regulations states: "For estate tax purposes, regardless of who is treated as the owner of a life insurance contract under the final regulations, the inclusion of the policy proceeds in a decedent's gross estate will continue to be determined under section 2042."[438] The Split-Dollar Regulations assume the estate tax consequences of split-dollar arrangements are determined under I.R.C. § 2042 and the other general estate tax provisions under the Internal Revenue Code because there is no specific authority for split-dollar arrangements for estate tax purposes. However, there *is* substantial authority for split-dollar transactions like the Transaction at issue here.

[438] T.D. 9092, sec. 5, Gift Tax Treatment of Split-Dollar Life Insurance Arrangements, 2003-2 C.B. 1055.

The Split-Dollar Agreements state:

> The parties intend that such collateral assignment shall convey no right, power or duty that is an incident of ownership… as such phrase is defined under Sections 2035 and 2042 of the Internal Revenue Code of 1986…

and

> The insurance Trust shall remain the sole and absolute owner of the Policy except as provided in this Agreement. Such ownership rights shall include but shall not be limited to the right to surrender or cancel the Policy and the right to designate a beneficiary or beneficiaries to receive any proceeds payable on the death of the insureds which are in excess of the Revocable Trust's share of such proceeds.[439]

Therefore, Petitioner did not retain any "incidents of ownership" under I.R.C. § 2042 that would require inclusion of the Life Insurance Policies in the gross estate. Petitioner relied upon Mr. Swanson's review of the interpretative authority of I.R.C. §§ 2036, 2038 and 2703, as those sections pertain to family limited partnerships, to determine whether those Code sections applied to split-dollar transactions for estate tax purposes. As of the date of the Transaction and the subsequent filing of the Estate Tax Return, split-dollar transactions had not been challenged for estate tax purposes. In fact, to Petitioner's knowledge, there is currently no direct guidance or authority addressing the estate tax consequences of split-dollar

[439] Exs. 26-J, Bates pgs. 592-593 & 28-J, Bates pgs. 606-607.

transactions. Moreover, Mr. Swanson testified that he considered each of these Code sections and applicable caselaw, such as *Estate of Strangi v. Commissioner*[440] and *Church v. United States*,[441] and concluded that I.R.C. §§ 2036, 2038, and 2703 did not apply. Accordingly, for the reasons stated in Sections I.D. through I.G., Petitioner had a reasonable basis for concluding that I.R.C. §§ 2036, 2038, and 2703 do not apply, because none of the I.R.C. §§ 2036 and 2038 inclusionary factors are present here. Moreover, courts have summarily rejected Respondent's argument that I.R.C. § 2703 allows Respondent to disregard restrictions that are "part and parcel" of the property interest held by a decedent at the time of his or her death.

Therefore, Petitioner valued the Split-Dollar Receivables in accordance with I.R.C. § 2031, and the Treasury Regulations promulgated thereunder, and relied upon the value determined by a qualified expert appraiser. Since Respondent has agreed that the value of Decedent's interests in the Split-Dollar Receivables as of the alternate valuation date was $2,282,195, a difference of only $145,065 from the value reported on the Estate Tax Return, Petitioner had substantial authority and a

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[440] 115 T.C. 478 (2000).
[441] 85 AFTR 2d 2000-804.

reasonable basis for the reporting position taken on the Estate Tax Return.

III. CONCLUSION

Based upon the facts and legal authority cited herein, the value of the Split-Dollar Receivables to be included in the gross estate, as of the alternate valuation date, is $2,282,195 per I.R.C. § 2031 and no accuracy related penalties apply.

Docket No. 13370-13

Respectfully submitted,

DATED: February 14, 2018

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Docket No. 13370-13

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing OPENING BRIEF FOR PETITIONER was served on Counsel for Respondent by mailing the same on February 14, 2018 in a postage paid wrapper addressed as follows:

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Date: By: G. Michelle Ferreira

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ESTATE OF MARION LEVINE, DECEASED, ROBERT L. LARSON, PERSONAL REPRESENTATIVE,
Petitioners,

ELECTRONICALLY FILED

v.

Docket No. 13370-13

COMMISSIONER OF INTERNAL REVENUE,
Respondent

RESPONDENT'S SERIATIM ANSWERING BRIEF

SERVED Mar 16 2018

UNITED STATES TAX COURT

ESTATE OF MARION LEVINE, DECEASED, ROBERT L. LARSON, PERSONAL REPRESENTATIVE,	)	
Petitioner,	)	
v.	)	Docket No. 13370-13
COMMISSIONER OF INTERNAL REVENUE,	)	Filed Electronically
Respondent.	)	

ANSWERING BRIEF FOR RESPONDENT

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UNITED STATES TAX COURT

ESTATE OF MARION LEVINE, DECEASED ROBERT L. LARSON, PERSONAL REPRESENTATIVE,	)	
Petitioner,	)	
v.	)	Docket No. 13370-13
COMMISSIONER OF INTERNAL REVENUE,	)	Filed Electronically
Respondent.	)	

ANSWERING BRIEF FOR RESPONDENT

PRELIMINARY STATEMENT

This case involves an estate tax deficiency determined by respondent totaling $3,018,759. Additionally, respondent has determined that petitioner is liable for a 40% gross estate tax valuation understatement penalty, pursuant to I.R.C. § 6662(h), with respect to the value of its rights in two split-dollar arrangements.

The trial of this case was held before the Honorable Mark V. Holmes, in Washington, D.C. on November 13th and 14th, 2017. The evidence in this case consists of a Stipulation of Facts ("SOF") containing one paragraph and Exhibit 1-J, a First Supplemental Stipulation of Facts ("FSSOF") containing paragraphs 1 through 95 and Exhibits 2-J through 55-J[1], a Second Supplemental Stipulation of Facts ("SSSOF") containing paragraphs 96 through 126 and Exhibits 56-J through 77-J, and a Third Supplemental Stipulation of Facts ("TSSOF"), containing paragraphs 127 through 145 and Exhibits 78-J through 95-J. The evidence in this case also consists of the trial testimony of six witnesses and trial Exhibits 96-R through 99-R.

The Court ordered the parties to file seriatim briefs. Petitioner's Opening Brief was due and filed on February 14, 2018. Respondent's Answering Brief is due on March 16, 2018. Petitioner's Reply to Respondent's Answering Brief is due on April 2, 2018. A Rule 155 computation will be necessary.

[1] Respondent initially objected to Exhibit 13-P, but withdrew his objection at trial. Petitioner initially objected to Exhibits 12-R, 16-R, 19-R, 20-R, 42-R, 46-R, 50-R, 52-R, and 53-R. Petitioner withdrew its objection to Exhibit 53-R in the TSSOF (¶ 127). Exhibits 16-R, 19-R, 20-R and 50-R were admitted into evidence at trial. Respondent did not offer Exhibits 12-R, 42-R, 46-R, or 52-R into evidence.

QUESTIONS PRESENTED[2]

1. Whether petitioner should have included in the gross estate the combined cash surrender value, $6,153,478, of the life insurance policies that were purchased by the Decedent as part of two split-dollar life insurance arrangements[3].

a. Alternatively, whether petitioner should have included in the gross estate the then present value of the Decedent's right to be repaid under the split-dollar arrangements[4].

2. Whether petitioner is liable for a 40% gross estate tax valuation understatement penalty, pursuant to section

[2] The notice of deficiency contains several additional adjustments that have been resolved by the parties. There is one additional issue that the parties have yet to resolve: whether petitioner is entitled to deduct from the gross estate a $1,000,000 charitable contribution that the Estate has not paid in full to the George and Marion Levine Charitable Foundation. Although the purported bequest has not been paid in full, respondent intends to concede this adjustment if petitioner provides proof that full payment has been made prior to the entering of a decision in this case.

[3] The notice of deficiency sets forth two alternative determinations concerning the value of the Decedent's interest in the split-dollar arrangements: (1) the actuarial value was $6,767,950, and (2) the value includable in the estate was the amount of the premiums paid, $6,500,000. (Ex. 3-J). Respondent concedes each of these alternative determinations.

[4] If the Court determines that the combined cash surrender value of the policies is not includable in the Estate, the parties have stipulated that the discounted present value of the Decedent's right was $2,282,195 as of the Alternate Valuation Date.

6662(h), with respect to the value of the rights in the split-dollar arrangements reported on the Decedent's estate tax return.

POINTS RELIED UPON

1. Petitioner should have reported the combined cash surrender value of the life insurance policies that were purchased as part of two split-dollar life insurance arrangements on the Decedent's estate tax return.

2. The combined cash surrender value of the policies is includable in the Decedent's gross estate pursuant to sections 2036(a)(1) and/or 2036(a)(2) because the Decedent made an inter vivos transfer of $6,500,000 that was used to purchase two separate whole life insurance policies on the lives of her daughter and son-in-law and the Decedent retained the right to (1) the income from the split-dollar arrangements that her Revocable Trust entered into with her newly formed Insurance Trust, and/or (2) designate the persons who would possess or enjoy the transferred property.

3. The combined cash surrender value of the policies is includable in the Decedent's gross estate pursuant to section 2038 because the Decedent made a transfer of $6,500,000 and the Decedent retained, either alone or in conjunction with others,

the power to alter, amend, revoke or terminate the enjoyment of the property in question.

4. Even if the full value of the life insurance policies is not includable in the Decedent's gross estate under sections 2036 or 2038, the special valuation rules under section 2703 are applicable to the split-dollar arrangements. The special valuation rules under section 2703 provide that the restrictions in the split-dollar agreements should be disregarded and, therefore, the combined cash surrender value of the life insurance policies is includable in the Decedent's gross estate.

5. The split-dollar arrangements do not meet the bona fide sale for adequate and full consideration exceptions to sections 2036, 2038 or 2703 because (1) the split-dollar arrangements were not bona fide sales, and (2) the Decedent did not receive "adequate and full consideration" in exchange for transferring $6,500,000 to the life insurance companies.

6. Although the Court's opinion in Estate of Powell v. Commissioner, 148 T.C. No. 18 (2017) is not directly on point, the Court's opinion in that case supports respondent's position.

7. The Court's opinion in Estate of Morrissette, 146 T.C. No. 171 (2016) is not relevant to the estate tax adjustment at issue in this case.

8. Respondent has met his burden of production under section 7491(c), and as construed by the court in Graev v. Commissioner, 149 T.C. No. 23 (2017) with respect to the section 6662(h) gross estate tax valuation understatement penalty. Respondent has shown that the Estate claimed that the value of the Decedent's interests in the split-dollar arrangements was less than 40 percent of the correct value of those interests. Respondent has also shown that the initial determination to assert the gross estate tax valuation understatement penalty was personally approved, in writing, by the immediate supervisor of the individual who made the initial determination to assert the penalty, as required by section 6751(b)(1).

9. Petitioner failed to meet its burden of proof that it has a reasonable cause defense to the gross estate tax valuation penalty.

10. The Decedent's attorneys-in-fact did not understand the split-dollar strategy and did not read Mr. Swanson's opinion letter before they entered into the split-dollar arrangements. Therefore, the Decedent's attorneys-in-fact did not "rely" on Mr. Swanson within the meaning of Treasury Regulations section 1.6664-4(b)(1).

11. It was not objectively reasonable for the Decedent's attorneys-in-fact to rely on the advice of Mr. Swanson because Mr. Swanson introduced the split-dollar strategy to the attorneys-in-fact by telling them that they could use this strategy to "make $15,000,000 look like $1,500,000 to $7,500,000". The Decedent's attorneys-in-fact should have been concerned that Mr. Swanson's claims were "too good to be true." <u>See</u> <u>Stobie Creek Investments LLC v. United States</u>, 608 F.3d 1366 (Fed. Cir. 2010).

12. The Decedent's attorneys-in-fact cannot reasonably rely in good faith on the advice of Mr. Swanson because Mr. Swanson was a promoter of the split-dollar arrangements at issue in this case. <u>See</u> <u>Avrahami v. Commissioner</u>, 149 T.C. No. 7 (2017).

13. The reasonable basis and substantial authority exceptions cited by petitioner are not applicable in this case because those defenses do not apply to the gross estate tax valuation understatement penalty. The regulations cited by petitioner in support of its position apply only to negligence and substantial understatement penalties asserted with respect to underpayments of <u>income</u> tax. <u>See</u> §§ 1.6662-3, 1.6662-4.

REQUESTED FINDINGS OF FACT

Marion Levine ("the Decedent") was born in 1920 in St. Paul, Minnesota. (Ex. 4-J). The Decedent was a successful business woman who owned and operated a successful chain of grocery stores in Minnesota with her husband, George Levine, between the 1950s and early 1980s. (Tr. 299:6 - 299:14). The Levines had two children together, Robert H. Levine ("Mr. Levine") and Nancy S. Saliterman ("Mrs. Saliterman"). (Ex. 6-J, Bates 297). George Levine passed away in 1974 and the Decedent continued to operate the grocery stores until she sold the business for $5,000,000 in 1981. (Tr. 299:6 - 299:14 & 300:5 - 300:9). The Decedent invested the sales proceeds in mobile home parks and other business opportunities. (Tr. 300:5 - 300:24). These investments were very successful and the Decedent's wealth grew exponentially over the years. (Tr. 300:5 - 300:9).

In 1988, the Decedent formed the Marion Levine Trust (the "Revocable Trust") and designated herself as the Trustee. (FSSOF ¶¶ 7 - 8, Ex. 5-J). The Decedent named her children, Mr. Levine and Mrs. Saliterman, and her grandchildren as the beneficiaries. (FSSOF ¶ 9). On February 7, 2005, the Decedent resigned as the Trustee of the Revocable Trust and designated Mr. Levine, Mrs. Saliterman, and Robert L. Larson ("Mr. Larson") as the co-Trustees of the Revocable Trust. (FSSOF ¶ 13). Mr. Larson is a longtime friend and business colleague of the Decedent and has been one of Mr. Levine's business partners for more than fifty years. (Tr. 251:16 - 251:17, 303:1 - 303:10). Mr. Levine, Mrs. Saliterman, and Mr. Larson are currently the co-Trustees of the Revocable Trust and have been the co-Trustees of the Revocable Trust since February 7, 2005. (FSSOF ¶ 14).

On May 17, 1996, when the Decedent was 76 years old, she signed a Power of Attorney which designated Mr. Levine, Mrs. Saliterman, and Mr. Larson as her attorneys-in-fact. (FSSOF ¶ 12, Ex. 9-J). The terms of the Power of Attorney are very broad; the attorneys-in-fact were granted the power to manage all of the Decedent's affairs. (Ex. 9-J, Tr. 330:6 - 330:20). Mr. Levine, Mrs. Saliterman, and Mr. Larson remained the Decedent's attorneys-in-fact and continued to manage her affairs until the Decedent passed away on January 22, 2009 at the age of 88. (FSSOF ¶¶ 3, 4 & 12, Ex. 9-J).

Although petitioner disagrees with this assertion, it appears that the Decedent's health had gradually deteriorated during the last decade of her life and from 2003 until the time of her death, the Decedent's "behavior was quiet, erratic, and vacant and that she was unable to participate in conversation."

(Ex. 85-J, Bates 2494). Regardless of the state of the Decedent's health in the years prior to her death, it is indisputable that the attorneys-in-fact had the power to manage all of the Decedent's affairs, including her estate planning. (FSSOF ¶ 12, Ex. 9-J).

Despite the fact that the attorneys-in-fact had collective control over the Decedent's estate planning, Mr. Levine took the lead with respect to these matters and he met regularly with the Decedent's estate planning attorney. (Tr. 220:24 - 221:11). In late 2007, approximately one year prior to the Decedent's death, Mr. Levine grew tired of working with the Decedent's estate planning attorney so he replaced him with an estate planning attorney named Shane Swanson[5] ("Mr. Swanson"). (Tr. 222:8 - 222:20, 330:21 - 331:9).

On November 19, 2007, Howard Rubin, a member of Mr. Swanson's firm, sent an engagement letter to Mr. Levine which stated that the firm would be representing Mr. Levine and Mrs. Saliterman as their mother's attorneys-in-fact, in lieu of their mother, because she was incapacitated. (Ex. 78-J). Mr. Swanson's firm agreed to assist in the implementation of several estate planning strategies for a flat fee of $120,000. (Tr.

[5] Mr. Swanson is also the estate planning attorney for Mr. Levine, Mrs. Saliterman and Mr. Larson. (Tr. 32:9 - 32:12).

28:6 - 28:10, 30:9 - 30:17). Although one of Mr. Swanson's colleagues signed the engagement letter, Mr. Swanson was the primary point of contact with the attorneys-in-fact and he conducted all of the estate planning work. (Tr. 31:20 - 32:1).

Within days of sending the engagement letter, Mr. Swanson introduced Mr. Levine to a "new idea" involving split-dollar life insurance arrangements. (Ex. 13-P, Bates, 371). Mr. Swanson then sent an email to Mr. Levine, Mr. Larson, and Mark Saliterman[6] on November 29, 2007 in which he told them that they could use this "new idea" to "take $15,000,000 and make it look like $1,500,000 to $7,500,000" and thereby significantly reduce the Decedent's estate tax liability. (Ex. 13-P, Bates 371, Tr. 109:23 - 110:4). This "new idea" was a proposed split-dollar life insurance strategy, which was not contemplated by the Decedent's prior estate planning attorney. (Tr. 30:25 - 31:13).

Approximately one month later, on January 7, 2008, Mr. Swanson sent a letter to the attorneys-in-fact which summarized the proposal and explained the purported tax consequences. (Ex. 13-P). This letter, which was the only letter that Mr. Swanson wrote explaining the split-dollar strategy (Tr. 111:10 - 111:14), made no mention of any purpose for using the split-

[6] Mark Saliterman is a Certified Public Accountant and was Mrs. Saliterman's brother-in-law.

dollar strategy aside from the purported estate tax savings of $3,217,075. (Ex. 13-P). Mr. Larson did not read the letter (Tr. 223:16 - 224:11), Mrs. Saliterman admits that she probably did not read the letter or comprehend its contents (Tr. 279:18 - 280:3), and Mr. Levine does not recall if he read the letter (Tr. 336:5 - 337:7).

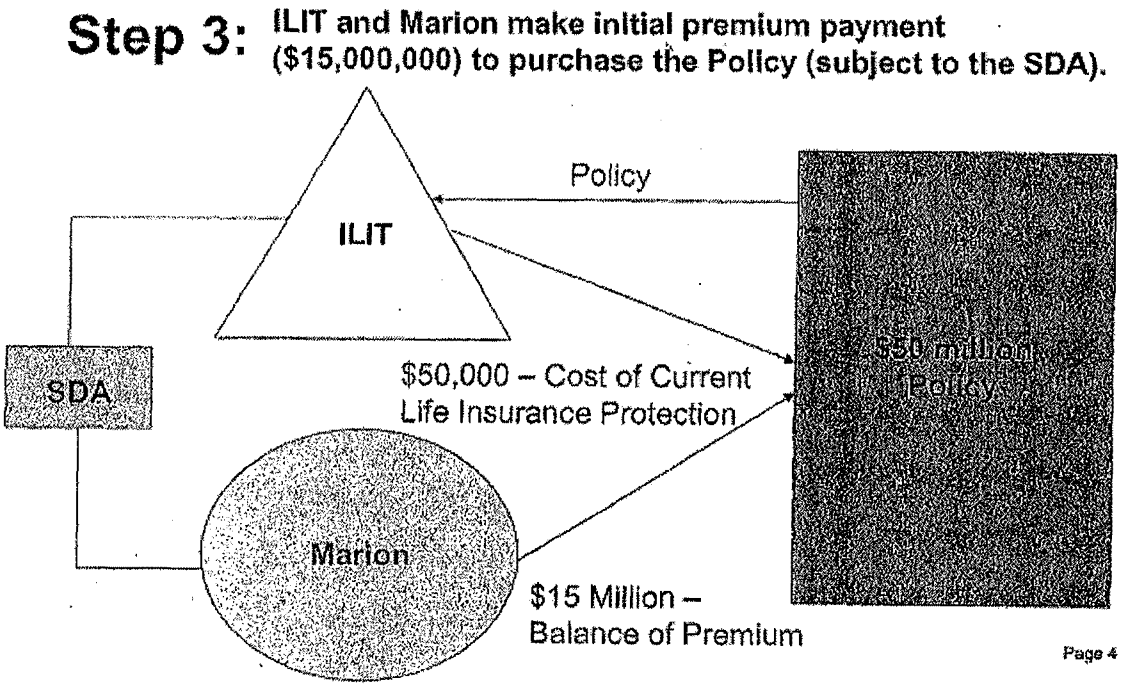
Mr. Swanson also met with the attorneys-in-fact and made a PowerPoint presentation regarding the proposed strategy in early 2008. (Ex. 14-J, Tr. 48:6 - 48:17, 310:19 - 310:23). Mr. Swanson's letter (Ex. 13-P) and PowerPoint presentation (Ex. 14-J) explained the split-dollar strategy as follows:

- **Step 1**: The Decedent, via her attorneys-in-fact, would contribute funds to a newly created insurance trust. The beneficiaries of this trust would be Mr. Levine, Mrs. Saliterman, and their respective children. (Ex. 13-P, Bates 360, Ex. 14-J, Bates 478).
- **Step 2**: The newly formed insurance trust would enter into a split-dollar agreement with the Decedent. This agreement would provide that the Decedent would contribute funds to the insurance trust so that the insurance trust could pay for life insurance policies on the lives of Mr. Levine and Mrs. Saliterman. In

exchange, the Decedent would be entitled to receive the greater of the premiums paid or the cash value of the policies upon the death of the insureds or the surrender of the policies. (Ex. 13-P, Bates 360).

- **Step 3**: The insurance trust would use the funds that were contributed by the Decedent to make initial one-time premium payments of $15,000,000 to purchase the life insurance policies on the lives of Mr. Levine and Mrs. Saliterman. (Ex. 13-P, Bates 360, Ex. 14-J, Bates 480).
- **Step 4**: Since the Decedent was entitled to receive at least $15,000,000 in approximately 25 years, a present value discount would apply to the Decedent's right to repayment and her interest would be valued at only $4,700,000 for estate tax purposes. (Ex. 14-J, Bates 481).

The following excerpt from Mr. Swanson's presentation illustrates the proposed structure of the split-dollar arrangements:



(Ex. 14-J, Bates 480).

The following excerpt from Mr. Swanson's presentation sets forth the purported estate tax valuation consequences of the split-dollar arrangements:

Potential Value of Marion's Interest in SDA*

- **Assume**
  - **(1) Marion subsequently dies;**
  - **(2) The SDA will not terminate until Nancy's (and/or Bob and/or Larry's) death;**
  - **(3) Nancy's (and/or Bob and/or Larry's) remaining life expectancy is 25 years; and**
  - **(4) The current long term AFR rate is 4.72%.**
- **Under SDA, Marion entitled to receive <u>at least</u> $15 million.**
- **Calculating present value of a $15 million receivable in 25 years at a 4.72% discount rate, **Marion's interest would be valued at:**

$4.7 million

(Ex. 14-J, Bates 481). As the excerpt demonstrates, the estate tax savings was dependent upon the application of a significant "present value" discount to the proceeds that the Decedent was entitled to receive when her daughter, son and/or son-in-law passed away in approximately 25 years. Id.

At some point between January 7, 2008 and January 11, 2008, Mr. Larson and Mr. Swanson discussed the amount that should be channeled into this strategy. (Ex. 99-R, P. 2). Mr. Swanson and Mr. Larson initially discussed allocating at least $6,000,000 to the strategy, but they wanted "to borrow as much as possible in addition to that, hopefully $5,000,000 to $10,000,000", to funnel into the strategy. Id. All of the relevant correspondence indicates that the amount to be funneled into the split-dollar strategy was based entirely on the amount of cash that could be raised; not the amount of life insurance the Levine family needed. (Exs. 16-R, 19-R, & 99-R).

Although the attorneys-in-fact did not understand the strategy (Tr. 224:12 - 224:16, 279:18 - 280:3, 337:8 - 337:16), they ultimately entered into two separate split-dollar arrangements on behalf of the Decedent. (FSSOF ¶ 6). Mr. Swanson assisted the attorneys-in-fact with every aspect[7] of these arrangements. (Tr. 114:11 - 115:7).

The first step of implementing this strategy was the creation of a new entity that would hold the life insurance policies that would be purchased as part of the strategy. (Ex. 13-P, Bates 360, Ex. 14-J, Bates 780). Mr. Swanson helped the attorneys-in-fact form the Marion Levine 2008 Irrevocable Trust ("the Insurance Trust") by drafting an Insurance Trust Agreement. (Ex. 15-J, Tr. 49:16 - 49:17). This document was

[7] He helped them form the Marion Levine 2008 Irrevocable Trust (the "Insurance Trust"), he drafted all of the transactional documents, he introduced them to the South Dakota Trust Company to serve as the purported Trustee of the Insurance Trust, he helped them acquire the life insurance policies from the Legacy Capital Group Arkansas, Inc., and he introduced them to McGladrey, the appraisal firm that valued the Decedent's rights at 1/3 of the value of the life insurance policies. (Tr. 114: 11 - 115:7 & 97:16 - 97:20). He even spoke with Mr. Larson and Mr. Levine about the Decedent's estate planning on a weekly basis during the last year of her life. (Tr. 40:14 - 41:5).

signed by the attorneys-in-fact on January 31, 2008, just weeks after first being introduced to the strategy. (Ex. 15-J). The agreement names the Decedent's descendants, Mr. Levine, Mrs. Saliterman and their respective children, as the beneficiaries. (FSSOF ¶ 19, Ex. 15-J). Although the Decedent's grandchildren were identified as potential beneficiaries, the Insurance Trust merely provides for equal distributions between Mr. Levine and Mrs. Saliterman's families. (Ex 98-R). The Trust was designed so that Mr. Levine and Mrs. Saliterman had the right to direct how distributions were distributed at their death and even allowed for the Decedent's children to extinguish their children's interests in the Insurance Trust. Id.

The Insurance Trust named the South Dakota Trust Company as the Trustee. (Ex. 15-J). However, its duties and fiduciary responsibilities were practically nonexistent. That is because the Insurance Trust Agreement includes some noteworthy provisions. Specifically, Paragraph 7.5 of the agreement provides that the South Dakota Trust Company was required to follow the written instructions of the "Investment Committee" with respect to the retention, purchase, sale, or encumbrance of trust property and the investment and reinvestment of principal and income held thereunder. (Ex. 15-J). Mr. Larson was named the sole member of the Investment Committee and he has remained as the sole member of the Investment Committee since the formation of the Insurance Trust[8]. (FSSOF ¶ 23, Ex. 15-J). Thus, the trust agreement was written in such a way that the Trustee was required to follow the directions of Mr. Larson, one of the co-trustees of the Revocable Trust (the other party in the split-dollar arrangements).

The second step of implementing the split-dollar strategy was focused on applying for life insurance policies on the Decedent's children, Mr. Levine and Mrs. Saliterman. Mr. Swanson took the lead with respect to this process by contacting Jason Prather, an insurance agent and one of his longtime colleagues. (Tr. 81:8 - 82:24, 115:6 - 115:13, Ex. 16-R). Mr. Swanson had originally suggested obtaining life insurance on the lives of Mr. Levine and Mrs. Saliterman, but Mr. Levine was uninsurable at a competitive rate given his pre-existing health conditions. (Tr. 115:19 - 116:24, 267:2 - 267:8). Thus, a decision was made to obtain insurance on the lives of Mrs.

[8] It is worth noting that Mr. Larson admitted at trial that he told respondent's counsel in August of 2017 that he did not remember anything about the Investment Committee. It is also worth noting that Mr. 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. (Tr. 126:3 - 126:10).

Saliterman and her husband Larry Saliterman ("Mr. Saliterman"). (Tr. 116:4 - 116:8). Once it was determined that Mr. and Mrs. Saliterman would be the individuals insured under the strategy, Mr. Swanson contacted Mr. Prather. (Tr. 117:4 - 117:7). By March 12, 2008, Mr. Swanson informed Mr. Prather that Mr. Levine and Mr. Larson were raising cash for the strategy and that they anticipated that they would able to raise at least $8,000,000 within the next 30 to 60 days. (Ex. 16-R).

In April of 2008, Mr. and Mrs. Saliterman applied for joint one-time payment life insurance policies from the Pacific Life Insurance Company and the John Hancock Life Insurance Company. (Exs. 17-J & 18-J). The John Hancock application indicated that the purpose for the insurance was "Estate Planning". (Ex. 18-J). One week later, on April 25, 2018, Mr. Levine told Mr. Swanson that he thought he would have the ability to commit $4,000,000 to the strategy within one week. (Ex. 19-R). This prompted Mr. Swanson to recommend that they place the first $4,000,000 with Pacific Life because that policy had "the best cash values[9]." Id.

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[9] The cash value of the policy would only be relevant if the life insurance policy was surrendered prior to the death of the insureds.

Three days later, on April 28, 2008, Mark Saliterman told Mr. Swanson that he would like to proceed with the insurance companies in the following order: Pacific Life, John Hancock and MetLife. (Ex. 20-R). Mr. Swanson reiterated that the attorneys-in-fact should "get riders that help the cash value[10] early on." Id. On May 12, 2008, Mr. Swanson sent a letter to the attorneys-in-fact in which he informed them that the first life insurance policy was ready to be issued as soon as the premium was available. (Ex. 21-J).

Between June 10, 2008 and August 8, 2008, the attorneys-in-fact undertook a series of steps to obtain the financing needed to enter into the split-dollar arrangements[11]. (FSSOF ¶ 24). Specifically, they obtained (1) a $3,800,000 loan which accrued interest at an annual rate of 6.35% and was required to be repaid in 60 equal monthly payments, (2) a $2,000,000 loan which accrued interest at an annual rate of 5.25% and was required to be repaid in a single balloon payment exactly one year later, and (3) a $516,000 loan which accrued interest at an annual rate of 6.9% and was required to be repaid within five years. Id.

[10] Again, the cash value of the policy would only be relevant if the life insurance policy was surrendered prior to the death of the insureds.

[11] Mr. Swanson assisted with this process by providing an opinion letter that the attorneys-in-fact provided to The Business Bank. (Ex. 43-J, Bates 813 - 814).

With the loans in place, the attorneys-in-fact used the financing to purchase $6,500,000 in life insurance on the lives of Mr. and Mrs. Saliterman. (FSSOF ¶¶ 25 - 32). However, the funds were not contributed to the Insurance Trust as originally contemplated by Mr. Swanson. Rather, the attorneys-in-fact and the Decedent's businesses transferred the funds directly to the life insurance companies. For example, on June 13, 2008, the Penn Lake Shopping Center, LLC wired $4,000,000 to the Pacific Life Insurance Company. (FSSOF ¶ 27). Of this amount, $3,730,000 derived from a $3,800,000 loan that the Penn Lake Shopping Center, LLC obtained from Central Bank and $270,000 derived from funds of Penn Lake Shopping Center, LLC's savings account. Id. In exchange for the $4,000,000 premium payment, the Pacific Life Insurance Company issued a last-to-die life insurance policy on the lives of Mrs. Saliterman and Mr. Saliterman (the "Pacific Life Policy"). (FSSOF ¶ 28). The Pacific Life Policy is a whole life policy and has a death benefit of $10,750,000. (FSSOF ¶¶ 37 & 29). The cash surrender value for this policy was guaranteed to increase by at least 3 percent per year. (FSSOF ¶ 38).

Also, on July 18, 2008, Private Bank Minnesota wired $2,000,000 to the John Hancock Life Insurance Company. (FSSOF ¶

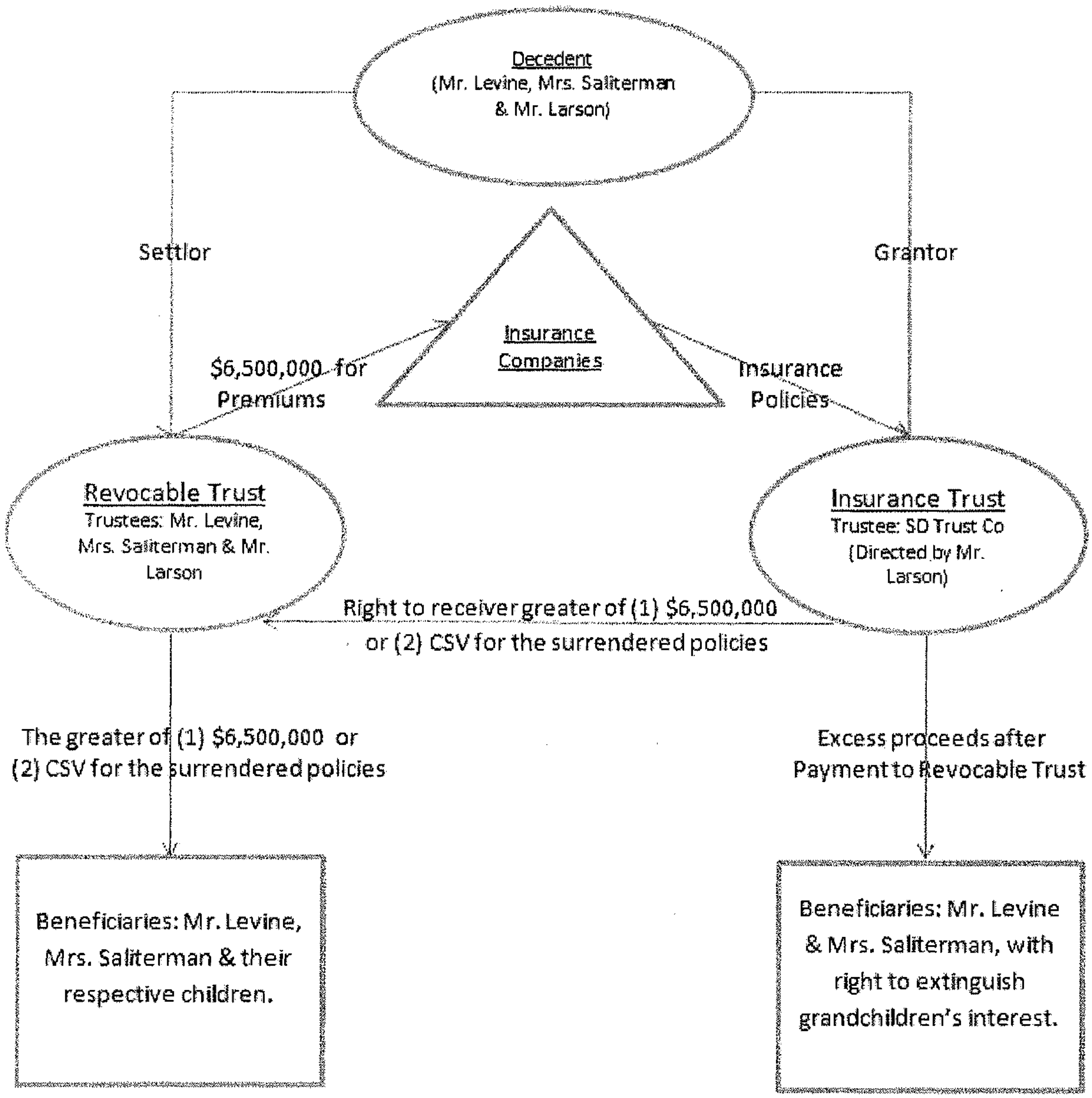
30). This amount derived from a Personal Line of Credit Agreement and Disclosure that the attorneys-in-fact entered into with Private Bank Minnesota on July 16, 2008. Id. On August 11, 2008, The Business Bank wired $500,000 to the John Hancock Life Insurance Company. (FSSOF ¶ 31). This amount derived from the $516,000 loan that Mrs. Saliterman and Mr. Larson, in their capacity as co-trustees of the Revocable Trust, entered into with the Business Bank. Id. In exchange for the $2,500,000 in premium payments from the attorneys-in-fact, the John Hancock Life Insurance Company issued a last-to-die life insurance policy on the lives of Mrs. Saliterman and Mr. Saliterman (the "John Hancock Policy"). (FSSOF ¶ 32). The John Hancock Policy is a whole life insurance policy and has a death benefit of $6,496,877. (FSSOF ¶¶ 37 & 33). The cash surrender value for this policy was guaranteed to increase by at least 3 percent per year. (FSSOF ¶ 38).

Meanwhile, between June 1, 2008 and July 9, 2008, the attorneys-in-fact, in their capacity as the trustees of the Revocable Trust, executed two collateral assignments of life insurance policies and entered into two split-dollar agreements with the Insurance Trust. (FSSOF ¶ 25, Exs. 26-J through 29-

J[12]). The split-dollar agreements provided that the Revocable Trust was responsible for paying all premiums on the policies and, in exchange, would receive, upon the death of the last surviving insured or the termination of the policies, the greater of (1) the total amount of premiums paid, $6,500,000, or (2) the current cash surrender value of the policies. (FSSOF ¶ 26(c), Exs. 26-J & 28-J).

In other words, the split-dollar agreements provided that the Revocable Trust was entitled to receive upon the death of Mr. and Mrs. Saliterman or upon the earlier surrender of the policies the greater of: (1) the total amount of premiums paid, or (2) the cash surrender value of the policies. (FSSOF ¶ 26(c), Exs. 26-J & 28-J). The following diagram illustrates the parties and the purported terms of the split-dollar agreements:

[12] All four of these documents were drafted by Mr. Swanson. (Tr. 114:18 - 114:23).



At the time, Mrs. Saliterman was 62 years old and Mr. Saliterman was 67 years old and they had a combined life expectancy of 25 years. (FSSOF ¶ 34, Tr. 67:10 - 67:11 & 311:12). Thus, the split-dollar arrangements created the appearance that the $6,500,000 was not accessible for approximately 25 years. (Tr. 67:10 - 67:11 & 311:12). However, the attorneys-in-fact stood on both sides of these agreements and had the ability to unwind the arrangements at any time, including six months later when the Decedent passed away.

On April 22, 2010, the Estate filed a Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return (the "Estate Tax Return"). (FSSOF ¶ 39). The Estate elected to value the Decedent's gross estate using the alternate valuation date of July 22, 2009 (the "Alternate Valuation Date"). (FFSOF ¶ 39(a)). The Estate reported that the combined fair market value of its rights under the split-dollar agreements was $2,137,130 as of the Alternate Valuation Date (FSSOF ¶ 39(b) & (d)) despite the fact that the combined cash surrender value of the policies was $6,153,478 as of that date. (FSSOF ¶ 39(c) (e)).

Respondent assigned Estate and Gift Tax Attorney Scott Ratke to examine the Estate Tax Return. (FSSOF ¶ 40). Mr. Ratke made several adjustments to the Estate Tax Return including an adjustment to the value of the Decedent's rights under the split-dollar arrangements. (Ex. 3-J). Mr. Ratke also determined that the Estate was liable for a 40 percent gross estate tax valuation understatement penalty, pursuant to section

6662(h), with respect to the value it reported for its rights in the split-dollar arrangements. Id. Mr. Ratke memorialized this initial penalty determination by preparing a penalty approval form. (Ex. 53-R). On February 26, 2013, Estate and Gift Tax Attorney Nicole Bard, Mr. Ratke's immediate supervisor at the time the penalty was asserted, personally approved Mr. Ratke's initial determination to assert the section 6662(h) penalty in writing by signing the penalty approval form prepared by Mr. Ratke. (TSSOF ¶ 127, Ex. 53-R).

Respondent issued a notice of deficiency to the Estate on April 19, 2013. (Ex. 3-J). The notice of deficiency sets forth several alternative positions with respect to the adjustment to the value of the Decedent's rights in the split-dollar arrangements. (Ex. 3-J). The Estate filed a timely petition with the Court and properly challenged the adjustments in the notice of deficiency. On September 11, 2017, the parties filed a Second Stipulation of Settled Issues which narrowed respondent's theories to one primary and two alternative positions. Respondent has since conceded that the full amount transferred to pay the premiums for the life insurance policies, $6,500,000, is not includable in the Estate. Accordingly, respondent's primary position is that the combined cash surrender value of the policies as of the Alternate Valuation Date, $6,153,478, is includable in the Estate.

If the Court disagrees with respondent's primary position, then the amount that should have been reported on the Estate Tax Return was the "present value" of the rights that the Decedent received under the split-dollar arrangements, which the parties have stipulated was $2,282,195 as of the Alternate Valuation Date.

MATERIAL DISAGREEMENTS WITH PETITIONER'S REQUESTED FINDINGS OF FACT

Respondent disagrees with several of petitioner's requested findings of fact. Although some of the disagreements are inconsequential, respondent disagrees with the following material requested findings of fact for the following reasons:

Petitioner's Requested Findings of Fact Concerning Ms. Levine's Health and Her Involvement in her Businesses and Estate Planning[13]

Petitioner requests that the Court find the following facts: the Decedent "remained very active in her business ventures until about six months before her death," she came to her business' office "regularly to review profit statements and attend meetings until just before her death," she was "never

[13] There are similar requested findings of facts throughout petitioner's Opening Brief that are not mentioned here because those requested findings of fact are redundant.

diagnosed with dementia...during her lifetime," the "Decedent continued to manage her legal affairs until approximately six months before her death," "Mr. Swanson understood Decedent to be physically quite strong in 2007," and the "Decedent approved the transaction, but limited the total amount of premium to $6,500,000." (P's Brief, PP. 13, 22, & 24 - 25, 32).

Petitioner's requested findings of fact contradict sworn statements that Mr. Larson made on October 29, 2013 in an unrelated lawsuit. Specifically, Mr. Larson swore before a notary to the following statements: (1) "Ms. Nelson observed Mrs. Levine's behavior from 2003 until the time of her death and recalls that Mrs. Levine's behavior was quiet, erratic, and vacant and that she was unable to participate in conversation," (2) "Mr. Levine also observed changes in Mrs. Levine's behavior and demeanor from 2000 to her death and recalls that starting in or around 2003, when she began experiencing signs of dementia and Alzheimer's, Mrs. Levine often appeared vacant and was difficult to engage in conversation," and (3) "Prior to 2003 when Mrs. Levine began experiencing symptoms of dementia and Alzheimer's disease, Mrs. Levine was an experienced, astute, and careful businesswoman." (Ex. 85-J, Bates 2494 & 2495). Also, the Decedent's obituary states that the "family wishes to thank

Sandra Nelson and the health care team for their compassionate care provided over the years and assistance in living her life to the end with dignity." (Ex. 56-J).

Petitioner's sworn statements in 2013 as well as the statements in the Decedent's obituary contradict the above requested findings of fact. Also, Mr. Swanson admitted at trial that he did not meet with the Decedent during the last two years of her life. (Tr. 164:12 - 164:16). Thus, Mr. Swanson's testimony that he understood her to be physically strong during this period is not credible.

Petitioner's Requested Findings of Fact Concerning the Purported Purposes for Entering into the Split-Dollar Arrangements

Petitioner stated that the split-dollar transactions served many purposes including (1) providing the Decedent with a market rate of return on her excess capital, (2) the transaction was a way to plan for the Decedent's legacy, (3) the "transaction not only provided estate planning for Decedent, it also provided life insurance protection for her children for their own estate planning," and (4) the transaction enabled the Decedent to diversify her assets. (P's Brief, PP. 29 - 31). Petitioner points exclusively to trial testimony in support of these purported purposes. (P's Brief, PP. 29 - 31, FNs 138 - 149).

Petitioner's requested findings of fact are not supported by the communications that took place around the time the attorneys-in-fact decided to enter into the split-dollar arrangements. Mr. Levine was first introduced to the general concept of the split-dollar strategy on or about November 29, 2017 (Ex. 13-P, Bates 371), just ten days after Mr. Swanson's firm sent an engagement letter to him. (Ex. 78-J). Approximately one month later, Mr. Swanson gave a presentation concerning the strategy to the attorneys-in-fact and sent them an opinion letter. (Exs. 13-P & 14-J). All three of Mr. Swanson's initial communications pointed out the perceived estate tax savings that would be generated from this strategy. (Exs. 13-P, Bates 371, Ex. 13-P, Bates 360 - 366, Ex. 14-J). None of these communications mention any purposes for utilizing the strategy aside from "an estate tax savings of approximately $3,217,075." Id. The attorneys-in-fact began implementing the steps necessary to enter into the split-dollar arrangements just weeks after these communications. Thus, there is no evidence, aside from self-serving testimony, that anyone considered any non-tax purpose for entering into the split-dollar arrangements during the relevant time frame[14].

[14] Furthermore no evidence was entered to support any "business"

Petitioner's Requested Findings of Fact Concerning the Life Insurance Policies

Petitioner claims that "John Hancock and Pacific Life were chosen because the two companies provided the best rate of return (consistent with treasury bonds) and had less counterparty risk and the two companies were financially solid with good credit ratings." (P's Brief, PP. 38 - 39).

The evidence admitted at trial strongly suggests that Mr. Swanson and the attorneys-in-fact chose the John Hancock and Pacific Life policies because those policies offered the best cash surrender values; the policies were not chosen for the reasons stated above. For example, Mr. Swanson provided an illustration that showed the various cash values of the policies, for the first nine years, with a rider that enhanced the cash value early on. (Ex. 19-R). Mr. Swanson then recommended that the attorneys-in-fact purchase the Pacific Life Policy because it offered the best cash values. Id. Mr. Swanson reiterated this recommendation in a separate email in which he told the attorneys-in-fact that they "should get the riders that help the cash value early on." (Ex. 20-R). The attorneys-in-fact followed Mr. Swanson's advice and purchased

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aspect of the arrangement, including evidence of financial planning to grow Decedent's business in order to pay off the more than $6 million in "new" loans that were undertaken.

cash value enhancement riders for each of the policies. (Ex. 30-J, Bates 619, 31-J, Bates 663). There is no logical reason for paying for cash value enhancement riders, for the purpose of enhancing the cash value in the early years, unless the attorneys-in-fact contemplated surrendering the policies prior to the death of the insureds, an anticipated outcome given the structures of the loans and the lack of due diligence of the parties.

ARGUMENT

I. Issue 1: Whether petitioner should have included in the gross estate the combined cash surrender value, $6,153,478, of the life insurance policies that were purchased as part of two split-dollar life insurance arrangements?

Section 2001(a) imposes an excise tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. The gross estate of a decedent includes, to the extent provided for in sections 2031 through 2046, "the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated." I.R.C. § 2031(a). Respondent's position is that the combined cash surrender value of the life insurance policies, $6,153,478, must be included in the gross estate pursuant to sections 2036, 2038 and/or 2703.

A. The combined cash surrender value of the policies is includable in the gross estate pursuant to section 2036(a).

The general purpose of section 2036 "is to include in a decedent's gross estate transfers that are essentially testamentary in nature." Ray v. United States, 762 F.2d 1361, 1362 (9th Cir. 1985), quoting United States v. Estate of Grace, 395 U.S. 316, 320 (1969). Thus, an asset transferred by a decedent while he was alive cannot be excluded from his gross estate unless he "absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property." Estate of Rosen v. Commissioner, 91 T.C.M. (CCH) 1220, 1231 (2006) quoting Commissioner v. Estate of Church, 335 U.S. 632, 645 (1949).

Section 2036 brings the full value of transferred property back into the Decedent's estate if:

(1) the Decedent made an inter vivos transfer of property;

(2) the Decedent's transfer was not a bona fide sale for adequate and full consideration; and

(3) the Decedent retained the possession or enjoyment of, or the right to the income from, the property or the

right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom in the transferred property which she did not give up before she died.

See Estate of Bongard v. Commissioner, 124 T.C. 95, 112 (2005). Stated differently, section 2036 has two exceptions to a general rule that includes in Decedent's estate all inter vivos transfers of her property. Estate of Hurford v. Commissioner, 96 T.C.M. (CCH) 422, 439 (2008). As is explained below, neither of these exceptions applies to the transfers at issue in this case.

1. The Decedent made an inter vivos transfer of $6,500,000.

"The term 'transfer' as used in section 2036(a) is broadly defined, reflecting the purpose of section 2036(a) which is to include in the value of a decedent's gross estate the values of all property she transferred but retained an interest in during her lifetime." Estate of Jorgensen v. Commissioner, 97 T.C.M. (CCH) 1328, 1333 (2009).

The attorneys-in-fact, who stood in the shoes of the Decedent, made "inter vivos transfers" when they transferred $6,500,000 of the Decedent's cash to the life insurance companies as part of the purchase of the Pacific Life and John

Hancock policies that were issued to the Insurance Trust. (FSSOF ¶¶ 27, 30, 31). These actions clearly fall within the broad definition of a "transfer". Despite this fact, petitioner argues that there was no transfer of property because the Decedent received Split-Dollar Receivables (or "rights") from the transactions and she has never transferred those "rights" from her estate. (P's Brief, P. 78).

Petitioner's narrow interpretation of the intended meaning of "transfer" is illogical and contradicts the Court's broad interpretation of the term as noted in Estate of Jorgensen, 97 T.C.M. (CCH) 1328, 1333 (2009). The Decedent clearly made a transfer within the meaning of section 2036 when her attorneys-in-fact wired the funds to the life insurance companies as an indirect transfer to the Insurance Trust and the terms of the split-dollar arrangements provided that the Decedent would retain the right to return of these funds plus interest.

2. The Decedent's transfer was not a bona fide sale for adequate and full consideration.

Section 2036 does not apply to a "bona fide sale for adequate and full consideration in money or money's worth." Estate of Jorgensen, 97 T.C.M. (CCH) 1328, 1333.

Respondent maintains that there never was a sale or an exchange, as contemplated by section 2036, because the Decedent, through her Revocable Trust, "retained" the right to the income from the transferred property. Viewed through the lens of section 2036, not every transfer is or should be treated as a sale or an exchange. For instance, if a parent deeds property to a child and "reserves" a life estate, it is counter-intuitive to say that the parent exchanged 100% of the property for a life estate. As in the present case, Decedent conditioned the transfer on "reserving" the income therefrom, just as a parent "reserves" a life estate when transferring a remainder interest to a child.

To satisfy the bona fide sale exception, petitioner must establish both (1) the non-tax bona fides of the transaction, and (2) the existence of full and adequate consideration. Estate of Powell v. Commissioner, 148 T.C. No. 18, at *11 (2017). Whether a transfer is bona fide "is a question of motive." Jorgensen, 97 T.C.M. (CCH) at 1328. There must be some objective proof that the transaction would not materially differ if the parties involved were negotiating at arm's length. Id.

Also, when considering the bona fide sale exception under section 2036, courts have determined that "[t]he objective evidence must indicate that the non-tax reason was a significant factor that motivated the [transaction]." Estate of Bongard, 124 T.C. at 118; see also Estate of Korby v. Commissioner, 47 F.3d 848 (8^{th} Cir. 2006) ("The transaction must 'be made in good faith' which requires an examination as to whether there was 'some potential for benefit other than the potential estate tax advantages that might result from holding assets in the partnership form.'"). A significant purpose must be an actual motivation, not a theoretical justification. Estate of Liljestrand v. Commissioner, 102 T.C.M. (CCH) 440 (2011).

Finally, deciding whether a transfer was for "adequate and full" consideration is a question of value - did what the Decedent give up roughly equal the value of what she received? Estate of Bongard, 124 T.C. at 118. All of the objective facts in this case strongly suggest that the Decedent, through the split-dollar arrangements, did not exchange assets of roughly equal value. The Decedent retained the rights to the return of funds plus interest and these transfers were not bona fide sales for adequate and full consideration.

a. The split-dollar arrangements were not bona fide sales.

Respondent contends that the transfer of the funds for the benefit of the insurance trust was not a sale. However, if they were treated as a sale, such sale was not bona fide.

Petitioner has the burden of proving that there was a non-tax reason that was a significant factor behind the transaction in order to demonstrate that the arrangements constituted bona fide sales. See Estate of Bongard, 124 T.C. at 118; Estate of Harper v. Commissioner, 83 T.C.M. (CCH) 1641 (2002). A review of all of the underlying correspondence and transactional documents reveal that the sole purpose for entering into these arrangements was estate tax savings. For example, Mr. Swanson's first communication concerning the strategy indicates that this "new idea" could be used to "take $15,000,000 and make it look like $1,500,000 to $7,500,000" and thereby significantly reduce the Decedent's estate tax liability. (Ex. 13-P, Bates 371, Tr. 109:23 - 110:4).

Mr. Swanson's second communication, the PowerPoint presentation that he made to the attorneys-in-fact, again only focuses on estate tax savings and suggests that the strategy could be used to reduce the gross estate by $10,300,000. (Ex. 14-J, Bates 481). Mr. Swanson's third communication, his opinion letter dated January 7, 2008, makes no mention of any purposes for utilizing the strategy aside from "an estate tax savings of approximately $3,217,075." (Ex. 13-P, Bates 365).

The above communications took place soon after the attorneys-in-fact were first introduced to the split-dollar strategy and shortly[15] before the attorneys-in-fact began implementing the steps necessary to enter into the split-dollar arrangements. Accordingly, these communications are the most credible sources of evidence concerning the actual purposes for which the strategy was implemented.

Petitioner argues that there were several non-tax business reasons for the transactions: (1) the arrangements were long-term investments, (2) the transaction diversified the Decedent's portfolio of assets, and (3) the transaction provided life insurance protection for the Decedent's children so their children could pay their eventual estate tax without the need to sell the family's real estate assets. (P's Brief, PP. 90 & 108).

Petitioner's arguments that the arrangements were long-term investments that diversified her portfolio are not credible or supported by the objective facts. As noted above, the relevant correspondence fails to make any mention of this strategy being utilized for investment purposes. (Exs. 13-P & 14-J). In fact, correspondence between Mr. Swanson and one of his associates that was sent just days after discussing the strategy with the

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[15] The attorneys-in-fact formed the Insurance Trust 24 days after Mr. Swanson sent the January 7th opinion letter. (FSSOF ¶ 17).

attorneys-in-facts casts serious doubts on whether Mr. Swanson viewed the strategy as an investment[16]. (Ex. 99-R).

Even if it is assumed that split-dollar arrangements can be investments, the attorneys-in-fact in this case could not have conceivably viewed the split-dollar arrangements as viable investments. As noted above, the attorneys-in-fact obtained loans to purchase the policies and these loans accrued interest at a rate of 5.25 percent to 6.9 percent per year. (FSSOF ¶ 24). Although the cash surrender value of the insurance policies increased at a guaranteed minimum rate of 3 percent per year, this guaranteed growth rate was significantly lower than the interest rates for the loans. (FSSOF ¶¶ 24 & 38). Using these debts to pay the premiums for the split-dollar policies was a negative investment because the Decedent was almost guaranteed to accrue more interest on the loans than she would earn from the split-dollar policies[17]. Thus, absent the substantial tax savings promised by Mr. Swanson, the split-dollar arrangements were not economically rational and were not

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[16] On January 11, 2008, Mr. Swanson stated: "I think an argument can be made that the split-dollar and the DIGITs are investments, although in this credit market it may be tough."
[17] The interest credited to the Pacific Life policy has ranged from 4.67 percent to 5.45 percent and the interest credited to the John Hancock policy has ranged from 4.3 percent to 4.8 percent. (Exs. 76-J & 77-J).

bona fide investments.

Additionally, the statement that the Decedent intended to make an investment supports Respondent's arguments. Respondent above argues that the Decedent's transfer of funds and retention of the right to repayment was more like an investment than a sale. To assert that there was a sale for full and adequate consideration and then state that the primary reason for the transfer of funds was for "investment purposes" is anomalous. Respondent agrees that the form here is more like an investment, but the facts do not support the argument that the Decedent actually intended to "invest" the borrowed funds in the split-dollar arrangement. The higher rate of interest on the money borrowed to "invest" in the split-dollar arrangements creates a negative investment in which no prudent investor would ever participate.

If the attorneys-in-fact were truly looking for a viable investment, they would have sought an asset that historically generated returns that exceeded the interest rate on the loans. There is nothing in the record that comes close to suggesting that the growth of the cash surrender value for the policies would exceed the interest rates associated with the loans. (Entire Record). More importantly, if the attorneys-in-fact were interested in diversifying the Decedent's portfolio, they would have invested in assets such as bonds, Exchange Traded Funds or equities which historically generate positive returns, but do not place restrictions on the disposition of the underlying assets like the split-dollar arrangements do in this case[18]. However, doing so would not have generated the significant present value discount that the split-dollar strategy purportedly generated.

Petitioner's third purported non-tax reason for entering into the arrangements - the transaction provided life insurance protection for the Decedent's children so their children could pay their eventual estate tax without the need to sell the family's real estate assets - also lacks merit. Petitioner is essentially arguing that part of the consideration that the Decedent received for entering into the split-dollar arrangements was the right to one day pay for her children's theoretical estate tax liabilities in the very distant future. Not only does the underlying correspondence fail to identify this as an "actual motivation[19]" for entering into the arrangements, but this purpose highlights the absurdity of

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[18] Instead, under the petitioner's theory of the case, Decedent immediately lost millions of dollars, a result petitioner seems to suggest was unintended.
[19] See Estate of Liljestrand, 102 T.C.M. (CCH) 440 (2011).

petitioner's position. Mr. Levine and Mrs. Saliterman controlled every aspect of these arrangements, they stood on both sides of the arrangements, and now they are arguing that one of the Decedent's purposes for entering into these arrangements was because she wanted to pay for their theoretical estate tax liability when they passed away many years later.

Even if it were assumed that paying for Mr. Levine and Mrs. Saliterman's eventual estate tax liabilities was an actual and legitimate purpose for entering into the split-dollar arrangements[20], it is worth noting that there is a high probability that the arrangements would fail to meet this goal. If the terms of the split-dollar agreements are respected, the death benefits will not be paid out until after the death of Mrs. Saliterman and her ex-husband, Mr. Saliterman. If Mr. Levine and Mrs. Saliterman predecease Mr. Saliterman, then the life insurance policies would remain in place indefinitely until Mr. Saliterman passes away, which could be many years later. In that case, the death benefits would not be available to help pay for Mr. Levine and Mrs. Saliterman's theoretical estate taxes. Thus, petitioner's third purported "theoretical justification" should be disregarded.

[20] If the Decedent had made an inter vivos transfer to her children for that purpose, she would have made a taxable gift.

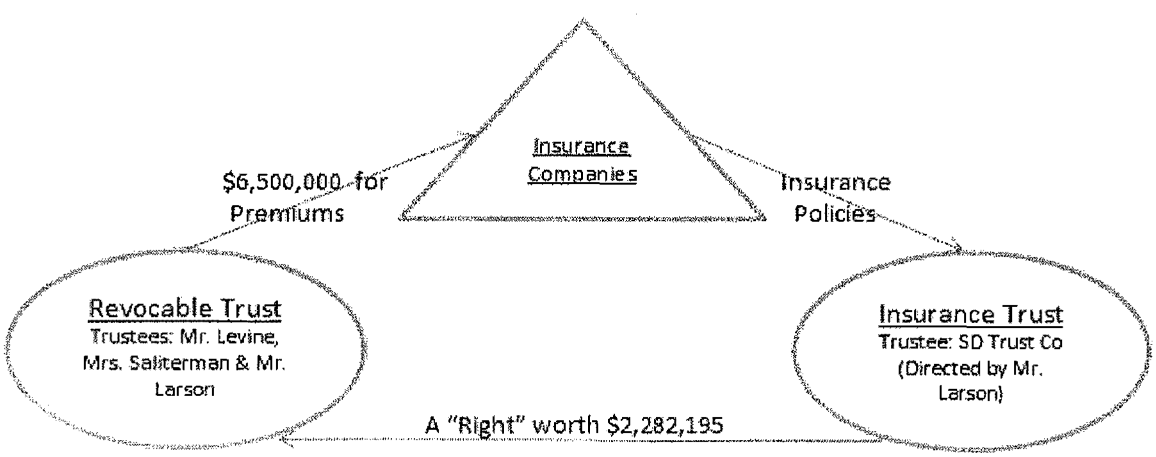
Should the court find there was a sale, then for the reasons given above, the sale was not bona fide.

b. The Decedent did not receive "adequate and full consideration."

Assuming arguendo that the split-dollar arrangements were "bona fide sales," petitioner would still have the burden of proving that the Decedent received "adequate and full consideration" in exchange for the payment of the insurance premiums. Estate of Bongard, 124 T.C. at 118. The Court generally considers whether a transfer depletes a decedent's estate when determining whether the Estate received adequate and full consideration. Estate of Powell, 148 T.C. No. 18, at *8 (2017); see also Estate of Magnin v. Commissioner, 184 F.3d 1074, 1079 (9th Cir. 1999) ("[T]he purpose underlying * * * section [2036(a)] is to prevent the depletion of the decedent's gross estate").

The facts related to this issue are very straightforward and indisputable: the attorneys-in-fact agreed to transfer $6,500,000 of the Decedent's wealth in exchange for a right that the parties have stipulated was worth $2,282,195. It defies logic to suggest that any rational person in an arm's length transaction would obtain $6,500,000 in loans and invest in "rights" that are worth $2,282,195. More importantly, it is inconceivable that an 88 year-old widow suffering from a number of serious ailments, including Alzheimer's, would spend $6,500,000 on the right to be repaid in approximately 25 years, when she would be 113 years old. If the parties were truly negotiating at arm's length, the transaction would materially differ because the Decedent would have undoubtedly insisted on receiving a "right" worth $6,500,000.

Petitioner first argues that there has been no depletion of the Decedent's gross estate as a result of the split-dollar strategy. (P's Brief, PP. 110 - 112). To support this position, petitioner points out that the Decedent was eventually entitled to receive 100% of the premiums paid as well as a guaranteed return on her investment. (P's Brief, P. 111). Petitioner's argument ignores the basic mechanics of the split-dollar arrangements:



As the above diagram illustrates, the attorneys-in-fact used this strategy to transfer $6,500,000 in exchange for a "right" that was worth $2,282,195. Thus, this strategy depleted the Decedent's estate by $4,217,805.

Petitioner also argues that even if the strategy resulted in the depletion of the Decedent's estate, the diminution must be disregarded. (P's Brief, PP. 112 - 116). Petitioner cites to two cases in support of this position: Estate of Harper, 83 T.C.M. (CCH) 1641 (2002), and Kimbell v. United States, 371 F.3d 257 (5th Cir. 2004). (P's Brief, PP. 112 - 113). Petitioner argues that these cases provide an exception to the full and adequate consideration requirement when a transferor receives an asset that has a "fair market value, i.e., immediate sale potential, of substantially less than the dollars just paid" when the difference is attributable to valuation discounts. (P's Brief, P. 113, citing Kimbell, 371 F.3d at 266). Petitioner goes on to argue that the discount resulting from the Decedent's current inability to access the cash surrender value of the life insurance policies should be treated no differently than the lack of control or lack of marketability discounts applicable to partnership interests. (P's Brief, PP. 113 - 114).

Petitioner's interpretation and reliance on the above cases is faulty. In Kimbell, the Court reviewed whether a taxpayer's inter vivos transfer of oil and gas assets to a limited partnership managed by her son was a bona fide sale, and thus not subject to recapture for estate tax purposes under section 2036. Although the Court acknowledged that a transfer can qualify as "full and adequate consideration" when a transferor acquires an asset (i.e., a limited partnership interest) that is worth less than the amount paid or contributed, the split-dollar transactions here do not fall within this limited exception.

As the Court in Kimbell noted, an investor in a limited partnership may be willing to accept the discounted partnership interest because they "do so with the expectation of realizing benefits such as management expertise, security and preservation of assets, capital appreciation and avoidance of personal liability." Kimbell, 371 F.3d at 266. In other words, an investor may be willing to accept a partnership interest that is initially worth less than what the investor contributed because the other members of the partnership may have expertise or business skills that will contribute to the success of the business and ultimately translate into exponential growth in the value of the investor's interest in the partnership.

The transaction at issue in this case can be distinguished from the limited partnership transaction at issue in Kimbell. The Decedent did not make a contribution to a partnership or entity that was expected to engage in an ongoing business. Also, the investor (the Decedent) transferred $6,500,000 to the insurance companies in exchange for the insurance companies transferring life insurance policies to the Decedent's newly formed Insurance Trust. The cash surrender values associated with those policies increased in value based on guaranteed rates of return, which were not impacted by the business decisions of the Insurance Trust or even the Investment Committee. Furthermore, the Decedent did not place the policies in the Insurance Trust with the expectation that the Insurance Trust offered her management expertise, security and preservation of her assets, or to help her avoid personal liability.

Although the Kimbell case identifies a very limited exception to the "full and adequate" consideration requirement, the transactions in this case differ substantially from the transaction and expectations of the taxpayer in Kimbell. Thus, the narrow exception delineated in Kimbell does not apply in this case. Finally, petitioner does not explain why the Court's opinion in Estate of Harper supports the position that the diminution of the Decedent's Estate must be disregarded in this case. (P's Brief, PP. 112 - 116). Respondent has reviewed the Court's opinion in Estate of Harper and is unable to discern how that opinion supports petitioner's position.

B. The Decedent retained the possession or enjoyment of, or the right to the income from, the property or the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom an interest or right enumerated in the transferred property which she did not relinquish before her death.

An inter vivos transfer of property is included in a gross estate if the Decedent retained (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom. I.R.C. § 2036(a).

1. The Decedent retained, under section 2036(a)(1), the right to possession and enjoyment of the property transferred.

The Decedent through her attorneys-in-fact controlled the right to the possession and enjoyment of the property. The ability to control the policies resided in the attorneys-in-fact as they were on both sides of the transactions. The details of such control are described below.

In the year prior to her death, the Decedent was incapacitated and "unable to participate in conversation", let alone a discussion about the decision to enter into the split-dollar arrangements. (Ex. 78-J, Ex. 85-J, Bates 2494). Mr. Swanson, the promoter of this strategy, did not even meet with the Decedent during the last two years of her life. (Tr. 164:12 - 164:16). Instead, Mr. Swanson worked exclusively with the attorneys-in-fact and helped them transfer $6,500,000 of the Decedent's wealth for their benefit[21].

It is clear from the following objective facts that the attorneys-in-fact stood in the shoes of the Decedent for all intents and purposes and they retained the "right to the income from the property" and/or the right to "designate the persons who shall possess or enjoy the property or the income therefrom":

- The attorneys-in-fact had the power to manage all of the Decedent's affairs, including her estate planning. (FSSOF ¶ 12, Ex. 9-J).
- The Decedent's children, Mr. Levine and Mrs. Saliterman, had the ability to control all of the Decedent's affairs because the Power of Attorney only

[21] As the Decedent's sole descendants, Mr. Levine and Mrs. Saliterman, or their respective children, would ultimately receive 100% of the distributions from the Revocable and the Insurance Trusts.

required a 2/3 vote in order to exercise any powers on behalf of the Decedent. (Ex. 9-J, Bates, 341).

- The attorneys-in-fact were also the co-Trustees of the Revocable Trust and therefore controlled that entity, which was one of the two parties to the split-dollar agreements. (FSSOF ¶¶ 12 & 13).
- The attorneys-in-fact were repeatedly told that they could save millions of dollars in estate taxes (Ex. 13-P, Bates 365 & 371, Ex. 14-J, Bates 481) and then they entered into the agreements despite the fact that they did not understand the strategy. (Tr. 224:12 - 224:16, 279:18 - 280:3, 337:8 - 337:16).
- The attorneys-in-fact formed the Insurance Trust, the other party to the split-dollar agreements. (FSSOF ¶ 17).
- The purported Trustee of the Insurance Trust, the South Dakota Trust Company, is a "directed trustee" that has no authority or decision making ability related to the Insurance Trust's property. (Tr. 357:6 - 357:24, 358:12 - 358:20, 360:11 - 360:20, & 366:11 - 366:16).

- Mr. Swanson drafted the Insurance Trust agreement to include a provision that provided that the Trustee of the Insurance Trust was required to follow the written instructions of an "Investment Committee" with respect to the retention, purchase, sale or encumbrance of trust property. (FSSOF ¶ 22, Ex. 15-J, Bates 504-505).

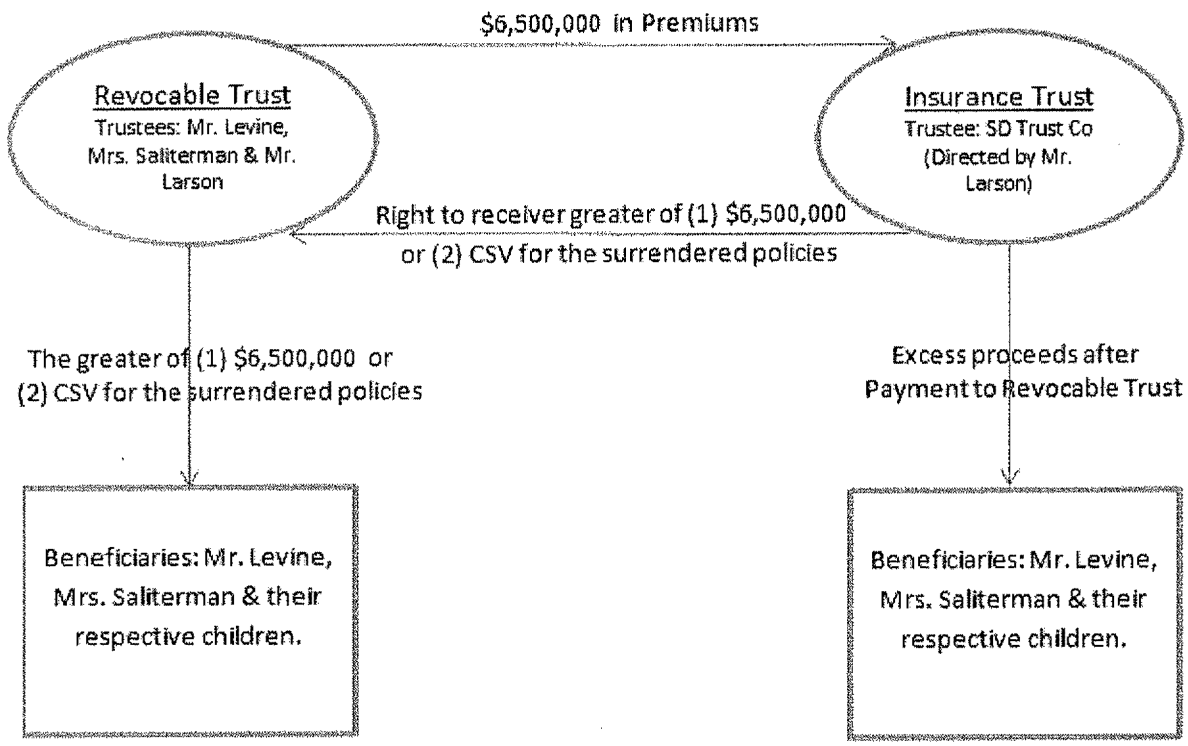
- The attorneys-in-fact named Mr. Larson, who was an attorney-in-fact for the Decedent and co-Trustee of the Revocable Trust, as the sole Investment Committee member for the Insurance Trust. (FSSOF ¶ 23).

- Mr. Larson is a longtime friend and loyal business partner of the Decedent. (Tr. 177:2 - 177:18, 178:16 - 179:12). Mr. Larson has also been one of Mr. Levine's business partners for more than fifty years. (Tr. 302:22 - 303:7).

- The Decedent's children had the actual or an implied power, as two of the three attorneys-in-fact, to instruct Mr. Larson to direct the Insurance Trust to sell trust assets (i.e. surrender the life insurance policies and unwind the transaction). (Ex. 9-J, Ex. 15-J).

- Mr. Swanson told the attorneys-in-fact that "the insurance policies may be surrendered at any time so there is no minimum commitment required." (Ex. 13-P, Bates 365).
- The Insurance Trust was scheduled to terminate upon the earlier of 15 years or such time as determined by the Trustee (Ex. 15-J, Bates 488), which was 10 years short of the combined life expectancy of the insureds. (FSSOF ¶ 34, Tr. 67:10 - 67:11 & 311:12).
- The attorneys-in-fact had the ability to compel the dissolution of the Insurance Trust by failing to pay the Trustee's annual fees. (Tr. 363:18 - 364:9).
- The beneficiaries of the Revocable Trust and the Insurance Trust were the Decedent's children, Mr. Levine and Mrs. Saliterman, and their respective children. (FSSOF ¶¶ 9 & 19).

Thus, any fiduciary duties that Mr. Larson owed to the beneficiaries of the Insurance Trust were clearly illusory. The following diagram helps illustrate this point:



All of the above facts are highly persuasive in demonstrating that the attorneys-in-fact, who again are akin to the Decedent for all intents and purposes, controlled every aspect of the arrangements. There is virtually no substance to the above arrangements because the purported agreements were essentially an agreement between the Decedent's attorneys-in-fact and themselves. Regardless of whether the policies are surrendered or remain in place until the death of the insureds, the outcome is the same: the funds will be distributed to Mr. Levine and Mrs. Saliterman - or their respective children -

assuming Mr. Levine and Mrs. Saliterman do not extinguish this right[22].

Therefore, the objective facts demonstrate that the Decedent, through her attorneys-in-fact, retained the possession or enjoyment of the property under section 2036(a)(1). It is also worth noting that the above agreements were written in such a way that the income and corpus in each of the above trusts would eventually be distributed to the very people who set up the arrangements, Mr. Levine and Mrs. Saliterman.

2. The Decedent retained, under section 2036(a)(1), the right to the income from the split-dollar arrangements.

Even if we assume that the objective facts do not establish that the Decedent (the attorneys-in-fact) retained the possession or enjoyment from the transferred property, the Decedent still retained a right to the income from the split-dollar arrangements by virtue of the terms of the split-dollar agreements.

Section 2036(a)(1) includes in a decedent's gross estate property she transferred to another but in which she keeps a

[22] The Trust was designed so that Mr. Levine and Mrs. Saliterman had the right to direct how distributions were distributed at their death and allowed for Mr. Levine and Mrs. Saliterman to extinguish their children's interests in the Insurance Trust. (Ex. 98-R).

"right to the income from the property" until death. The reach of section 2036(a)(1) generally encompasses lifetime transfers that are essentially testamentary in nature. Estate of Bongard, 124 T.C. 95, 112 (2005). Here, the "property" at issue is either (1) the life insurance policies (the intended investment vehicle), or (2) the rights under the split-dollar arrangement to receive the greater of the $6,500,000 or cash value.

As far as Decedent is concerned, the rights are economically two sides to the same coin. Regardless of which "property" we focus on, it is indisputable that both assets were guaranteed to appreciate at a rate of at least 3 percent per year. (FSSOF ¶ 38). As noted above, the split-dollar arrangements provide that the Decedent was entitled to receive an amount equal to the greater of: (1) the total amount of premiums paid, or (2) the cash value of the policies at the time of death of the insureds. (Exs. 26-J & 28-J). Put differently, the split-dollar agreements provided that the Decedent was entitled receive at a minimum, $6,500,000, and she was guaranteed to receive more than that amount if the combined cash surrender values for the life insurance policies ever exceeded $6,500,000. Id.

However, there is no indication or evidence that the Insurance Trust held or owned any significant assets other than the life insurance policies. (Entire Record). Thus, when the policies were first purchased, the most that the Decedent's Revocable Trust would have received under the split-dollar arrangements would have been the combined cash surrender value of the policies if the policies were surrendered and the transaction were unwound before the combined cash surrender values for the policies exceeded $6,500,000. Thus, from Day 1, the amount that the Decedent was entitled to receive has always been directly tied to the cash surrender values for the respective life insurance policies.

The life insurance policies that were purchased in this case were credited with interest income on a monthly basis and the cash surrender values for each policy appreciated from the first day on which the policies were purchased. (FSSOF ¶ 38, SSSOF ¶ 102). As the cash surrender values appreciated over the years, the Decedent's right to repayment also increased in value. For example, if the Decedent had survived until March of 2014, the cash surrender values for the John Hancock and the Pacific Life policies would have been $2,781,004 and $4,579,098, respectively, or $7,360,102, collectively. (SSSOF ¶ 102, Ex.

76-J, Bates 2287 & Ex. 77-J, Bates 2353). Thus, the Decedent's Revocable Trust would have received this amount if (1) the insureds passed away, or (2) the parties agreed to surrender the policies and unwind this unnecessary transaction. This amount, $7,360,102, clearly exceeds the $6,500,000 that the Decedent "invested" in this strategy, and the difference between these two amounts would clearly constitute "income" under section 61. The terms of the split-dollar arrangements provide that the Decedent retained the right to this income, which falls squarely within the meaning of section 2036(a)(1).

Petitioner argues that section 2036(a)(1) does not apply because the Decedent did not retain possession, enjoyment or the right to income from the $6,500,000. (P's Brief, P. 79). More specifically, petitioner argues that none of the factors that courts consider in determining whether section 2036 applies are present in this case. (P's Brief, P. 80).

Respondent disagrees. Masquerading behind the complex set of facts (two trusts, life insurance policies, agreements, assignments, loans) is a very simple construct: Decedent's Revocable trust transferred $6,500,000 (directly or indirectly) to the insurance trust and the parties to the transfer agreed that the income from the property transferred would be payable to the Decedent by reason of the Revocable trust. The parties intended to and actually funneled the funds into two life insurance policies. Decedent's Revocable Trust was entitled to the greater of $6,500,000 or the cash value measured immediately before death or at an earlier termination. There should be no dispute that the Decedent had the right to the income that is represented by increasing cash value. The fact that the income was to accumulate and would be paid in the future, most likely after the Decedent's death, is immaterial for purposes of section 2036.

Despite repeatedly admitting that the transactions in this case are fundamentally different from a family limited partnership (P's Brief, PP. 81, 83, 88 & 103), petitioner cites to Estate of Harper in support of the proposition that the courts generally consider the following factors when evaluating whether a decedent's ties to the property transferred to a family limited partnership have been sufficiently severed to avoid estate tax inclusion: (1) whether the decedent's relationship with the assets changed after the transfer; (2) whether the formalities of the entity's separate legal existence were respected; (3) the amount of assets held by the decedent outside the family limited partnership; and (4) whether there was a non-tax reason for forming the family limited partnership. (P's Brief, PP. 81, FN 342).

The Court's opinion in Estate of Harper does not identify a list of factors that courts routinely consider when evaluating transfers to family limited partnerships. Estate of Harper, 83 T.C.M. (CCH) 1641 (2002). Rather, the Court focused on whether there existed an implicit agreement that the decedent would retain control or enjoyment, i.e., economic benefit, of the assets he transferred to the limited partnership. Id. at 1648. As petitioner noted, the transactions in this case are fundamentally different from family limited partnership cases. (P's Brief, PP. 81, 83, 88 & 103). Therefore, the factors cited by petitioner are mostly irrelevant in the context of this case of first impression.

As explained above, respondent's position is relatively straightforward: the transfers in this case must be disregarded because the Decedent retained the proverbial strings that pull the transferred assets back into her estate. Furthermore, the Decedent cannot meet either of the exceptions to section 2036. Therefore, the combined cash surrender value of the policies must be included in the gross estate.

In the event that the Court determines that the factors cited by petitioner are relevant, respondent contends that the factors do not support petitioner's position for the following reasons.

a. The Decedent's relationship with the $6,500,000 did not permanently change.

Petitioner claims that a critical factor courts consider in determining whether section 2036(a) applies "is a decedent's relationship with the assets before and after the transfer to a family limited partnership." (P's Brief, PP. 81 - 82). Petitioner then argues that this purported factor supports petitioner's position because the Decedent's "relationship with the $6,500,000 used to fund the Life Insurance Policies has fundamentally and permanently changed." (P's Brief, P. 82). Respondent disagrees.

Not only is this purported factor irrelevant outside the context of the family limited partnership cases cited by petitioner, but the Decedent's relationship with the $6,500,000 that was used to purchase the life insurance policies did not fundamentally change. As is explained at length above, all of the objective facts establish that the attorneys-in-fact stood in the shoes of the Decedent for all intents and purposes at all relevant times and they had the ability to do whatever they wanted with respect to the life insurance policies. See Section

I.B.1., *supra*. Thus, the attorneys-in-fact, acting on behalf of the Decedent, had the ability to direct the surrender of the policies and unwind the transaction in order to reconstitute the cash surrender values into cash and repay the Decedent's loans. Accordingly, the Decedent's relationship with the $6,500,000 did not fundamentally change and this purported factor does not support petitioner's position.

b. The parties have not respected the formalities of the split-dollar arrangements.

Petitioner states that courts generally consider whether the members of a family limited partnership observe and respect the formalities of the entity's separate legal existence. (P's Brief, P. 84, citing Estate of Harper, 83 T.C.M. (CCH) 1641 (2002)). Respondent acknowledges that these facts are important in the context of family limited partnership cases because the courts are generally evaluating whether the partnership was a bona fide business and/or whether the partnership was a complete sham. See e.g. Estate of Harper, 83 T.C.M. (CCH) at 1654. However, an analysis of these types of facts is unnecessary in the context of intergenerational split-dollar arrangements because neither party is arguing that the Insurance Trust was a bona fide business which is expected to observe and respect business formalities.

Nevertheless, petitioner argues that every aspect of the split-dollar arrangements has been followed according to its form. (P's Brief, P. 85). Petitioner's position lacks merit for several reasons. First, Mr. Swanson and the attorneys-in-fact failed to observe and respect one of the very first steps of the split-dollar strategy: rather than transfer funds from the Decedent's Revocable Trust to the Insurance Trust so that the Insurance Trust could purchase the life insurance policies as originally contemplated (Ex. 13-P, Bates 360 & Ex. 14-J, Bates 478), the attorneys-in-fact wired funds from the Decedent's business account directly to Pacific Life and they instructed Private Bank to wire loan proceeds directly to John Hancock. (FSSOF ¶¶ 27, 30 & 31). Thus, the Decedent purchased the life insurance policies; not the Insurance Trust.

Also, the Insurance Trust agreement provides that the Trustee shall follow the written directions of the Investment Committee with respect to the purchase of trust property. (Ex. 15-J, Bates 505). This provision was completely ignored by the attorneys-in-fact when they acquired the life insurance policies. For example, Mr. and Mrs. Saliterman applied for the life insurance policies in April of 2008 (Exs. 17-J & 18-J) and the attorneys-in-fact paid for the John Hancock policy on July 16, 2008 (Ex. 40-J). Both of these events occurred before the Direction Letter, which instructed the Trustee to acquire the policy, was actually sent to the Trustee on August 4, 2008. (Ex. 44-J).

Also, the Trustee of the Insurance Trust played absolutely no role in the acquisition of the life insurance policies or negotiating the terms of the split-dollar arrangements. In fact, the attorneys-in-fact worked exclusively with Mr. Swanson with respect to every step of the transactions and the Trustee of the Insurance Trust simply did what Mr. Swanson instructed her to do. (Tr. 89:2 - 89:7).

The split-dollar arrangements in this case are fundamentally different from the limited partnership issues in the cases cited by petitioner. Thus, the factors cited by petitioner are irrelevant in this context. Nevertheless, if the Court determines that these factors are relevant, the above facts demonstrate that the attorneys-in-fact failed to follow the formalities of the split-dollar arrangements.

c. The attorneys-in-fact did not retain sufficient liquid assets to support the Decedent's financial needs for the remainder of her life.

Petitioner argues that one of the "most important factors courts consider in applying section 2036(a) is the amount of assets a decedent held outside the family limited partnership and whether those assets were sufficient to support the decedent's financial needs for the rest of his or her life." (P's Brief, P. 86). Petitioner's reliance on this factor is flawed and the application of this factor magnifies how intergenerational split-dollar arrangements are fundamentally different from the family limited partnership cases cited by petitioner.

In the limited partnership cases cited by petitioner, the taxpayers transferred all or most of their wealth, including their homes, vehicles, and investments to the limited partnerships in exchange for an interest in the limited partnership. Estate of Reichardt v. Commissioner, 114 T.C. 144 (2000); Estate of Thompson, 382 F.3d 367 (3rd Cir. 2004); Estate of Strangi v. Commissioner, 85 T.C.M. (CCH) 1331 (2003). In those cases, the Courts evaluated whether the limited partnership was formed for valid business purposes or if the taxpayers were taking advantage of the "partnership wrapper" to generate significant valuation discounts. See e.g. Estate of Reichardt, 114 T.C. at 152.

Here, the split-dollar arrangements are fundamentally different from the limited partnership transactions. First, the Decedent did not contribute all or most of her assets to the strategy because the split-dollar strategy was merely one of at least five strategies used by the attorneys-in-fact to reduce the Decedent's gross estate. (Ex. 78-J). Second, unlike the limited partnership cases, the attorneys-in-fact could not transfer the Decedent's home, vehicles or other tangible property as part of the transaction; rather they could only contribute cash. The reason for this is simple: the attorneys-in-fact had to generate cash for this transaction to work because the life insurance companies would only accept cash.

Also, assuming the Court determines that the amount of assets that the Decedent held outside of the split-dollar arrangements is a relevant factor that must be considered in this case, this factor actually favors the government. In order to pay for the life insurance policies, the attorneys-in-fact had to leverage the Decedent's business assets and obtain $6,500,000 in loans because the Decedent lacked sufficient cash to pay for the life insurance policies. These loans were short-term loans that accrued interest at relatively high rates. (FSSOF ¶ 24). In fact, one of the loans was required to be repaid in a single $2,000,000 balloon payment exactly one year later. (FSSOF ¶ 24(b)).

Despite the fact that the Decedent was wealthy, it does not appear that she had sufficient liquid assets to satisfy her financial needs for the remainder of her life. On January 1, 2008, the Decedent had $33,000 in cash. (Ex. 64-J, Bates 1722). Although the Decedent's financial statement indicates that she also had $1,793,000 in money market accounts, it does not appear that she had access to these funds. (Ex. 64-J, Bates 1722). A closer review of the Decedent's financial statement indicates that those funds were deposited in sixteen different bank accounts, thirteen of which appear to be business or partnership accounts. (Ex. 64-J, Bates 1755). There is nothing in the record suggesting that the Decedent had unfettered access to those funds. (Entire Record). Even if we assume that the Decedent had unlimited access to those money market accounts, she only had access to $1,826,000 in liquid assets as of January 1, 2008. Nearly all of the Decedent's remaining assets were tied up in Real Estate and Limited Partnerships. (Ex. 64-J, Bates 1722).

Meanwhile, the Decedent was struggling with numerous physical and mental ailments and required assistance from a team of caregivers during the last few years of her life. (Ex. 56-

J). Although the attorneys-in-fact now claim that the Decedent was healthy and could care for herself, credible evidence (Ex. 85-J) suggests otherwise and there should at least be a presumption that she needed the assistance of caregivers, which was likely expensive. More importantly, the Decedent was now obligated to repay $6,500,000 plus interest within five years. (FSSOF ¶ 24). This new obligation clearly reduced her liquidity and put a strain on the Decedent's ability to satisfy her financial needs for the remainder of her life; unless, of course, the Decedent's death was imminent.

The bottom line here is that if the Court determines that the Decedent's access to other assets is an important factor in this case, then it appears that the attorneys-in-fact put the Decedent in a precarious financial situation by entering into the split-dollar arrangements. The attorneys-in-fact obtained $6,500,000 in loans on behalf of the Decedent and agreed to repay those loans, including significant interest, within one to five years. In order to meet her new loan obligations, the Decedent would likely need to liquidate at least some of her real estate assets if the Decedent had survived longer and did not surrender the insurance policies during the term of the loans. Doing this seems highly counterintuitive considering one of petitioner's primary arguments is that the Decedent entered into these arrangements to help pay her children's eventual and theoretical estate taxes so that they would not have to liquidate their real estate assets to pay their own estate tax liabilities. (P's Brief, P. 90).

Finally, one of the issues that has not yet been resolved by the parties is whether petitioner is entitled to a $1,000,000 deduction for a charitable bequest to the George and Marion Levine Foundation. The parties entered into a Stipulation of Settled Issues on October 31, 2017 which provides that the charitable deduction shall be allowed if petitioner provides proof of payment of the charitable bequest prior to the conclusion of this case. It seems irrational for petitioner to suggest that the attorneys-in-fact retained sufficient cash to meet the financial needs of the Decedent, yet nine years later, they still have not had sufficient liquidity to pay the bequest that the Decedent intended to make to her own charitable foundation. Accordingly, the Court should either disregard this factor altogether or hold that this factor favors the government's position.

d. There were no significant non-tax reasons for entering into the transactions.

Petitioner argues that there were several significant non-tax reasons for the split-dollar transactions. (P's Brief, P. 90). Petitioner's purported non-tax reasons and respondent's response thereto are addressed in Section I.A. above.

Accordingly, for the reasons given above, Decedent retained, under section 2036(a)(1), the right to the income by reason of the split-dollar arrangements.

3. The Decedent retained, under section 2036(a)(2), the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

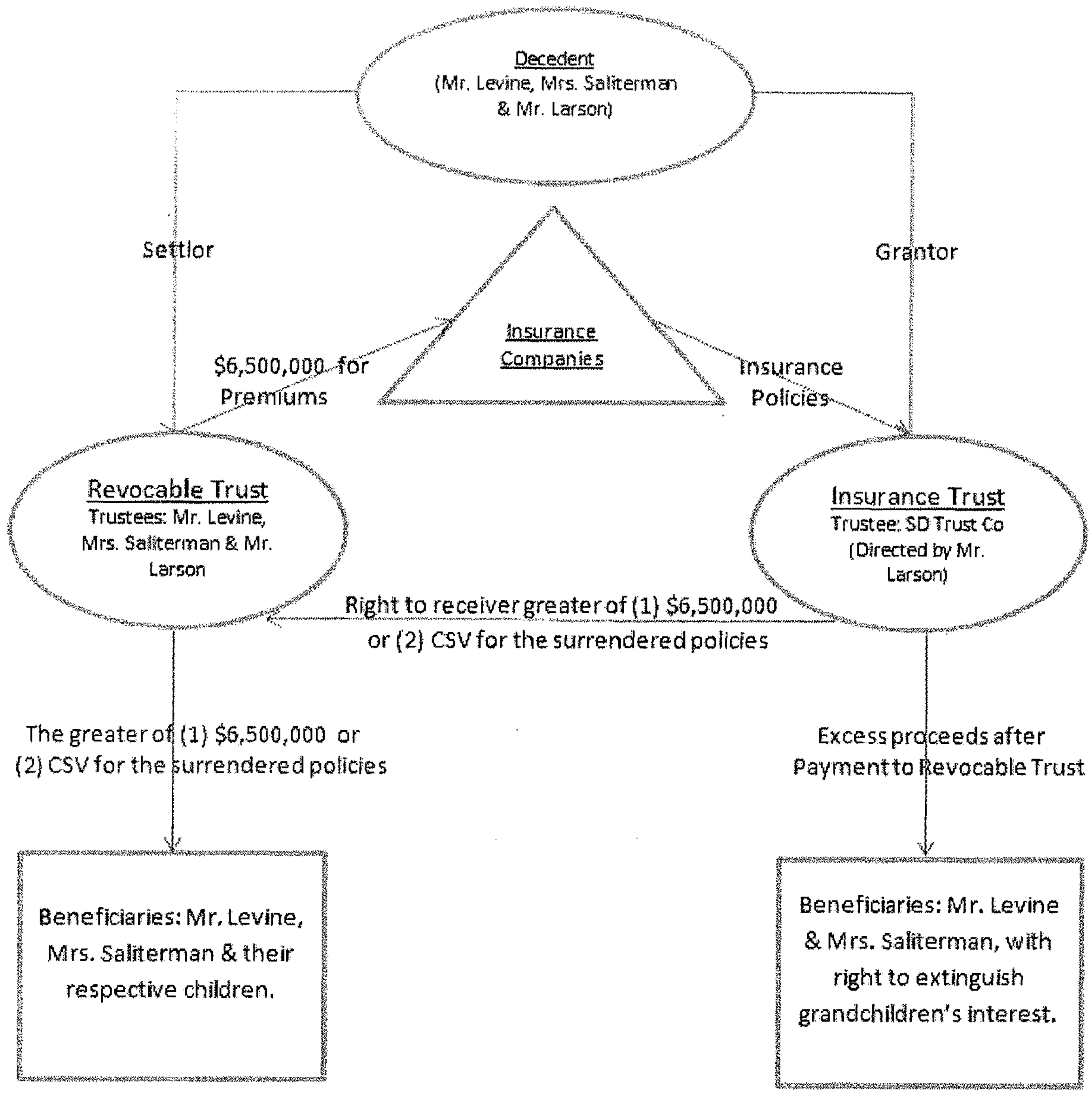
Section 2036(a)(2) applies to the split-dollar arrangements as well. Section 2036(a)(2) includes in the estate property in which a decedent keeps until death the right, either alone or in conjunction with any person, to designate the person who shall possess or enjoy the property or the income therefrom. As is explained in detail above, all of the objective facts suggest that the attorneys-in-fact stood in the shoes of the Decedent for all intents and purposes and they controlled every aspect of the arrangements including the ability to designate who would possess or enjoy the transferred property.

While the split-dollar arrangements in question involved a complex series of transactions, and followed an equally complex path of origination and assignment, it is clear that the nature of Decedent's relationship with the policies did not change in any respect throughout the life of the transactions. The Decedent's attorneys-in-fact controlled the policies at every step of the transaction. The Decedent's attorneys-in-fact also remained the beneficiaries of the policies at every step of the transaction. So while formal titles may have changed, virtually nothing else did.

Mr. Larson was a co-Trustee for the Decedent's Revocable Trust and an attorney-in-fact for the Decedent. He was also the sole member of the Investment Committee capable of directing the action of the Insurance Trust. The Decedent (Mr. Larson) and the Insurance Trust (again, Mr. Larson) together, and in conjunction with each other, have the right to designate who shall possess or enjoy the cash surrender value and the income therefrom, either by surrendering the policy or terminating the arrangement together. Section 2036(a)(2) is intended to apply where parties together can affect the same outcome as direct ownership by the Decedent. As such, the combined cash surrender value of the life insurance policies should be included in her estate under section 2036(a)(2).

Petitioner argues that respondent's position "fails to consider the fiduciary obligation that Mr. Larson owes to the beneficiaries of the Insurance Trust, which, as a matter of law, prevented him from canceling the Transaction." (P's Brief, P. 101). Petitioner also argues that Mr. Larson would violate the fiduciary duties he owed to the Decedent if he were to cancel the insurance policies. (P's Brief, PP. 104 - 105).

Petitioner's arguments concerning Mr. Larson's purported fiduciary duties mirror the arguments made by the petitioners in Estate of Strangi, 85 T.C.M. (CCH) 1331 (2003) and Estate of Powell, 148 T.C. No. 18 (2017). In each of those cases, the Court held that the fiduciary duties cited by the petitioners were merely "illusory" and, therefore, section 2036(a)(2) applied. Here, the fiduciary duties that Mr. Larson owes to the beneficiaries of the Insurance Trust and the Decedent are clearly "illusory". The following diagram helps illustrate this point:



Mr. Levine and Mrs. Saliterman effectively controlled all three levels of the split-dollar arrangements. They were the Decedent's attorneys-in-fact, they were the co-trustees of the Revocable Trust, and they were the beneficiaries of the Revocable Trust and the Insurance Trust. Thus, it begs the question, how could Mr. Larson violate his fiduciary duties to the beneficiaries of the Insurance Trust by following the orders of Mr. Levine and Mrs. Saliterman (in their capacity as the Decedent's attorneys-in-fact) to surrender the life insurance policies? Mr. Levine and Mrs. Saliterman are the beneficiaries of the Insurance Trust and they stand to benefit under these arrangements regardless of whether the policies remain in place or are surrendered during their lifetimes.

The same is true concerning Mr. Larson's fiduciary duties to the Decedent - how would he violate any fiduciary duties owed to her by following the orders from the majority (Mr. Levine and Mrs. Saliterman) of the Decedent's attorneys-in-fact? Mr. Levine and Mrs. Saliterman were the individuals who entered into these arrangements. It would not make sense for them to sue Mr. Larson for violating his fiduciary duties to the Decedent as a result of orders that came directly from them. If following such orders would be a violation of Mr. Larson's fiduciary duties, then he has likely already violated those obligations. By working with the Decedent's children to enter into these arrangements, Mr. Larson assisted them in transferring $6,500,000 of the Decedent's wealth for Mr. Levine and Mrs. Saliterman's benefit and these arrangements depleted the

Decedent's Estate by $4,217,805.

Finally, petitioner argues that this case is different from Estate of Strangi and Estate of Powell because Mr. Larson is not a member of the Decedent's family. (P's Brief, 103). Petitioner suggests that Mr. Larson was an unrelated third-party who could not terminate the policies because of his fiduciary obligations. (P's Brief, PP. 103 - 105). The objective facts suggest otherwise.

Mr. Larson is a longtime friend and business colleague of the Decedent and has been one of Mr. Levine's business partners for more than fifty years. (Tr. 251:16 - 251:17, 303:1 - 303:10). Mr. Larson also executed a document in an unrelated lawsuit that repeatedly stated that from 2003 until the time of her death, the Decedent was quiet, erratic, and vacant and that she was unable to participate in conversation (Ex. 85-J), yet he testified in this case that the Decedent was relatively healthy during the two years preceding her death and that she would come into the office regularly and they traveled to Palm Springs together. (Tr. 191:2 - 191:25). These statements clearly contradict one another and this fact confirms that Mr. Larson was not an independent third-party. Mr. Larson was like family to the Levines and he was willing to contradict himself for his friend of fifty years.

C. The combined cash surrender value of the life insurance policies should be included in the gross estate pursuant to section 2038.

Section 2038 provides that, in general, the value of the gross estate shall include the value of all property--

> To the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) 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), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Treas. Reg. § 20.2038-1(a)(3) provides that it is immaterial that the power is exercisable only in conjunction with someone having an adverse interest. Section 2038 is applicable to any power affecting the time and manner of enjoyment of the property or its income, even though it may not change the designated beneficiaries. "For example, section 2038 is applicable to a power reserved by the grantor of a trust to accumulate income or distribute it to A, and to distribute corpus to A, even though the remainder is vested in A or his estate, and no other person has any beneficial interest in the trust." See Treas. Reg. § 20.2038-1(a)(3).

Section 2038(a)(1) largely mirrors section 2036(a)(2) but focuses on the Decedent's power to "alter, amend, revoke or terminate" the enjoyment of the property in question. As stated previously, the attorneys-in-fact controlled the entirety of Decedent's affairs since May 19, 1996. This control includes the ability to "alter, amend, revoke or terminate" any aspect of the split-dollar agreements. The termination of the split-dollar agreements would immediately provide the Decedent (the attorneys-in-fact) with complete control over the cash value of the policies and the ability to do this falls squarely within section 2038(a)(1) for many of the same reasons that are explained in the preceding sections.

Like section 2036(a), section 2038(a)(1) excepts from its application any transfer of property otherwise subject to that section which is a bona fide sale for adequate and full consideration. "The respective exceptions in sections 2036(a) and 2038(a)(1) have the same meaning". Estate of Anna Mirowski v. Commissioner, 95 T.C.M. (CCH) 1277, 1296 (2008). As such, petitioner also fails to satisfy the bona fide sale exception under section 2038(a)(1) for the same reasons that are explained in section I.A.2., *supra*. Accordingly, the combined cash surrender value of the policies is includable in the Estate under section 2038(a)(1) because the Decedent retained the power to "alter, amend, revoke or terminate" the split-dollar arrangements and petitioner has failed to satisfy the bona fide sale exception.

D. The special valuation rules under section 2703 are applicable in determining the value of the rights in the split-dollar arrangements.

Respondent's primary position is that sections 2036 and/or 2038 are applicable and these sections provide that the combined cash surrender value of the life insurance policies, $6,153,478, is includable in the Estate regardless of the application of section 2703. This is the value of the policies on the Alternate Valuation Date. This amount is indisputable (FSSOF ¶ 39(c) & 39(e)) and is the amount that should have been reported by the Estate regardless of the application of the special valuation rules. Respondent's alternative position is that the special valuation rules under section 2703 are applicable to the split-dollar arrangements.

1. The value of the property shall be determined without regard to any restriction on the right to sell or use such property.

Respondent asserts that the split-dollar arrangements contain a restriction on Decedent's right to unilaterally access the funds transferred to the insurance companies for the benefit of the Insurance Trust. Upon entering into the split-dollar arrangements, the Decedent purportedly relinquished her right to unilaterally control the transferred funds and/or the life insurance policies that were purchased with the transferred funds. Prior to executing the agreement, the Decedent (through her attorneys-in-fact) had unfettered right to control the $6,500,000 in borrowed funds.

By signing the split-dollar agreements, the Decedent (through her attorneys-in-fact) placed a restriction on the right to control the funds and underlying property. In fact, it is this exact restriction that gives rise to petitioner's argument that the rights of repayments are worth a fraction of their original value. The restricted right to access the $6,500,000 is the crux of the entire split-dollar arrangement. No prudent business person would enter into any arrangement which would cause the immediate reduction in value with no hope of recoupment. If the access restriction is ignored, then the

Decedent had full rights to the cash surrender value of the policies.

2. The value of the property shall be determined under section 2703(a)(2) unless petitioner meets all three requirements of section 2703(b).

Section 2703 provides that any restriction in an agreement on the sale or use of transferred property must be ignored unless the taxpayer shows that the transfer is (1) a bona fide business arrangement, (2) not a device to transfer property to members of a decedent's family for less than full and adequate consideration in money or money's worth, and (3) the terms are comparable to similar arrangements entered into by persons in an arm's length transaction. See I.R.C. § 2703(b). Petitioner must show that the restriction placed on the funds via the split-dollar arrangements can pass all three of the requirements under 2703(b), otherwise the restriction in the split-dollar agreements must be ignored and the combined cash surrender values will be includable in the gross estate.

As discussed above, the split-dollar transactions do not constitute bona fide business transactions or sales for full and adequate consideration. See Section I.A.2., *supra*. Furthermore, respondent maintains that employment split-dollar is relevant to the issues in this case for two reasons.

First, the final split-dollar regulations are a direct product of the economic benefit regime first developed in the employment area, starting with Rev. Rul. 64-328, and culminating with the rules put forth in the final split-dollar regulations. In the almost 50 years that elapsed from Rev. Rul. 64-328 to the final regulations, the private split-dollar rules "tagged" along with the employment rules. In fact, it has been only in the last several years that private split-dollar transactions started to deviate from an arm's-length transaction, thus producing tax consequences vastly different from their employment cousin. The final regulations should not be viewed in a vacuum, the history and the structure of employment split-dollar provides the necessary tools to understand the final split-dollar regulations.

Second, the very nature of employment split-dollar cuts to the very heart of the current dispute between petitioner and respondent, specifically, that in a bona fide business arrangement an employer (a) will not insure someone other than the immediate employee, and (b) will not purchase a paid up policy, or if there is a paid up policy the employer will be able to "access" the employer's investment (inside build-up). The effect of insuring a lower generation, prepaying the policy, and unilaterally giving up the right to currently benefit from the investment means there are additional benefits that must be counted for, not seen in the bona fide business arrangement. Thus, petitioner cannot meet the first requirement of section 2703(b).

Furthermore, under the terms of the split-dollar arrangements, the attorneys-in-fact used $6,500,000 of the Decedent's assets to purchase life insurance on the lives of the Decedent's daughter and son-in-law. Regardless of whether the policies were surrendered soon after purchase or remained in full effect until the death of the insureds, the proceeds from these policies were required to be paid to the Decedent's Revocable Trust and the Decedent's Insurance Trust. Because the beneficiaries of each of these Trusts were the Decedent's children (that is, the attorneys-in-fact who structured this transaction together with Mr. Larson), petitioner cannot satisfy the second requirement and show that these arrangements were not devices to transfer property to the Decedent's family for less than full and adequate consideration. See I.R.C. § 2703(b)(2). Petitioner even seems to concede this point by taking the position that one of the primary purposes for entering into the split-dollar arrangements was to pay for the Decedent's children's eventual estate tax liabilities. (P's Brief, P. 90).

Finally, petitioner has not shown that the split-dollar arrangements were comparable to similar arrangements entered into by persons in arm's length transactions. As noted above, it is inconceivable that someone in an arm's length transaction would leverage their business assets to obtain $6,500,000 in loans and then invest the loan proceeds in a transaction that restricted his/her ability to be repaid for roughly 25 years. Regardless, petitioner has not made any attempt to prove that the split-dollar agreements in this case are similar to split-dollar agreements used in any other arm's length transactions. Thus, petitioner cannot meet the requirements of section 2703(b).

Because petitioner cannot satisfy any of the requirements of section 2703(b), the restrictions in the split-dollar arrangements must be ignored pursuant to section 2703(a). Once the restrictions in the split-dollar agreements are ignored, the effective consequence is that the Decedent had the right to access the combined cash surrender value of the policies at any time, including the alternative valuation date. Since the combined cash surrender value of the policies was $6,153,478 as of that date, this is the amount that is includable in the Estate.

Petitioner contends that respondent's application of section 2703 should be rejected because the Decedent did not own the life insurance policies, nor did she have the right to the cash surrender value of the policies at any time. (P's Brief, P. 120). Although the terms of the split-dollar agreements provide that the Insurance Trust owned the life insurance policies, the Decedent clearly had the right to access the cash surrender value of the policies. As explained above, the Decedent's attorneys-in-fact controlled every aspect of these arrangements, they stood on both sides of the agreements and they effectively had the ability to surrender the polices and unwind the transactions on behalf of the Decedent at any time. There is absolutely no reason why the attorneys-in-fact would have purchased life insurance policies with cash value enhancers for the early years unless they had the ability to surrender the policies. (Exs. 19-R, 20-R, 30-J, Bates 619 & 31-J, Bates 663).

Petitioner also contends that the Court must look solely to the property interest held by the Decedent at the time of her death, which are the "rights" under the split-dollar agreements. (P's Brief, PP. 120 - 121). If we focus strictly on the

Decedent's "rights" under the split-dollar arrangements as proposed by petitioner, then the ultimate result is the same, and the combined cash surrender value of the policies is includable in the Estate. Under the terms of the agreements, the Decedent received the "right" to be repaid $6,500,000 or a greater cash value when (a) the split-dollar agreements were terminated, (b) the relevant life insurance policies were surrendered, or (c) the insureds under the policies died. The basic restriction in this case is the requirement that both parties must consent to an early termination, which controls the economic benefits of the arrangement (i.e., the right to be immediately repaid). The mutual consent restriction must be disregarded under section 2703(a). Since the Decedent cannot meet the exception to section 2703(a), the value of the Decedent's property, her "rights", shall be determined without regard to the imposed restriction. If the restriction is disregarded pursuant to section 2703(a), the effect is that the steep "present value" discount is eliminated and the value of the Decedent's "rights" would be the same as the combined cash surrender value of the underlying life insurance policies.

II. Petitioner's other arguments concerning the split-dollar arrangements also lack merit.

Petitioner made many different arguments concerning the split-dollar arrangements throughout its Opening Brief. Respondent has responded to most of petitioner's arguments in the preceding sections of this Answering Brief. To the extent respondent has not responded to petitioner's substantive arguments, respondent does so below.

A. The Split-Dollar Treasury Regulations are irrelevant in the context of this estate tax case.

Petitioner references Treasury Regulation § 1.61-22 (the "Split-Dollar Regulations") numerous times through its Opening Brief. (P's Brief, PP. 66 – 70, 85, 91, 94, 108, 134, 139, 140). The following is the first sentence of the Split-Dollar Regulations:

> This section provides rules for the taxation of a split-dollar life insurance arrangement for purposes of the income tax, the gift tax, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act(RRTA), and the Self-Employment Contributions Act of 1954 (SECA).

Treas. Reg. § 1.61-22(a)(1). The Split-Dollar Regulations do not provide any rules for the taxation of a split-dollar life insurance arrangement for purposes of the estate tax and none of the above taxes are at issue in this case.

It is also worth noting that all of the examples in the Split-Dollar Regulations address split-dollar arrangements in the context of agreements between employers and their employees, unlike the intergenerational split-dollar arrangements at issue here. Thus, petitioner's arguments that the transaction in this case was provided for in respondent's regulations and that Mr. Swanson structured the transactions to follow the requirements under the regulations should be disregarded.

B. Petitioner's argument that section 2036(a)(1) only applies to "present or current possessory" interests lacks merit.

Petitioner maintains that section 2036(a)(1) does not apply in this case because that section "only applies to present or current possessory interests in property, not future interests." (P's Brief, P. 92). Petitioner further claims that the Decedent had no present economic benefit from the $6,500,000 of funds used to acquire the life insurance policies because she was not entitled to repayment of these funds until the death of the last surviving insured. Id.

Petitioner's argument implies that a Decedent must be immediately and "currently" entitled to receive the income generated from the property in order for section 2036(a)(1) to apply. Petitioner's argument is not supported by the plain reading of section 2036(a)(1). There is no reference to a decedent's "current" right to income in that section. That section simply requires "the possession or enjoyment of, or the right to the income from, the property". I.R.C. § 2036(a)(1). Respondent explained in detail above why the facts and terms of the split-dollar agreements establish that the Decedent retained such rights. Further, petitioner's interpretation would create an exception that would swallow the rule and planners would merely accumulate the income to be paid after death thereby rendering section 2036 ineffective.

C. Respondent's position is not inconsistent with Treas. Reg. § 20.2031-4.

Petitioner claims that if the Court were to adopt respondent's interpretation of section 2036(a)(1), then every estate that owned a loan, note receivable or bond, would be required to include the full amount of the loaned principle in the gross estate, regardless of whether the loan or bond would be repaid. (P's Brief, PP. 98 - 99). Petitioner's assertion is simply wrong. Respondent's interpretation of section 2036(a)(1) is consistent with the line of cases cited by petitioner in which a decedent transferred assets to a family limited partnership, but the decedent retained a "proverbial string" which effectively pulled the assets back into her estate pursuant to section 2036(a)(1). See Section I.A., *supra*. The split-dollar strategy used by petitioner was not a bona fide loan as petitioner attempts to characterize it throughout its Opening Brief[23]. Accordingly, any assertions that respondent's position in this case undermines appropriate valuation discounts applicable to promissory notes or bonds should be disregarded.

D. Revenue Ruling 2008-35 supports respondent's position that the full fair market value of life insurance policies should be included in the Estate pursuant to sections 2036(a)(1) and/or 2703.

In Revenue Ruling 2008-35, 2008-29 I.R.B. 116, Taxpayer A entered into an agreement with Bank M which provided that Taxpayer A agreed to deposit marketable securities and cash into a Restricted Management Account ("RMA") with Bank M. The RMA was designed to enhance the investment performance of the portfolio by allowing Bank M to maximize the portfolio's long-term investment performance without the risk of withdrawal before the expiration of the selected term of the RMA. Bank M agreed to accept a reduced investment management fee in exchange for Taxpayer A agreeing to a fixed term of the RMA. Taxpayer A contributed $50 to the RMA in Year 1. In Year 3, Taxpayer A extended the term of the RMA to Year 7. Taxpayer A died in Year

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[23] Respondent notes that petitioner previously argued that the loan regime under section 1.7872-15 did not apply and by implication there were no loans. See Docket No. 9345-15.

4. At the time of Taxpayer A's death, the fair market value of the assets held in Taxpayer A's RMA was $55.

One of the issues considered by the IRS in Revenue Ruling 2008-35 was whether the restrictions imposed by the RMA resulted in a value that is less than the fair market value of the assets in the RMA for purposes of the estate tax. The IRS concluded that the full $55 was includable in Taxpayer A's estate regardless of the fact that the restrictions in the RMA restricted his access to the underlying assets until three years later. Specifically, the IRS concluded that section 2036 applied to Taxpayer A's retained interest in the assets of the RMA and section 2703(a)(2) applied to disregard the restrictions on the sale or use of the property for federal estate tax valuation purposes.

Like the taxpayer in Revenue Ruling 2008-35, the Decedent here contributed assets to a purported investment vehicle to be owned by the Insurance Trust and the value of those assets appreciated during the Decedent's remaining six months of life. Respondent's position, therefore, is that the full fair market value of the assets the Decedent invested in the split-dollar strategy would be includable in the Estate under the principles outlined in Revenue Ruling 2008-35.

Petitioner argues that Revenue Ruling 2008-35 is distinguishable from the present case for various reasons. (P's Brief, PP. 94 - 98 & 126). Respondent acknowledges that the facts and investment vehicle used in Revenue Ruling 2008-35 are somewhat different from the facts and vehicle used here, but the differences are without effect and the underlying concepts are not. The taxpayer in Revenue Ruling 2008-35 and the Decedent here made a transfer of assets, they purportedly agreed that they could not access those assets until years later, the assets appreciated in value and generated income, and they passed away owning the right to be repaid at a later date. Thus, the result in this case should be no different than the result in Revenue Ruling 2008-35. Respondent does acknowledge that Revenue Ruling 2008-35 has little, if any, precedential value. Nevertheless, this ruling provides a clear explanation of respondent's interpretation of the application of section 2036 and/or 2703 in the context of agreements that restrict a taxpayer's access to assets that are contributed to an investment vehicle such as split-dollar arrangements and RMAs.

E. Section 2035 does not apply to the split-dollar arrangements at issue in this case.

Petitioner contends that section 2035 does not apply to the split-dollar arrangements at issue in this case. (P's Brief, PP. 117 - 119). Respondent agrees that section 2035 is not applicable in this case.

F. Petitioner's characterization of the split-dollar arrangement as an income tax deferral strategy is not supported by the facts and is irrelevant.

Petitioner argues that the split-dollar strategy is an income tax deferral strategy that is provided for under the Code and, therefore, it is difficult to understand how the strategy can be viewed as lacking a bona fide component. (P's Brief, PP. 109 - 110). First of all, none of Mr. Swanson's initial communications characterized this strategy as an income tax deferral strategy. (Exs. 13-P & 14-J). Instead, he strictly focused on and emphasized the estate tax savings.

Secondly, the intergenerational split-dollar arrangements at issue in this case are not specifically provided for under the Code and regulations as petitioner suggests. Thus, petitioner's argument that it is incomprehensible that this strategy can be viewed as lacking a bona fide component lacks merit. Finally, even if petitioner intended to use this transaction as an income tax deferral strategy that is found to be provided for under the Code and regulations, none of the code sections and regulations cited by petitioner related to this point purport to address the estate tax consequences of intergenerational split-dollar arrangements. Thus, petitioner's arguments should be disregarded.

III. Although the Court's opinion in Estate of Powell is not directly on point, the Court's opinion in that case supports respondent's position.

At the conclusion of the trial, the Court asked the parties to compare and contrast this case with the Court's opinion in Estate of Powell v. Commissioner, 148 T.C. No. 18 (2017). (Tr. 391:21 - 391:24).

In Estate of Powell, Mr. Powell, the decedent's son, who was acting on his mother's behalf, transferred cash and securities worth $10,000,752 from his mother's revocable trust to a limited partnership in exchange for a 99% limited partnership interest in that entity. Estate of Powell, 148 T.C. No. 18, at 2. Mr. Powell formed the limited partnership, NHP, two days earlier. Id. NHP's partnership agreement gave Mr. Powell the sole discretion to determine the amount and timing of distributions and allowed for the entity's dissolution with the written consent of all partners. Id. On the same day, Mr.

Powell gifted the 99% interest to a charitable lead annuity trust ("CLAT"). Id.

Respondent subsequently issued notices of deficiency to the decedent's estate for both estate and gift tax[24]. Id. at 3. The primary adjustment in the estate tax notice of deficiency related to the decedent's interest in the property she transferred to NHP. Id. Respondent determined that the value of the property the decedent transferred to NHP was includable in her estate pursuant to sections 2036, 2038, and/or 2703. Id. The determinations set forth in the notice of deficiency were almost identical to the determinations set forth in the notice of deficiency for this case. Id. & Ex. 3-J, Bates 265 - 266.

Respondent filed a motion for partial summary judgment and argued that section 2036(a)(1) and (2) applied to the decedent's transfer of cash and securities to NHP. Estate of Powell, 148 T.C. No. 18, at 4. Respondent argued that section 2036(a)(1) applied to the transfer at issue because it was subject to an implied agreement under which the decedent retained the possession or enjoyment of the transferred property or the right to income from that property. Id. Respondent also argued that

[24] Our analysis of Estate of Powell will focus primarily on the estate tax issues since the gift tax issues do not appear to be relevant in the instant case.

section 2036(a)(2) applied to the transfer because of the decedent's ability, acting with her sons, to dissolve NHP and thereby designate those who would possess the transferred property or the income from the property. Id. The Court agreed with respondent that the transfer was subject to a right described in section 2036(a)(2) and therefore decided that it did not need to address respondent's argument under section 2036(a)(1). Id.

In reaching this decision, the Court stated that the decedent's ability to dissolve NHP with the cooperation of her sons constituted a "right...in conjunction with others..., to designate the persons who shall possess or enjoy the property [she transferred] or the income therefrom," within the meaning of section 2036(a)(2). Id. at 5. The Court also considered the decedent's son's discretion to determine the amount and timing of partnership distributions. Id. at 6. The Court compared these powers to similar cases in which petitioners argued that such powers were subject to State law fiduciary duties and, therefore, insufficient to trigger the application of section 2036(a)(2). Id. The Court concluded that any fiduciary duties that limited Mr. Powell's discretion in regard to distributions by NHP were "illusory" and thus did not prevent his authority over partnership distributions from being a right that, if retained by decedent at her death, would be described in section 2036(a)(2). Id. at 7.

The Court went on to explain the interplay of sections 2036 and 2043 with respect to the inclusion of the full value of the cash and securities in the decedent's estate. Id. The Court held that although section 2036(a)(2) applied, that section does not require inclusion of the full date-of-death value of the cash and securities transferred to NHP; rather, section 2043(a) limits the amount includable in the value of the decedent's estate, by reason of section 2036(a)(2), to the excess of the fair market value at the time of death of the cash and securities over the value of the consideration received therefor by the decedent. Id. at 9. Put differently, section 2036(a)(2), as limited by section 2043(a), included in the value of the decedent's gross estate the amount of any discounts applicable in valuing the 99% limited partnership interest in NHP. Id. The Court characterized this amount as the "hole" in the "doughnut." Id.

The Court's approach in Estate of Powell was novel and differed from the approach that the Court has taken in similar cases. See e.g. Estate of Thompson v. Commissioner, 84 T.C.M.

(CCH) 374 (2002) ("Section 2036(a) effectively includes in the gross estate the full fair market value...of all property transferred in which the decedent had retained an interest"); Estate of Harper, 83 T.C.M. (CCH) 1641, 1654 ("the property contributed by decedent to HFLP is included in his gross estate pursuant to section 2036(a).").

The Honorable Judge Lauber wrote a concurring opinion in which he stated that the Court's exploration of section 2043(a) seemed to be a solution in search of a problem. Estate of Powell, 148 T.C. No. 18, at 18. Judge Lauber concluded that if section 2036(a)(2) is read as it always has been read, then the Court should "disregard" this "transfer with a string" and include in the decedent's estate what she held before the purported transfer (i.e. the $10 million in cash and securities). Id. Judge Lauber went on to explain the majority of the Court's opinion as follows:

> Invoking section 2043(a), the Court divides the $10 million into a "doughnut" and a "doughnut hole." The "doughnut" consists of the limited partnership interest allegedly received by the decedent; on the Court's theory, this is pulled back into the gross estate via section 2035 or 2038, and its value then included under section 2033. As a result, section 2036(a), paired with section 2043(a), has the much-reduced function of bringing back into the gross estate, not the full value of the $10 million as that section by its terms requires, but only "the amount of any discounts (that is, the doughnut holes) allowed in valuing the partnership interest." See op. Ct. pp. 26-27. This

> theory seemingly validates the estate's claimed discount for lack of marketability, which seems highly suspect on the facts presented.

Id. at 18.

The attorneys-in-fact in the case at hand engaged in similar deathbed-like tax planning. They transferred $6,500,000 to a newly formed entity and executed agreements which purported to limit the Decedent's ability to access the cash value of the underlying assets for approximately 25 years. Although the tax strategy and entity used in this case differ from the strategy and limited partnership used in Estate of Powell, the ultimate result should not.

Respondent's position is that, like Mr. Powell, the attorneys-in-fact made a transfer and the Decedent retained the proverbial "string" that pulls the assets back into her estate. Similar to Mr. Powell, the attorneys-in-fact in this case stood on both sides of the transactions and had the ability to unwind[25] the arrangements at any time. Furthermore, any fiduciary duties that they may have had were clearly "illusory" because the beneficiaries of trusts that entered into the split-dollar agreements were the same people who were responsible for

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[25] Unwinding the split-dollar transaction is akin to dissolving the partnership in Estate of Powell.

structuring the transaction for the Decedent: Mr. Levine and Mrs. Saliterman.

Respondent agrees with Judge Lauber's position that section 2036(a) effectively pulls the full fair market value of the assets transferred back into the estate. Under this theory, the Court would simply look to the fair market value of the underlying life insurance policies, $6,153,478, and disregard the purported transfer to the Insurance Trust. Nevertheless, respondent acknowledges that the Court's majority opinion in Estate of Powell is likely controlling. Thus, if the Court's holding in Estate of Powell is applied to the facts at issue in this case, then it is respondent's position that the "doughnut" in this case is the "rights" that the Decedent received in exchange for paying the $6,500,000 in premiums and that the "doughnut hole" is the present value discount that the Estate applied to the value of the decedent's "rights". Thus, the value of the "doughnut" would be $2,282,195 (the discounted present value), as stipulated by the parties, and the value of the "doughnut hole" would be $3,871,283. Accordingly, the amount includable in the Estate would be $6,153,478 ($2,282,195 + $3,871,283).

IV. The Court's opinion in Estate of Morrissette is not relevant to the estate tax adjustment at issue in this case.

The Court also asked the parties to compare and contrast this case with the Court's opinion in Estate of Morrissette, 146 T.C. No. 171 (2016). (Tr. 391:21 - 391:24). Petitioner addressed Estate of Morrissette in Section I.B. of its Opening Brief. (P's Brief, PP. 70 - 73).

As noted by petitioner in its Opening Brief, the sole issue decided by the Court in Estate of Morrissette was whether the split-dollar arrangements at issue in that case were governed by the economic benefit regime under the Split-Dollar Regulations. (P's Brief, P. 71). The issue in Estate of Morrissette was a gift tax valuation issue, which is not at issue in the current case because any gift tax adjustments stemming from the transactions at issue here were disposed of on July 13, 2016, when the Court granted petitioner's motion for summary judgment in Estate of Levine v. Commissioner, Docket No. 9345-15.

Furthermore, as noted by petitioner, the Court in Estate of Morrissette stated that it was "not deciding whether the estate's valuation of the receivable (the portion of the cash value of each policy the CMM was entitled to receive) in the gross estate is correct." (P's Brief, P. 73 citing Estate of

Morrissette, 146 T.C. 172, FN 2.). Accordingly, it is respondent's position that Estate of Morrissette is not relevant in this estate tax case[26].

V. Petitioner is liable for a gross estate tax valuation penalty[27] with respect to the value of its rights in the split-dollar arrangements.

Sections 6662(a), (b), and (g) impose an accuracy-related penalty of 20 percent on an underpayment of tax attributable to a substantial estate or gift tax valuation understatement. A substantial estate tax valuation understatement exists if the value of any property claimed on an estate tax return is 65 percent or less of the of the amount determined to be the correct value of that property. I.R.C. § 6662(g)(1). Section 6662(h)(2)(C) imposes an increased penalty of 40 percent if the

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[26] It is worth noting that respondent does not concur in the result in the Morrissette gift tax case. Due to a combined statutory notice of deficiency, the gift tax case is not currently ripe for Appeal. The decision to make such an Appeal will be determined at the conclusion of the Morrissette estate tax case.

[27] Respondent also determined, alternatively, that petitioner is liable for a 20 percent substantial estate tax valuation understatement penalty pursuant to section 6662(g). However, the correct value of the Decedent's rights in the split-dollar arrangements is either (1) $6,153,478 or (2) $2,282,195. If the correct value of the Decedent's rights in the split-dollar arrangements is $6,153,478, there will be a gross valuation understatement and petitioner will be liable for the increased penalty absent a valid reasonable cause defense. If the correct value of the Decedent's rights is $2,282,195, petitioner will not be liable for any penalties under section 6662.

underpayment of estate and gift tax is attributable to a gross valuation understatement. A gross valuation understatement exists if the value of any property claimed on an estate tax return is 40 percent or less of the amount determined to be the correct value. I.R.C. § 6662(h)(2)(C).

The Estate reported that the combined fair market value of its rights under the split-dollar agreements was $2,137,130. (FSSOF ¶ 39(b) & (d)). This amount is only 34.73%[28] of the combined cash surrender values, $6,153,478. Accordingly, if the Court determines that the correct value of the Decedent's rights in the split-dollar arrangements is the combined cash surrender value of the life insurance policies, the gross valuation understatement penalty would apply because the claimed value would be less than 40% of the amount determined to be the correct value.

A. Respondent has met his burden of production.

Respondent bears the initial burden of production to show that the penalty applies. I.R.C. § 7491(c). To satisfy his burden of production, respondent must present sufficient evidence to show that it is appropriate to impose the penalty. Graev v. Commissioner, 149 T.C. No. 23, slip op. at 14 (2017).

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[28] $2,137,130/$6,153,478 = 34.73%.

Compliance with the requirement in section 6751(b)(1) that the initial determination to assert a penalty be personally approved in writing by the immediate supervisor of the individual who made such initial determination is part of respondent's burden of production with respect to the liability of an individual[29] for any penalty. Id.

If the Court agrees with respondent's primary position, respondent will have shown that a gross estate tax valuation understatement exists because he will have shown that the value of the Decedent's rights under the split-dollar agreement were reported on the Decedent's estate tax return at a value less than 40% of the correct value. I.R.C. § 6662(h)(2)(C). Furthermore, respondent has met his burden of demonstrating compliance with section 6751(b)(1) because the parties stipulated to the following:

> Estate & Gift Tax Attorney Nicole Bard, the Acting Group Manager and the immediate supervisor for Estate & Gift Tax Attorney Scott Ratke, approved Mr. Ratke's assertion of the Gross Valuation Misstatement Penalty that he asserted with respect to Schedule G, item 23 of the Decedent's Estate tax Return.

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[29] As this Court has noted, it is unclear whether the Court's ruling in Graev III that section 6751(b) compliance is part of respondent's burden of production extends to cases where the petitioner is a taxpayer but is not an individual, although the Court does traditionally apply section 7491(c) in estate tax cases. See Docket No. 17152-13, Order dated Jan. 4, 2018.

(TSSOF ¶ 127). This stipulation confirms that Mr. Ratke was the individual who made an initial determination to assert the gross valuation misstatement penalty and that initial determination was personally approved, in writing, by his immediate supervisor.

As further evidence of compliance with the written supervisory approval requirement of section 6751(b)(1), respondent introduced into evidence a penalty approval form prepared by Mr. Ratke with respect to the Decedent's estate tax return. (Ex. 53-R) The form includes the Decedent's name and taxpayer identification number, and the box for assertion of the section 6662(h) penalty is checked. Id. In the section of the form for use by the group manager, the box next to the word "Approved" is checked, and the form is signed and dated by Mr. Ratke's immediate supervisor at that time, Nicole Bard. Id.

Despite the stipulation and the penalty approval form, petitioner now argues that respondent cannot meet his burden of production because petitioner claims that respondent's penalty approval form was defective. (P's Brief, PP. 129 - 130). Specifically, petitioner argues that Mr. Ratke did not make an "initial determination" because his penalty approval form references an unrelated case. (P's Brief, P. 129).

Petitioner's argument is misleading and baseless. The following excerpt from the penalty approval form highlights the statements that petitioner is challenging:

Explain Assertion/Non-Assertion of Penalty(s)

There is an gross understatement of Schedule G, item 23. It was returned at $1,432,131 and the corrected value is $6,767,950; therefore under I.R.C. 6662(h)(2)(c) a 40% penalty is applied to the estate tax attributable to this asset.

There is not "reasonable cause" to abate this penalty. It was applied in another stat. notice case in another territory and Area Counsel supports assertion of this penalty.

(Ex. 53-R). The above excerpt clearly shows that Mr. Ratke made an "initial determination" that there was a gross estate tax understatement related to the split-dollar arrangements (Schedule G, Item 23 of the Estate Tax Return) such that petitioner is liable for the penalty under section 6662(h)(2)(C). If the first paragraph of the above excerpt was read alone, there would be no question that Mr. Ratke made an "initial determination" to assert a section 6662(h) penalty against petitioner. The fact that the subsequent paragraph referenced the assertion of a penalty in another case does not negate the fact that Mr. Ratke made an "initial determination" here to assert the section 6662(h) penalty.

Petitioner also argues that there cannot be a "valuation misstatement" in this case because the value determined by respondent is based solely on respondent's legal theories. (P's Brief, P. 132). Petitioner is wrong. The valuation misstatement here is attributable to petitioner's failure to report the combined cash surrender value of the policies on the Estate tax return. As is explained above, section 2036 permits respondent to disregard "transfers with a string" and include in the decedent's estate what she held before the purported transfer. Estate of Thompson, 84 T.C.M. (CCH) 374 (2002) ("Section 2036(a) effectively includes in the gross estate the full fair market value...of all property transferred in which the decedent had retained an interest").

In some ways, this case is similar to the family limited partnership cases cited by petitioner in which the courts have found the family limited partnership to be nothing more than a "partnership wrapper." (P's Brief, P. 81, FN 343). In all of those cases, the courts held that the value of the partnership assets is what is includable in the estate. That is exactly what respondent is doing here, focusing on the value of the life insurance policies instead of the steeply discounted value of the Decedent's rights under the split-dollar arrangements.

B. Petitioner failed to prove the applicability of a reasonable cause defense.

Respondent's burden of production under section 7491(c) does not include rebutting any possible defenses. Higbee v. Commissioner, 116 T.C. 438, 446-47 (2001). Once respondent meets his initial burden of production, petitioner bears the burden of proving that respondent's determination is incorrect or that there was reasonable cause for its position and it acted in good faith. Id. Petitioner must prove the applicability of any defenses or exceptions, including reasonable cause. I.R.C. § 6664(c)(1); Higbee, 116 T.C. at 447.

Petitioner argued that it has a reasonable cause defense because the attorneys-in-fact relied on the advice of Mr. Swanson. (P's Brief, P. 134) Reliance on a professional tax advisor may constitute reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. Treas. Reg. § 1.6664-4(b)(1). However, all facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on the advice of a professional tax advisor. Treas. Reg. § 1.6664-4(c)(1); Hansen v. Commissioner, 471 F.3d 1021, 1032 (9th Cir. 2006).

In determining whether reliance on an adviser negates liability for an accuracy-related penalty under section 6662, the Tax Court has established a three-part test. The petitioner must prove the following, by the preponderance of the evidence: (1) that the advisor was a competent professional who has sufficient expertise to justify reliance, (2) that the petitioner provided necessary and accurate information to the advisor, and (3) that the taxpayer actually relied in good faith on the advisor's judgment. Neonatology Assocs. P.A. v. Commissioner, 115 T.C. 43, 99 (2000). The regulations specify that in no event will a taxpayer be considered to have reasonably relied in good faith on a tax professional's advice unless: (1) the advice is not based on unreasonable factual assumptions, and (2) the advice is not based upon a representation or assumption which the taxpayer knows, or has reason to know, is unlikely to be true, such as an inaccurate representation or assumption as to the taxpayer's purpose for entering into a transaction or for structuring a transaction in a particular manner. Treas. Reg. § 1.6664-4(c)(1)(ii). In other words, "the taxpayer's reliance on the advice must itself be *objectively* reasonable." Stobie Creek Investments LLC v. United States, 608 F.3d 1366, 1381 (Fed. Cir. 2010).

a. The attorneys-in-fact did not rely on the advice of Mr. Swanson.

Petitioner has the burden of proving that it was objectively reasonable for the attorneys-in-fact to rely on the advice of Mr. Swanson because he is the only tax adviser that petitioner claims the attorneys-in-fact relied upon (P's Brief, PP. 133 - 137). See Neonatology Assocs., 115 T.C. at 99;. Petitioners cannot meet their burden of proving that they relied on Mr. Swanson for two reasons.

First, all three attorneys-in-fact confirmed at trial that they entered into the agreements despite the fact that they did not understand the strategy. (Tr. 224:12 - 224:16, 279:18 - 280:3, 337:8 - 337:16). Second, Mr. Swanson only wrote one letter that explained the split-dollar strategy (Tr. 111:10 - 111:14, Ex. 13-P) and Mr. Larson admitted that he did not read the letter (Tr. 223:16 - 224:11), Mrs. Saliterman admits that she probably did not read the letter or comprehend its contents (Tr. 279:18 - 280:3), and Mr. Levine does not recall if he read the letter (Tr. 336:15 - 337:7).

Accordingly, petitioner cannot meet its burden of proof because the attorneys-in-fact cannot show that they relied on Mr. Swanson if they (1) did not understand his purported advice, and (2) they failed to read Mr. Swanson's only letter explaining the strategy.

b. It was not objectively reasonable for the attorneys-in-fact to rely on the advice of Mr. Swanson.

A taxpayer's reliance on advice is not reasonable if the taxpayer knew or should have known the transaction was "'too good to be true' based on all of the circumstances, including the taxpayer's education, sophistication, business experience, and purposes for entering into the transaction." Stobie Creek, 608 F.3d at 1381-1382.

Assuming the attorneys-in-fact prevail in proving that they relied on Mr. Swanson, it was not objectively reasonable for them to rely on his advice because the purported tax benefits were "too good to be true" and the attorneys-in-fact made no effort to obtain advice from an independent adviser before entering into the transactions. Mr. Swanson introduced the split-dollar strategy to the attorneys-in-fact by telling them that they could "take $15,000,000 and make it look like $1,500,000 to $7,500,000". (Ex. 13-P, Bates 371). In light of the high level of education, sophistication and business experience of the attorneys-in-fact, it is hard to believe that they were not concerned that this bold assertion was "too good to be true." Furthermore, respondent posits that it is almost never reasonable to rely on a professional who claims to be able to use a transaction to radically reduce the apparent value of an asset without reducing its actual value.

Finally, Mark Saliterman, a Certified Public Accountant and Mrs. Saliterman's brother-in-law at the time, responded to Mr. Swanson's questionable email and raised several concerns about the strategy. (Ex. 13-P, Bates 370). Yet, none of the attorneys-in-fact discussed the split-dollar strategy with Mr. Saliterman or any other professional tax advisers. (Tr. 226:10 - 227:3, 277:8 - 277:24, 335:14 - 336:4). These objective facts strongly suggest that it was objectively unreasonable for the attorneys-in-fact to rely on the advice of Mr. Swanson.

c. The attorneys-in-fact could not rely on the advice of Mr. Swanson because he was a promoter.

A taxpayer cannot reasonably rely in good faith on an adviser who is a "promoter" of the disputed transaction. Avrahami v. Commissioner, 149 T.C. No. 7, *33 (2017); 106 Ltd. v. Commissioner, 136 T.C. 67, 79-80 (2011), aff'd, 684 F.3d 84 (D.C. Cir. 2012); Neonatology Assocs., 115 T.C. at 98. A promoter is "an adviser who participated in structuring the transaction or is otherwise related to, has an interest in, or profits from the transaction." 106 Ltd., 136 T.C. at 79 (citing Tigers Eye Trading, LLC v. Commissioner, T.C. Memo. 2009-121). The attorneys-in-fact cannot reasonably rely on Mr. Swanson because he was a promoter of the split-dollar transaction.

Mr. Swanson was involved in every aspect of these arrangements and profited from the taxpayer's participation in the arrangements. He introduced the attorneys-in-fact to the transaction, he helped them form the Marion Levine 2008

Irrevocable Trust (the "Insurance Trust"), he drafted all of the transactional documents, he introduced them to the South Dakota Trust Company to serve as the purported trustee of the Insurance Trust, he helped them acquire the life insurance policies from Mr. Prather, one of his longtime colleagues, and he introduced them to McGladrey, the appraisal firm that valued the Decedent's rights at a fraction of the value of the life insurance policies. (Ex. 13-P, Bates 371, Ex. 14-J, Tr. 114:11 - 115:7 & 97:16 - 97:20). He also profited a great deal from the transaction by charging a flat fee of $120,000. Because Mr. Swanson was a promoter of the transaction, the attorneys-in-fact could not rely on him reasonably and in good faith. Petitioner has, therefore, failed to prove that it acted with reasonable cause and in good faith so as to avoid liability for the section 6662(h) accuracy-related penalty.

d. The substantial authority and reasonable basis exceptions cited by petitioner are not applicable in this estate tax case.

Petitioner argues that the Estate is not liable for the gross estate tax valuation penalty because the attorneys-in-fact had a reasonable basis and substantial authority for their tax treatment of the split-dollar insurance transaction because they complied with the split-dollar regulations when the transaction was structured and they considered all applicable estate tax authority when the transaction was reported for estate tax purposes. (P's Brief, PP. 139 - 140). Petitioner cites to Treasury Regulations sections 1.6662-3 and 1.6662-4 in support of its position. (P's Brief, PP. 137 - 139, FN 427 - 437). Petitioner's reliance on these regulations is misguided, however, because there is no substantial authority or reasonable basis exception to the gross estate tax valuation understatement penalty.

Section 6662(d) imposes a 20 percent penalty on underpayments attributable to a substantial understatement of income tax. In determining whether a taxpayer has a substantial understatement of income tax, section 6662(d)(2)(B) provides that the amount of any understatement shall not include any items for which the taxpayer had substantial authority or any items which were adequately disclosed and for which the taxpayer had a reasonable basis. Neither section 6662(g), which imposes a 20 percent penalty in the case of a substantial estate tax valuation understatement, nor section 6662(h), which increases the amount of the section 6662(g) penalty to 40 percent in the case of a gross estate tax valuation understatement, contains an exception for substantial authority or reasonable basis.

Moreover, the regulations cited by petitioner pertain to negligence and substantial understatement penalties imposed with respect to an underpayment of income tax and not an underpayment of estate tax. Treas. Regs. §§ 1.6662-3 and 1.6662-4. Thus, petitioner's substantial authority and reasonable basis arguments (P's Brief, PP. 137 - 143) should be disregarded.

CONCLUSION

It follows that the determination of the Commissioner of Internal Revenue, as modified herein, should be sustained.

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UNITED STATES TAX COURT

ESTATE OF MARION LEVINE, DECEASED, ROBERT L. LARSON, PERSONAL REPRESENTATIVE,	)	
Petitioner,	)	
v.	)	Docket No. 13370-13
COMMISSIONER OF INTERNAL REVENUE,	)	Judge Holmes
Respondent.	)	Filed Electronically

AMENDED REPLY BRIEF FOR PETITIONER

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Docket No. 13370-13

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PRELIMINARY STATEMENT

The Answering Brief of Respondent is premised on a single theme: because Decedent's children "stood on both sides" of the split-dollar life insurance transaction ("Transaction"), the entire legal effect of a transaction provided for under the Code and regulations must be ignored. Respondent's Answering Brief disregards the real legal obligations of Mr. Robert Larson, a person unrelated to Decedent and someone who does not benefit from the Transaction at all. To support Respondent's position, Respondent ignores the relevant law and facts to concoct a theory that "strongly suggests" the parties must have intended to surrender the life insurance policies before the deaths of Nancy and Larry Saliterman (the "Insureds"). The support for this hypothesis is not the record evidence, but a thinly veiled accusation that the witnesses must have lied and the fiduciary obligations in the Transactional documents have no legal effect.

Respondent's hypothetical theory is based solely only on four writings of the estate planner taken out of context: a PowerPoint presentation, a letter to Mark Saliterman and two emails sent to Mark Saliterman and Jason Prather. That there is no evidence supporting Respondent's speculation appears to be of no concern to Respondent. Respondent has not pointed to a single instance where a witness lied (and he does not do so in his Answering Brief), nor has he shown why it would be in anyone's interest to surrender the life insurance policies which still remain in place today.

Respondent's position can only be sustained if the Court disregards the totality of the evidentiary record and the legal authority. As this Reply Brief will show, Respondent's theory of the case is all conjecture and his arguments must fail as matter of law. Respondent's distorted interpretation of I.R.C. §§ 2036, 2038 and 2703, and the novel legal principles he attempts to extract from the authorities he cites, must fail. The record establishes Petitioner has carried its burden of proof that the Transaction was correctly reported for Federal estate tax purposes.

OBJECTIONS TO RESPONDENT'S PROPOSED FINDINGS OF FACT

Petitioner reaffirms its Requested Findings of Fact in its Opening Brief at pages 1 through 63. For each of Petitioner's Requested Findings of Fact, Petitioner provided copious cites to the record, as requested by the Court and as required by Tax Court Rule 151. To the extent Respondent has failed to rebut Petitioner's Requested Findings of Fact, Petitioner requests the Court to find those facts to be deemed admitted by Respondent.

As a preliminary matter, Respondent requests the Court to find many facts (both in his Requested Findings of Fact and the Argument section of his Answering Brief) which are not supported by the record (or which lack citations to the record).[1] As such, Petitioner will object to the facts requested by Respondent by topic:

Purposes For The Transaction

Respondent's position is that none of the purposes for the Transaction were valid because they were not delineated in two of the written communications prepared by Mr. Swanson, specifically, the PowerPoint presentation and the January 7, 2008 letter he drafted "around the time the attorneys-in-fact

[1] To the extent that Respondent requests facts that are argumentative, they are not statements of fact and are in violation of Tax Court Rule 151.

decided to enter into the Transaction."[2] However, the purposes for the Transaction are supported by the testimony of five witnesses who testified at trial and the objective facts in the record.[3] Respondent can point to no evidence which contradicts the witnesses' testimony regarding the purposes for the Transaction. The purposes for the Transaction, set forth in Petitioner's Opening Brief, were fourfold:

- To provide Decedent with a market rate of return on her excess capital;
- To plan for Decedent's legacy;
- To provide estate planning for Decedent and life insurance protection for her children; and
- To diversify Decedent's assets by taking the equity out of Penn Lake Shopping Center.[4]

The witnesses' testimony regarding the purposes for the Transaction was consistent with the two written documents relied upon by Respondent where Mr. Swanson outlined the income, gift and estate tax consequences of the Transaction.[5] Mr. Swanson is an estate planner and he was retained to prepare a comprehensive

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[2] Resp. Brief pgs. 30-31, 39-44.
[3] Shane Swanson, Nancy Saliterman, Robert Larson, Robert Levine & Howard Rubin.
[4] Pet. Brief pgs. 29-31 & fns. 138-149.
[5] Exs. 13-P & 14-J.

estate plan for Decedent.[6] It is indisputable that one of the purposes for the Transaction was estate planning for Decedent.[7] However, Respondent cannot identify any facts which contradict the other purposes for undertaking the Transaction, all of which were detailed in Petitioner's Opening Brief.[8]

Respondent argues that the Transaction was a "negative investment" for Decedent because the interest rates on the loans exceeded the interest Decedent earned on the split-dollar receivables under the Transaction (the "Split-Dollar Receivables").[9] To the extent that Respondent has requested findings of fact on this point, it is argument and in violation of Rule 151. To support this "fact," Respondent postulates that Decedent should have purchased bonds, Exchange Traded Funds or equities instead of the Split-Dollar Receivables.[10] Respondent has offered no evidence to support his claim that these investments would be better investments for Decedent, however, none of these investments could have achieved all four purposes for entering into the Transaction.

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[6] Ex. 78-J.
[7] Pet. Brief pgs. 29-30.
[8] Pet. Brief pgs. 29-30.
[9] Resp. Brief pgs. 41-42.
[10] *Id.*

The purposes of the Transaction are supported by the facts currently, approximately ten years after the Transaction was effected. Specifically, the Transaction has provided for all four of the aforementioned purposes:

- Decedent received more than a market rate of return on her investment.[11] As of March 2017, the amount owed to Decedent under the Split-Dollar Receivables was $8,138,138, well over the $6.5 million initial investment by Decedent.[12]
- The Transaction was a way to plan for Decedent's legacy because real estate assets have not been sold and will be passed to Decedent's children.[13]
- The Transaction provided estate planning for Decedent and life insurance protection for her children. Indeed, the Transaction is still in place and the attorneys-in-fact intend to keep it in place so there is life insurance protection for Decedent's children to pay their eventual estate taxes.[14]

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[11] Decedent was guaranteed a rate of return of 3% on her investment but the rate of return has actually ranged from 4.3% to 5.45%. Exs. 76-J & 77-J.
[12] Stip. ¶ 102; Exs. 76-J & 77-J.
[13] See Ex. 75-J, Bates 2180-2181.
[14] Pet. Brief pg. 56, fn. 282.

- The Transaction enabled Decedent to diversify her assets by taking equity out of Penn Lake Shopping Center, an asset owned outright by Decedent.[15]

Lastly, there are few written communications between Mr. Swanson and the attorneys-in-fact because none of them communicated with Mr. Swanson in writing, including by email.[16] Instead, Mr. Swanson provided his legal advice to the attorneys-in-fact orally and they spoke to each other and Decedent before proceeding with the Transaction.[17] Thus, it is understandable that the purposes for the Transaction were explained predominantly through the testimony of five witnesses, each of whom was present "at or during the time" the Transaction was effected.[18]

Decedent's Health

Respondent's Answering Brief creates nothing but intrigue concerning Decedent's health in the last twenty years of her life.[19] Indeed, Respondent would like the Court to believe that

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[15] Pet. Brief pgs. 29-31, 41-42.
[16] Pet. Brief pg. 54, fns. 273-275.
[17] Pet. Brief pg. 54, fns. 273-275.
[18] Respondent requested the legal files of both estate planners, Howard Rubin and Shane Swanson, via *subpoenas duces tecums,* and received thousands of pages from the planners' legal files. There were no emails from the attorneys-in-fact in Mr. Swanson's legal file.
[19] Resp. Brief pgs. 9-10, 27-29, 67-69.

Decedent was unable to care for herself or manage her businesses in 1996 when the Power of Attorney document was signed, without any evidentiary support.[20] The facts presented at trial, however, show that Decedent continued to manage her business and legal affairs for many years after she executed the 1996 Power of Attorney and she grew her wealth exponentially during that time.[21] It is difficult to imagine how an "incapacitated" person could grow her net worth from $5 million to $25 million without actively managing her investments in the last twenty years of her life.[22] Petitioner does not dispute that the attorneys-in-fact had the right, under the Power of Attorney, to conduct estate planning for Decedent.[23]

Respondent objects to the requested finding that Decedent was never diagnosed with Alzheimer's and dementia during her lifetime and he relies upon documents created after her death to support his claim.[24] Petitioner does not dispute that Decedent's death certificate lists one of the causes of death as Alzheimer's.[25] Petitioner does not dispute Decedent exhibited

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[20] *Id.*
[21] Pet Brief pgs. 12-13, fns. 27-28; pgs. 25-26, fns. 115 to 125.
[22] Pet. Brief pgs. 25-26, fns. 115-125.
[23] Ex. 9-J.
[24] Resp. Brief pgs. 27-29; Exs. 85-J & 56-J.
[25] Stip. ¶s 3, 4 & 5; Ex. 4-J.

signs of dementia during her lifetime.[26] However, Decedent was not incapacitated until the last months of her life[27] and she never required an "expensive" "team of caregivers" as Respondent alleges with absolutely no factual support.[28] While Decedent was eighty-six years old when the Transaction was effected, she was not terminally ill or dying. The estate planners would not have implemented GRATs and QPRTs (which require Decedent to live a certain number of years),[29] Ms. Saliterman would not have moved from Minneapolis to New York in 2007 and 2008[30] and the parties would not have incurred the capital gain on the sale of Arizona Renaissance, if Decedent's death was imminent.[31]

The signed discovery by Mr. Larson in the Caron litigation does not support Respondent's claim that his responses somehow contradict the testimony of the attorneys-in-fact regarding Decedent's health.[32] From Ms. Nelson's perspective,[33] Decedent's behavior was "quiet, erratic and vacant and she was unable to participate in conversation."[34] Facts presented at trial explain

[26] Pet. Brief pg. 13, fns. 29-32.
[27] Pet. Brief pg. 14, fns. 39-40.
[28] Resp. Brief pgs. 67-68.
[29] Ex. 78-J, Pet. Brief pgs. 24-25, fns. 107-114.
[30] Tr. 260: 23-24.
[31] Tr. 316: 18-21.
[32] Resp. Brief pgs. 28-29, 68.
[33] Respondent did not call Ms. Nelson as a witness at trial.
[34] Ex. 85-J.

Decedent’s behavior while she was at home with Ms. Nelson.[35] Decedent’s third husband, Harold Frishberg, was verbally abusive to Decedent and she was withdrawn and cowered in his presence, which is consistent with Ms. Nelson’s observations in the Caron litigation.[36] From Mr. Levine’s perspective, he “observed changes in Mrs. Levine’s behavior and demeanor from 2000 to her death and recalls that starting in or around 2003, when she began experiencing signs of dementia and Alzheimer’s, Mrs. Levine often appeared vacant and was difficult to engage in conversation.”[37] Mr. Levine testified that Decedent exhibited signs of dementia since her stroke in 2003, which is consistent with his statement in the Caron litigation.[38] The Caron litigation documents were prepared and signed in 2013, well after Decedent’s death and after the cause of death was determined.[39] Nothing in the responses to discovery is inconsistent with the witnesses’ testimony at trial.

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[35] Tr. 354: 8-20.
[36] Pet. Brief pgs. 10-11, fns. 13-16.
[37] Ex. 85-J.
[38] Pet. Brief pg. 13, fn. 32; Tr. 347: 10 through Tr. 349:1.
[39] Ex. 85-J.

Decedent's Net Worth, Income And Expenses

Despite the substantial evidence in the record regarding Decedent's net worth, income and assets,[40] Respondent argues that the loans to fund the Life Insurance Policies put Decedent in a "precarious financial situation" and the attorneys-in-fact "would likely need to liquidate at least some of her real estate assets if the Decedent had survived longer and did not surrender the insurance policies during the term of the loans."[41] Petitioner objects to these statements because they are incomplete, misrepresent the facts, are not supported by the record and are argumentative in violation of Rule 151.

In 2007, Decedent's net worth was in excess of $25 million and she was earning in excess of $1 million per year and she had no personal debt.[42] Respondent's analysis of Decedent's purported inability to repay the loans to fund the Life Insurance Policies makes no mention of the over $1 million in income Decedent earned in the years preceding her death.[43] Indeed, Decedent's annual income alone was sufficient to repay the loans used to fund the Life Insurance Policies.

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[40] Pet. Brief pgs. 25-26, fns. 115-125.
[41] Resp. Brief pgs. 68-69.
[42] Pet. Brief pgs. 25-26, fns. 115-125.
[43] Resp. Brief pgs. 66-69; Decedent's income tax returns for 2007, 2009 and 2009 are part of the record at Exs. 57-J, 58-J and 59-J.

Moreover, Respondent's claim that Decedent had no access to her own liquid assets— her stock portfolio of $1,632,059 and her money market account of $1,793,000— lacks evidentiary support.[44] There is nothing in the record that indicates Decedent was unable to liquidate her stock or money market assets and, indeed, her 2008 personal income tax return demonstrates that she sold a variety of stocks.[45] Respondent's Answering Brief also neglects to mention the $850,000 in income Decedent was to receive (and did receive) in 2008 from the sale of her interest in Arizona Renaissance.[46]

Most importantly, Respondent's Answering Brief fails to mention the significant loans to real estate partnerships which Decedent was carrying. In 2008, the parties anticipated repayment of $6,000,000 from these loans.[47] In an email from Mr. Swanson to his associate requesting the associate prepare a letter to the banks for the loans to fund the policies,[48] Mr. Swanson stated: "Bob Larson said Marion is going to receive

[44] Ex. 64-J, Bates 1722 & 1755-1756.
[45] Ex. 58-J, Bates 1080-1084.
[46] Ex. 58-J; Tr. 316: 18-21.
[47] Ex. 99-R.
[48] Ex. 43-J is the letter to The Business Bank which Mr. Swanson ultimately prepared as a result of the email to his associate at Ex. 99-R.

more than $6,000,000 in loan repayments this year."[49] Respondent's Answering Brief makes the $6,000,000 in loan repayments Decedent was entitled to receive in 2008 appear as if the parties intended to *borrow* $6,000,000 *in addition* to the $5 to $10 million the parties really intended to invest in the Transaction.[50] This is a misrepresentation of the facts.

Mr. Swanson, Mr. Larson and Mr. Levine testified at length regarding the plan to repay the loans used to fund the Life Insurance Policies.[51] Moreover, the Penn Lake/Central Bank Loan (which is not mentioned in Respondent's Answering Brief), was intended to be repaid over a long period of time to add the interest paid to Decedent's basis in the Split-Dollar Receivables.[52] The overwhelming facts, many of which Respondent ignores or misrepresents in his Answering Brief, show Decedent's ability to repay the loans was more than sufficient.

[49] This is the same email that Respondent tried to use out of context at page 40, fn. 16 of his Answering Brief by quoting Mr. Swanson's statement: "I think an argument can be made that the split-dollar and the DIGITs are investments, although in this credit market it may be tough." However, the true purpose of the email was to convince the banks to lend on the Transaction and to take a security interest in Decedent's real estate partnership interests. Ex. 99-R.

[50] See Resp. Brief pg. 15.

[51] Tr. 69: 6-12; Tr. 69: 25 through Tr. 70: 7; Tr. 203: 17 through Tr. 204: 1; Tr. 313: 20 through Tr. 315: 13.

[52] Pet. Brief pgs. 41-42.

Charitable Contribution Deduction

The parties stipulated that the charitable contribution of $1 million to the George and Marion Levine Foundation will be allowable when Petitioner provides proof of payment of the contribution.[53] Respondent implies that this issue remains unresolved between the parties, however, the parties have resolved this issue in the Third Stipulation of Settled Issues.[54] Petitioner has not paid the charitable contribution of $1 million pending the outcome of this case. Regardless of whether Petitioner prevails on the issues before the Court, a Rule 155 computation will be necessary.[55] Petitioner intends to pay the charitable contribution then, in order to get the deduction on Schedule O of the Estate Tax Return when the Rule 155 is computed. Respondent's assertion that Petitioner does not "have sufficient liquidity" to pay the charitable contribution currently, to demonstrate there was insufficient cash to meet the financial needs of Decedent nine years ago, is overreaching and unsupported by the record.

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[53] Third Stip. of Settled Issues, dated October 31, 2017.
[54] Resp. Brief pgs. 3, 69.
[55] The parties have resolved several issues in the First, Second and Third Stipulations of Settled Issues, which are not for trial, briefing and opinion.

John Hancock And Pacific Life Policies

Respondent requests the Court to find that the John Hancock and Pacific Life policies were chosen for the Transaction only because these policies provided the highest cash values, and, as such, the parties must have intended to surrender the policies prior to the deaths of the Insureds.[56] Respondent's Requested Finding of Facts on this topic are argumentative and are in violation of Rule 151, and Petitioner objects.[57] The evidence at trial established the reasons the parties chose the John Hancock and Pacific Life policies.[58]

Respondent supports his argument that the parties intended to surrender the policies by citing to statements taken out of context in two emails Mr. Swanson sent to Jason Prather and Mark Saliterman.[59] In the first email to Mark Saliterman, Mr. Swanson states: "I attach an illustration showing the comparison of the various companies. It shows the various cash values of the policies for the first nine years, with a rider than enhances

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[56] Resp. Brief pgs. 19-20, 31-32.

[57] Respondent repeatedly argues: "The cash value of the policy would only be relevant if the life insurance policy was surrendered prior to the death of the insureds." Resp. Brief pg. 19-20, fn. 9-10.

[58] Pet. Brief pgs. 38-39.

[59] Resp. Brief pgs. 20, 31-31.

the cash value early on and one that does not."[60] The illustration referenced in the email is not included with Respondent's exhibit, so it is impossible to discern what Mr. Swanson was really referring to.[61] In the second email to Jason Prather, the meaning of Mr. Swanson's statement is even less clear: "I spoke to Mark today. He would like to proceed with the companies in the following order: PacLife, John Hancock and MetLife. We should get the riders that help the cash values early on."[62]

Respondent's arguments that the two emails are somehow proof the parties intended to surrender them is a stretch. Petitioner has another explanation as to why Mr. Swanson recommended the enhancement riders: to increase Decedent's growth on the Split-Dollar Receivables earlier in the term of the investment. Indeed, if there was a higher cash surrender value early on and Decedent was guaranteed at least a 3% growth on her investment, a higher cash surrender value would result in a higher rate of return on Decedent's investment, as the growth

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[60] Resp. Brief pgs. 20, 31-32; Ex. 19-R.

[61] Ex. 19-R; Tr. 120: 10-11. Petitioner objected to the introduction of Ex. 19-R because the illustrations referenced in the email were not included with Respondent's exhibit.

[62] Resp. Brief pgs. 20, 31-32; Ex. 20-R. Respondent did not question Mr. Swanson at trial regarding the meaning of "cash values early on" in his two emails.

was compounded over the life of the investment. Moreover, the fee for the enhancement rider on the John Hancock policy was *de minimis and cost Decedent absolutely nothing*.[63] The enhancement riders were a "freebie" and, thus, a prudent protection on Decedent's investment.

Therefore, Respondent's Requested Findings of Fact regarding the enhancement riders as "proof" the parties intended to surrender the policies are argument in violation of Rule 151.[64]

Formalities

To support his argument that the formalities of the Transaction were not followed, Respondent points to three instances where the parties purportedly failed to follow formalities: (1) the payments for the Life Insurance Policies were not paid by the Insurance Trust, but were transferred directly from Decedent's bank accounts to the insurance companies; (2) the attorneys-in-fact ignored the provisions of the Insurance Trust when the Insureds applied for the life

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[63] The fee of the enhancement rider on the John Hancock policy was $500 but the cost was taken out of the commission paid to the insurance broker, Jason Prather. Decedent received credit for the full $2,500,000 of premiums paid, not $2,499,500. Exs. 31-J, 76-J.

[64] Resp. Brief pgs. 20, 31-32.

insurance directly; and (3) South Dakota Trust played no role in the acquisition and negotiation of the Life Insurance Policies.[65]

Petitioner cannot see how the payment directly from Decedent's bank accounts to the insurance companies negates the Transaction or demonstrates that formalities were not followed. Respondent's suggestion that the Insurance Trust was required to open its own bank account for the sole purpose of transferring the funds to the insurance companies is absurd. Moreover, per the express terms of the Transactional documents,[66] it is indisputable that Decedent loaned money to the Insurance Trust for the purchase of life insurance in exchange for the right to receive the greater of the cash surrender value or the premiums paid upon the deaths of the Insureds.[67] The flow of funds does not negate the legal effect of the Transactional documents.

Petitioner does not understand Respondent's second argument that South Dakota Trust should have applied for the life insurance, instead of Nancy and Larry Saliterman.[68] The life insurance was purchased on the lives of Nancy and Larry Saliterman, so only they could provide the necessary medical

[65] Resp. Brief pgs. 21, 62-63
[66] Insurance Trust, Ex.15-J; Collateral Assignments, Exs. 27-J & 29-J; Split-Dollar Agreements, Exs. 26-J & 28-J.
[67] Exs. 15-J, 26-J & 29-J.
[68] Resp. Brief pgs. 63-64.

information and complete the medical exam.[69] Incidentally, Respondent's argument is factually false because South Dakota Trust was involved in the application process because it signed both insurance applications and the trust certification, as was required by John Hancock.[70]

Respondent further argues that South Dakota Trust played no role in acquiring the insurance policies or negotiating the terms of the split-dollar agreements under the Transaction (the "Split-Dollar Agreements"). Respondent repeatedly argues South Dakota Trust's role as a directed trustee is somehow nefarious or unusual.[71] Petitioner does not dispute South Dakota Trust was a directed trustee, and, indeed, it was specifically chosen to serve in that role for all the reasons outlined in Petitioner's Opening Brief.[72] The parties retained Mr. Swanson to negotiate the terms of the Transaction, not South Dakota Trust.

[69] Exs. 17-J & 18-J.
[70] Exs. 17-J, Bates 538, 18-J, Bates 544, & 65-J.
[71] Resp. Brief pgs. 17, 51-52. Though Respondent claims South Dakota Trust's fiduciary responsibilities were "practically non-existent," South Dakota Trust's fiduciary obligations are identified in Section 7.4 of the Insurance Trust (Ex. 15-J at Bates pgs. 502-504) and are legally mandated by § 55-2-1 of the South Dakota Codified Laws.
[72] Pet. Brief pg. 34, fns. 165-169.

Insurance Trust Provisions

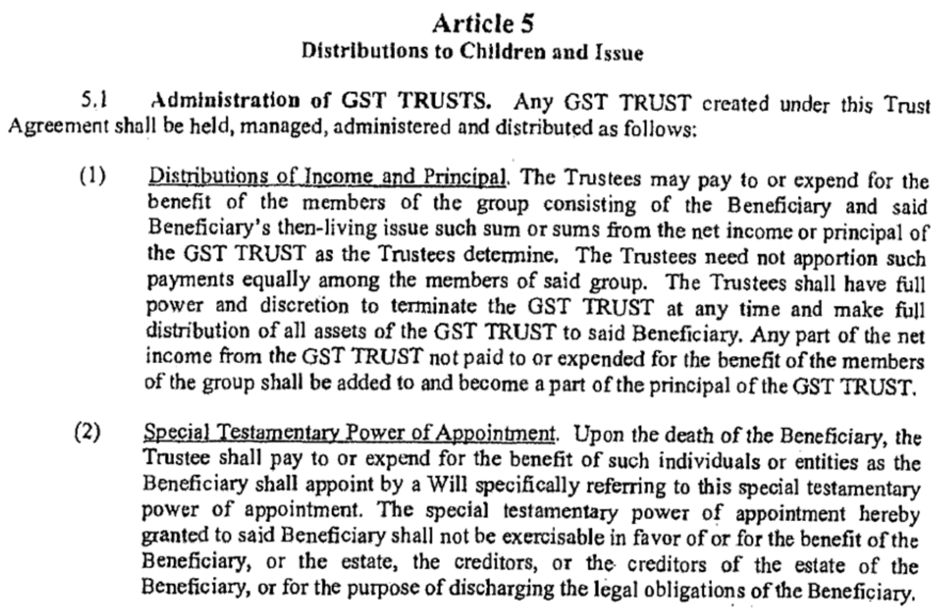
Respondent misrepresents the terms of the Revocable and Insurance Trusts to make the point that the same parties are purportedly the beneficiaries of both trusts and, accordingly, Mr. Larson's fiduciary duties under the terms of each trust and the 1996 Power of Attorney are somehow non-existent.[73] Respondent's Requested Findings of Fact regarding the purported terms in the Insurance Trust are grossly misrepresented and Petitioner objects.[74] Additionally, Petitioner objects to Respondent's illustrations of the "facts" of the Transaction, which he copied three times at pages 24, 54 and 73 of his Answering Brief, because it misstates the facts. Ms. Saliterman and Mr. Levine are not the only beneficiaries of the Insurance Trust.[75]

Insurance Trust:

1. Beneficiaries: The beneficiaries of the Insurance Trust are Decedent's children and grandchildren.[76] While Mr. Levine and Ms. Saliterman have a testamentary power of appointment to "extinguish" their children from inheriting their share under

[73] Resp. Brief pgs. 24-25, 43, 50-54, 71-75.
[74] *Id.*
[75] Revocable Trust, Ex. 5-J; Insurance Trust, Ex.15-J; Collateral Assignments, Exs. 27-J & 29-J; Split-Dollar Agreements, Exs. 26-J & 28-J.
[76] Ex. 15-J, Section 4.1, Bates 488.

the terms of the Insurance Trust (see excerpt below of Section 5.1(2) "Special Testamentary Power of Appointment" of the Insurance Trust instrument), Mr. Levine and Ms. Saliterman's right to alter the beneficiaries under the Insurance Trust cannot be exercised in favor of themselves, their estates or their creditors.[77]



Article 5
Distributions to Children and Issue

5.1 **Administration of GST TRUSTS.** Any GST TRUST created under this Trust Agreement shall be held, managed, administered and distributed as follows:

(1) Distributions of Income and Principal. The Trustees may pay to or expend for the benefit of the members of the group consisting of the Beneficiary and said Beneficiary's then-living issue such sum or sums from the net income or principal of the GST TRUST as the Trustees determine. The Trustees need not apportion such payments equally among the members of said group. The Trustees shall have full power and discretion to terminate the GST TRUST at any time and make full distribution of all assets of the GST TRUST to said Beneficiary. Any part of the net income from the GST TRUST not paid to or expended for the benefit of the members of the group shall be added to and become a part of the principal of the GST TRUST.

(2) Special Testamentary Power of Appointment. Upon the death of the Beneficiary, the Trustee shall pay to or expend for the benefit of such individuals or entities as the Beneficiary shall appoint by a Will specifically referring to this special testamentary power of appointment. The special testamentary power of appointment hereby granted to said Beneficiary shall not be exercisable in favor of or for the benefit of the Beneficiary, or the estate, the creditors, or the creditors of the estate of the Beneficiary, or for the purpose of discharging the legal obligations of the Beneficiary.

Mr. Levine and Ms. Saliterman's right to change the beneficiaries cannot take effect until their deaths.[78] In other words, if Mr. Levine and Ms. Saliterman remove one or all of their children from inheriting under the Insurance Trust, they must designate another beneficiary (not themselves or their

[77] Ex. 15-J, Section 5.1(2), Bates 489.
[78] *Id.*

estates) to receive that beneficiary's share.[79] Thus, Mr. Larson's fiduciary duties under the Insurance Trust are not only to Mr. Levine and Ms. Saliterman, as Respondent claims, but to the other beneficiaries of the trust, which currently are Decedent's grandchildren and their issue.[80]

2. Dissolution of the Insurance Trust: The Insurance Trust does not terminate ten years before the combined life expectancies of the Insureds.[81] Instead, fifteen years after the creation of the Insurance Trust, the trust shall be divided and continue into equal shares for Mr. Levine and Ms. Saliterman to separately plan with the corpus of their sub-trusts.[82] Patti Graumann did not draft the Insurance Trust, nor did she review it prior to trial.[83] In addition, Patti Graumann is not an attorney.[84] Thus, her interpretation of the trust on the stand is not credible.

3. Failure to Pay Trustee Fees: Respondent claims the attorneys-in-fact had the ability to dissolve the Insurance Trust by failing to pay fees to South Dakota Trust.[85] This is

[79] *Id.*
[80] Ex. 15-J, Section 4.1, Bates 488.
[81] Resp. Brief pg. 53, third bulleted point.
[82] Pet. Brief pgs. 33-34; Ex. 15-J, Article 4.1, Bates 488.
[83] Tr. 369: 4, Tr. 369: 7-10, Tr. 369: 13.
[84] Tr. 356: 8-12.
[85] Resp. Brief pg. 53, third bulleted point.

untrue as a matter of law[86] and it misstates what Ms. Graumann testified to at trial. Ms. Graumann testified: "It could possibly just become an unfunded trust in our system until the insurance is paid out, which would happen upon the death of the insured."[87]

Robert Larson

Respondent's Answering Brief makes many factual and argumentative statements about Mr. Larson's fiduciary duties under the terms of the 1996 Power of Attorney and as the sole member of the Insurance Trust. To the extent Respondent has requested Findings of Fact regarding Mr. Larson's fiduciary duties, Petitioner objects because they misrepresent the facts in the record and are argument in violation of Rule 151.[88] For example, Respondent misrepresents Mr. Larson's testimony

[86] The Insurance Trust does not dissolve for failing to pay South Dakota Trust's annual fee. See, e.g., § 31 of the Restatement (Third) of Trusts ("A trust does not fail because no trustee is designated or because the designated trustee declines, is unable, or ceases to act, unless the trust's creation or continuation depends on a specific person serving as trustee."); § 55-3-23 of the South Dakota Codified Laws (states that a trust terminates in limited circumstances—none of which include failure to pay the trustee); § 55-3-10 of the South Dakota Codified Laws (requires a trustee to exercise ordinary care and diligence in execution of a trust, whether or not he receives compensation).

[87] Tr. 364: 1-3.

[88] Resp. Brief pg. 24. Petitioner has already objected to the "illustration" *infra*.

regarding his role as sole member of the Investment Committee.[89] Respondent states in his Answering Brief: "Mr. Larson admitted at trial that he told respondent's counsel in August of 2017 that he did not remember anything about the Investment Committee."[90] Instead, Mr. Larson testified: "No, by that time I was so nervous I couldn't have given you a straight answer anyway."[91]

Respondent argues that Mr. Larson was not compensated for his role as the sole member of the Investment Committee.[92] Petitioner will explain, below, why payment to Mr. Larson is not required for him to have fiduciary duties as a matter of law. However, Mr. Larson received executor commissions, in the amount of $50,000, for administering Decedent's estate.[93]

Attorneys-in-Facts' Knowledge And Reliance Regarding The Transaction

Respondent requests the Court to find that the attorneys-in-fact did not understand the Transaction, yet they proceeded to enter into the agreements.[94] This misrepresents the testimony of the witnesses and Petitioner objects to this requested

[89] Resp. Brief pg. 18, fn. 8.
[90] *Id.*
[91] Tr. 220: 2-11.
[92] Resp. Brief pg. 18, fn. 8.
[93] Ex. 2-J, Bates 28.
[94] Resp. Brief pgs. 12, 109.

Finding of Fact. Each of the attorneys-in-fact and Mr. Swanson testified regarding what information they considered with each other and Decedent before entering into the Transaction, which is described in Petitioner's Opening Brief.[95]

ARGUMENT

I. I.R.C. § 2036(a)(1) DOES NOT APPLY BECAUSE DECEDENT HAD NO RIGHTS IN THE LIFE INSURANCE POLICIES

A. Decedent Did Not Retain The Possession, Enjoyment, or Right to Income From The Life Insurance Policies

Respondent contends that I.R.C. § 2036(a)(1) requires the inclusion of the cash surrender value of the Life Insurance Policies in Decedent's estate because Decedent either retained the income from the Life Insurance Policies or the rights under the Split-Dollar Agreements to receive the greater of $6,500,000 or the cash surrender value of the policies.[96] Respondent further claims that "as far as Decedent is concerned, the rights are economically two sides to the same coin," and, "regardless of which property we focus on, it is indisputable that both assets were guaranteed to appreciate at a rate of at least 3 percent per year."[97] These arguments fail because there is a significant difference between retaining the right to income

[95] Pet. Brief pgs. 30-31, fns. 145-149; pg. 32 fns. 156-157; & pgs. 54-55, fns. 276-278.
[96] Resp. Brief pg. 56.
[97] Resp. Brief pg. 56.

from the Life Insurance Policies and retaining the right to income from the Split-Dollar Receivables for purposes of I.R.C. § 2036(a)(1). Had Decedent retained ownership or the right to access the cash surrender value of the Life Insurance Policies, I.R.C. § 2036(a)(1) would require the inclusion of the cash surrender value of the Life Insurance Policies in Decedent's estate. However, Decedent did not own the Life Insurance Policies, nor did she have any right to access the cash surrender value of the policies or the income generated therefrom. As discussed in section I.D.1 of Petitioner's Opening Brief,[98] Decedent never owned the Life Insurance Policies and the $6,500,000 of premiums she advanced to the Insurance Trust was permanently reconstituted into the Split-Dollar Receivables. Therefore, I.R.C. § 2036(a)(1) cannot apply to require the inclusion of the Life Insurance Policies in the gross estate since Decedent did not own, possess, enjoy, use, or retain the right to income from the policies. However, I.R.C. § 2036(a)(1) does apply to the Split-Dollar Receivables since there is no question that Decedent owned the receivables at the time of her death, and, as such, Decedent has properly included

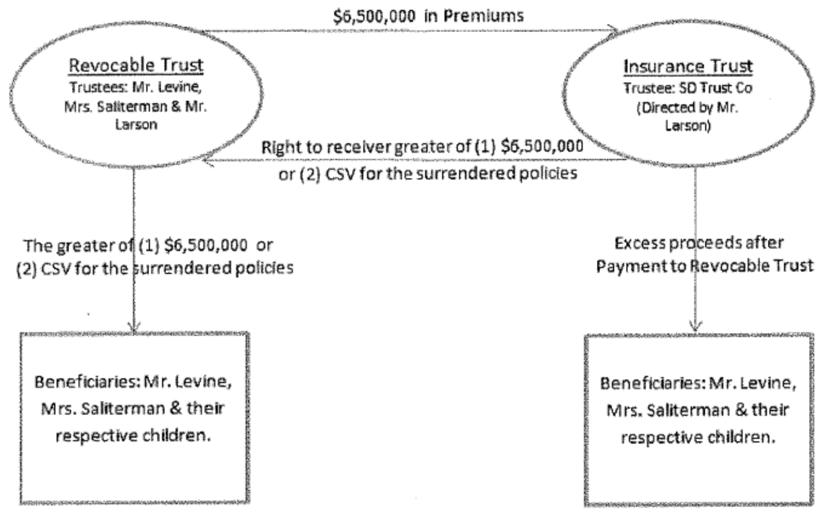
[98] Pet. Brief pg. 78.

the value of the receivables in her estate.[99]

B. Decedent's Attorneys-in-fact Did Not Stand on Both Sides of The Transaction

Respondent is undoubtedly aware that Decedent did not own the policies or have the right to surrender them and, instead, attempts to avoid this defect by asserting that Decedent, through her attorneys-in-fact, "stood on both sides of the Transaction"[100] and, thus, could unwind the Transaction at any time and access the cash surrender value of the policies. Specifically, Respondent claims that Decedent's children had the "actual or an implied power," as two of her three attorneys-in-fact, to instruct Mr. Larson to direct the Insurance Trust to surrender the Life Insurance Policies and unwind the Transaction.[101] Respondent attempts to argue this point three times[102] in his Answering Brief via the following illustration:[103]

[99] The amount actually reported for estate tax purposes, $2,137,130, is only $145,065 less than the amount stipulated between Respondent and Petitioner, $2,282,195, if Petitioner prevails at trial per the Second Stipulation of Settled Issues, filed September 11, 2017.
[100] Resp. Brief pgs. 50-55.
[101] Resp. Brief pg. 52.
[102] Resp. Brief pgs. 24, 54, 73.
[103] Resp. Brief pg. 54.



Respondent's illustration on its face demonstrates that neither Decedent nor her attorneys-in-fact "stood on both sides of the Transaction." Respondent's illustration shows that the only person who "stood on both sides of the Transaction" was Mr. Larson in his role as the sole member of the Investment Committee of the Insurance Trust and one of Decedent's three attorneys-in-fact. Mr. Larson was not a beneficiary of the Revocable Trust or the Insurance Trust. Respondent argues repeatedly[104] that "there is virtually no substance to the above arrangements because the purported agreements were essentially an agreement between the Decedent's attorneys-in-fact and themselves" and, according to Respondent, Decedent could unwind

[104] Resp. Brief pgs. 24, 54, 73, 34, 25, 98, 84, 70, 61.

the Transaction at any time.[105] These assertions are completely unsupported by the record and are incorrect as a matter of law. The fiduciary obligation Mr. Larson owed to the beneficiaries of the Insurance Trust was distinct from his obligation to Decedent under the 1996 Power of Attorney.[106]

Mr. Levine and Ms. Saliterman have no ability to control the Investment Committee of the Insurance Trust by virtue of their role as Decedent's attorneys-in-fact or as beneficiaries of the Insurance Trust.[107] Section 1.3 of the Insurance Trust makes it clear that the trust was irrevocable and Decedent irrevocably surrendered her interest in the trust and had no right to change, modify, amend, or revoke the trust.[108] After formation of the trust, Decedent had no legal right over the disposition of the Insurance Trust's assets. Since the attorneys-in-fact could not take any action under the 1996 Power of Attorney which Decedent could not take herself, and Decedent

[105] Resp. Brief pg. 54.
[106] Pet. Brief pg. 37-38.
[107] See Minnesota Statute Chapter 523, Section 523.12 specifies that an attorney-in-fact's actions bind the principal in the same manner as if the principal took the action his or herself. It provides: "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).
[108] Ex. 15-J, Bates 484-485.

had no right to surrender the policies, there is no scenario where the attorneys-in-fact can compel Mr. Larson to surrender the Life Insurance Policies.

C. Mr. Larson Has a Real And Meaningful Fiduciary Obligation to The Beneficiaries of The Insurance Trust

As discussed in detail in pages 102 to 103 of Petitioner's Opening Brief, Mr. Larson has real and significant fiduciary obligations to the beneficiaries of the Insurance Trust which prevent him from surrendering the Life Insurance Policies, because, if he surrenders the policies, the beneficiaries of the Insurance Trust receive nothing. Moreover, surrendering the policies would be a violation of Mr. Larson's fiduciary duty to Decedent for not carrying out her wishes because one of Decedent's purposes for the Transaction was to provide for her grandchildren.[109] If Mr. Larson surrendered the policies, there would be no death benefit for Decedent's grandchildren (as beneficiaries of the Insurance Trust). The evidence at trial demonstrated that it was everyone's intention (including Ms. Saliterman and Mr. Levine's) to keep the policies in place until the death of the last surviving Insured, in order for all to

[109] Tr. 207: 11-14, Tr. 207: 16.

receive the death benefit under the policies.[110]

Respondent claims that "it begs the question" how Mr. Larson could violate his fiduciary duty to the beneficiaries of the Insurance Trust or Decedent by following the orders of Mr. Levine and Ms. Saliterman, since they are beneficiaries under the Insurance Trust and could extinguish their children's interests in the Insurance Trust.[111] Respondent's assertion is factually and legally incorrect because Mr. Levine and Ms. Saliterman are not the only beneficiaries of the Insurance Trust. Mr. Larson has a fiduciary obligation to all of the beneficiaries of the trust. Respondent's argument on this point demonstrates that he does not comprehend what "extinguishing" a beneficiary's interest in the Insurance Trust means; neither Mr. Larson nor Ms. Saliterman can extinguish a beneficiary's interest in favor of themselves.[112]

While it is true that Mr. Levine and Ms. Saliterman could extinguish their children's interests in the Insurance Trust, this can only occur by will[113] and cannot take effect until their deaths. In addition, section 4.1 of the Insurance Trust gives

[110] Tr. 201: 5-6; Tr. 269: 5; Tr. 269: 10-14; Tr. 326: 20-21; Tr. 326: 23-25.
[111] Resp. Brief pgs. 55, 73.
[112] Ex. 15-J, Article 5.1(2), Bates 489.
[113] Ex. 15-J Bates 489, Section 5.1(2).

South Dakota Trust Company the right to make discretionary distributions of trust property to the children of Mr. Levine or Ms. Saliterman during the first fifteen years of the trust's existence.[114] Mr. Levine and Ms. Saliterman's children remain beneficiaries of the Insurance Trust during their lifetimes unless Mr. Levine or Ms. Saliterman designate alternate beneficiaries upon their deaths. Thus, absent an agreement by all seven beneficiaries (Mr. Levine has two children and Ms. Saliterman has three children), Mr. Larson would be in violation of his fiduciary obligation if he surrendered the Life Insurance Policies. As a consequence, he would be subject to potential legal liability to the beneficiaries for breaching this legal obligation. Respondent ignores Mr. Larson's legal obligation under the express terms of the Insurance Trust in his Answering Brief.

II. EVEN IF I.R.C. § 2036(a)(1) APPLIES, THE TRANSACTION MEETS THE BONA FIDE SALE FOR ADEQUATE AND FULL CONSIDERATION EXCEPTION

A. The Term "Sale" in The Bona Fide Sale Exception of I.R.C. § 2036 Has Been Construed Broadly

Respondent argues that the bona fide sale exception in I.R.C. § 2036 does not apply because "there never was a sale or an exchange, as contemplated by I.R.C. § 2036, because the

[114] Ex. 15-J.

Decedent, through her Revocable Trust, retained the right to the income from the transferred property."[115] Respondent also argues that not every transfer is, or should be treated as, a sale or an exchange for purposes of the bona fide sale exception. Moreover, Respondent claims the transfer of the funds to the Insurance Trust was not a sale but an investment.[116] These arguments fail for several reasons.

First, Respondent neglects to cite any legal authority to support his assertion that Decedent's loan of $6,500,000 for premiums paid for the Split-Dollar Receivables is an exchange which is not allowable under the bona fide sale exception of I.R.C. § 2036. Therefore, the Court should disregard this argument for that reason alone.[117] However, even if the Court considers Respondent's argument, it fails because the term "sale," as used in the context of I.R.C. §§ 2036 through 2038, has been interpreted broadly to encompass *any* transfer that produces an inflow of cash or property offsetting the outflow of property, regardless of whether the transaction is a sale for

[115] Resp. Brief pg. 36.
[116] Resp. Brief pgs. 36-37, 41.
[117] See *Milligan v. City of Red Oak, Iowa*, 230 F.3d 355, 360 (8th Cir. 2000) *per curiam* (finding that an argument made in passing that is not supported "with any argument or legal authority" is waived and need not be addressed).

cash or an exchange of one property for a different property.[118] Moreover, the characterization of Decedent's loan to fund the Insurance Trust as an investment has no bearing on whether the Transaction is a sale for purposes of I.R.C. § 2036.[119] Undoubtedly, a purchase and sale occur when an investor buys a bond. There is no reason why Decedent's loan or investment of the $6,500,000 to the Insurance Trust should be treated any differently under the prevailing legal authority.

B. Decedent Did Not Retain a Life Estate in The Life Insurance Policies

Respondent argues that Decedent's transfer of $6,500,000 to the insurance companies in exchange for the rights under the Split-Dollar Receivables is no different than a parent deeding a property to a child and reserving a life estate therein. As such, Respondent asserts that I.R.C. § 2036 requires the inclusion of the cash surrender value of the Life Insurance Policies in Decedent's estate.[120] Respondent's interpretation is fundamentally incorrect because it misstates the express terms

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[118] See, e.g., *Mollenberg's Estate v. Commissioner*, 173 F.2d 698 (2d Cir. 1949) (holding that term "sale" in § 811(d) of the Internal Revenue Code of 1939 (the predecessor to I.R.C. § 2036(a)), connotes "an exchange resulting from a bargain, one in which the beneficiary gives or the grantor receives something of money value or a binding promise"); *Peoples First National Bank v. U.S.*, 241 F.2d 420 (3d Cir. 1957).
[119] *Id.*
[120] Resp. Brief pg. 36.

of the Transaction and the rights established by the Split-Dollar Agreements. In the hypothetical example set forth by Respondent, a parent who reserves a life estate in the property is entitled to the use, possession, and/or right to income from the property for the duration of the parent's life.[121] Assuming the property subject to the life estate was a long-term bond, by retaining a life estate, the parent would be entitled to the interest income from the bond for the rest of his or her life, but would not be entitled to any of the principal repayment because this would inure to the child. Upon the parent's death, the parent's right to income would terminate, and the child, as the holder of the remainder interest, would be entitled to both the right to income and the outstanding principal. The child's remainder interest is a distinct property right apart from the bonds, which the child is free to keep or sell at any time.

Respondent confuses the respective interests held by Decedent and the Insurance Trust in the present case, because Decedent's interest in the Split-Dollar Receivables is akin to a remainder interest and the Insurance Trust's interest is akin to a life estate. By agreeing to permanently fund the Transaction, (i.e. forgoing the right to surrender the policies and the right

[121] Resp. Brief pg. 36.

to repayment until the death of the last surviving Insured), Decedent has essentially given away a life estate in the Life Insurance Policies to the Insurance Trust, which is measured on the joint lives of the Insureds. Through its "life estate" in the policies, the Insurance Trust is entitled to use and control the ownership rights of the Life Insurance Policies until the death of the last surviving Insured, which ensures that the policies will remain in force and the death benefit will be paid. The underlying concept of the Transaction is a financing arrangement: the Insurance Trust will use the earnings and growth on the premiums paid to pay for the life insurance protection provided by the policies. Applying Respondent's hypothetical correctly, Decedent has retained a remainder interest (if any) in the Life Insurance Policies through the Split-Dollar Receivables, because she is entitled to the greater of the cash surrender value or premiums paid after the death of the last surviving Insured.

C. Petitioner Had Legitimate Nontax Reasons For Engaging in The Transaction

To rebut Petitioner's nontax reasons for the Transaction, Respondent asserts: "If the attorneys-in-fact were truly looking for a viable investment, they would have sought an asset that historically generated returns that exceeded the interest rate on the loans." Moreover, Respondent claims: "If the attorneys-in-fact were interested in diversifying the Decedent's portfolio, they would have invested in assets such as bonds, Exchange Traded Funds or equities."[122] Respondent offers no evidentiary support for his recast of Decedent's investment potential and his argument factually lacks merit. The stock market dramatically declined, beginning in late 2007. Second, Respondent has no right to second-guess Decedent's investments to require Petitioner to pay more tax as a result of his hypothetical recast of the Transaction.[123] Moreover, the attorneys-in-fact did consider other investments but ultimately chose the Transaction because none of the other opportunities accomplished all of the investment purposes.[124] Therefore, Respondent's arguments that Decedent lacked nontax business reasons for pursuing the Transaction should be ignored.

Finally, Respondent's Answering Brief dismisses, without legal support, Petitioner's analysis of the Transaction as an income tax deferral.[125] Presumably, Respondent ignores the attendant income tax aspects of the Transaction (that the Estate

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[122] Resp. Brief pgs. 40-41.
[123] *Gregory v. Helvering*, 293 U.S. 465, 469 (it is axiomatic that taxpayers lawfully may arrange their affairs to keep taxes as low as possible).
[124] Tr. 51: 3-14; Tr. 52: 16 through Tr. 53: 1; Tr. 318: 14-18.
[125] Resp. Brief pgs. 92-93.

must pay income tax on Decedent's growth in her investment upon the death of the last surviving Insured), in order to be able to argue the Transaction has somehow "depleted" the gross estate for purposes of I.R.C. §§ 2036 and 2038. As discussed on page 110 of Petitioner's Opening Brief, split-dollar arrangements like the one at issue in this case are specifically provided for under Treasury Regulation § 1.61-22.

D. ***Kimbell v. U.S.*** **is Not Limited to Solely Investments in Operating Businesses**

Respondent acknowledges that *Kimbell v. U.S.*,[126] provides an exception to the "full and adequate" consideration requirement[127] but he argues that the Transaction differs substantially from the transaction and expectations of the taxpayer in *Kimbell*. For support, Respondent argues that *Kimbell* is distinguishable because the Transaction in the present case did not involve a contribution to a partnership or entity that was engaged in an ongoing business. According to Respondent, the return Decedent received on her investment was not impacted by the business decisions of the Insurance Trust or the Investment Committee. Respondent also argues Decedent did not place the policies in the Insurance Trust with the expectation that the Insurance

[126] 371 F.3d 257 (5th Cir. 2004).
[127] Resp. Brief pg. 47.

Trust would offer her management expertise, security or preservation of her assets. While it is true that the Insurance Trust was not engaged in an active business, the Court's holding in *Kimbell* is not limited to operating businesses because the majority of the assets contributed by Ms. Kimbell to the partnership were passive investment assets.[128] Indeed, only 15% of the *Kimbell* partnership's $2.5 million of assets were oil and gas working and royalty interests.[129]

Moreover, Respondent's attempt to distinguish the Transaction with the facts in *Kimbell* is too narrow.[130] As discussed in pages 114 to 116 of Petitioner's Opening Brief, the overall purposes for the Transaction must be considered. The collective benefits for Decedent demonstrate why she relinquished the ability to "turn right around [after the completion of the Transaction] and sell the newly acquired [Split-Dollar Receivables] for 100 cents on the dollar."[131] The Transaction was always intended to be a long-term, income tax deferred investment, and, as such, it was necessary for the Life Insurance Policies to remain intact in order to realize all of

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[128] 371 F.3d at 259.

[129] *Id.* At inception, approximately 15% of the assets of the Partnership were oil and gas working (11%) and royalty (4%) interests.

[130] Resp. Brief pgs. 47-48.

[131] *Kimbell*, 371 F.3d at 266.

the purposes for the Transaction.

III. <u>I.R.C. § 2036(a)(2) DOES NOT APPLY BECAUSE NEITHER DECEDENT NOR HER ATTORNEYS-IN-FACT COULD SURRENDER THE LIFE INSURANCE POLICIES</u>

A. <u>Mr. Larson's Fiduciary Obligations to The Beneficiaries of The Insurance Trust Are Not Illusory</u>

Respondent asserts that because the Decedent's attorneys-in-fact "stood on both sides of the Transaction," and "controlled every aspect of the arrangements," including the ability to designate who could possess or enjoy the transferred property, I.R.C. § 2036(a)(2) requires the inclusion of the cash surrender value of the Life Insurance Policies in the gross estate.[132] As discussed above in section I.C. of Petitioner's Reply Brief, this assertion misrepresents the attorney-in-fact's legal authority because they do not have the right to designate who can possess or enjoy the cash surrender value of the policies, or the income therefrom. Mr. Larson would be breaching his fiduciary obligation if he surrendered the policies. Respondent urges the Court to disregard Mr. Larson's fiduciary obligation to the beneficiaries of the Insurance Trust by claiming that his duties are no different than the "illusory" fiduciary duties found by the courts in *Estate of Strangi v.*

[132] Resp. Brief pgs. 70-71.

Commissioner[133] and *Estate of Powell v. Commissioner.*[134] However, Respondent concedes *Estate of Powell* "is not directly on point" to the facts in the instant case and Petitioner agrees.

As discussed in section I.D.3. of Petitioner's Opening Brief[135] and section I.C. above, Mr. Larson's fiduciary obligation to the beneficiaries of the Insurance Trust and the underlying economics of the Transaction are markedly different from the partnership at issue in *Estate of Powell*.[136] South Dakota Codified Law §§ 55-2-1 (*et seq.*) and 55-1B-4 impose a fiduciary obligation on trustees and trust advisors that is significantly greater than the fiduciary duty a majority shareholder owes to a minority shareholder. Under South Dakota Codified Law § 55-2-1, "in all matters connected with his trust a trustee is bound to act in the highest good faith towards his beneficiary…" Under South Dakota Codified Law § 55-2-2, a trustee is prohibited from using or dealing with trust property for his own profit. Furthermore, a trustee can be removed if he or she acquires any interest in, or becomes charged with any

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[133] T.C. Memo. 2003-145.
[134] 148 T.C. ___ (May 18, 2017).
[135] Pet. Brief pgs. 103-104.
[136] 148 T.C. ___ (May 18, 2017).

duty adverse to, the interest of the beneficiaries.[137] In contrast, the only fiduciary duties a partner owes to the partnership and his or her other partners are the duty of loyalty and the duty of care.[138]

Because of the conflict of interest between Mr. Larson's duties to Decedent as one of her three attorneys-in-fact, and his duties to the beneficiaries of the Insurance Trust as the sole member of the Investment Committee, Mr. Larson could not surrender the policies during or after Decedent's lifetime, even if Ms. Saliterman and Mr. Levine directed him to do so. If he attempted to do so, he would have to inform all of the beneficiaries of the Insurance Trust and could be removed from the Investment Committee.[139] Currently, Mr. Larson would be in violation of his fiduciary obligation if he surrendered the policies absent obtaining consent from all seven beneficiaries of the Insurance Trust. The Court should not disregard this obligation as "illusory" under *Estate of Powell* because Mr. Larson faces significant potential legal liability if he

[137] South Dakota Codified Law § 55-2-6 ("If a trustee acquires any interest or becomes charged with any duty adverse to the interest of his beneficiary in the subject of the trust, he must immediately inform the latter thereof and may be at once removed.").
[138] South Dakota Codified Law § 48-7A-404.
[139] South Dakota Codified Law § 55-2-6.

violates this obligation. Therefore, Decedent did not have the right to designate who possessed or enjoyed the right to income from the cash surrender value of the policies.

B. Respondent's Argument That Mr. Larson Has no Fiduciary Obligations to The Beneficiaries of The Insurance Trust Because he Was Not Compensated is Factually And Legally Incorrect

Respondent asserts that because Mr. Larson was not compensated for his role as the sole member of the Investment Committee, he does not have fiduciary obligations to the beneficiaries of the Insurance Trust.[140] This assertion is factually and legally incorrect. First, Mr. Larson was paid $50,000 of executor commissions for his role as Decedent's executor.[141] Second, there is no requirement in South Dakota[142] or general trust law[143] that a trust advisor receive financial compensation in order to have fiduciary obligations.

South Dakota Codified Laws § 55-1B-4 imposes a fiduciary obligation on investment trust advisors. South Dakota Codified Laws § 55-1B-4 provides:

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140 Resp. Brief pg. 18, fn. 8.

141 Ex. 2-J, Bates 28.

142 South Dakota Codified Laws §§ 55-1B-4 & 55-2-1.

143 § 70 of the Restatement (Third) of Trusts, Comment on Clause (b), d(1) ("Whether 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 (§ 76), with prudence (§ 77), and in good faith and conformity with other fiduciary duties referred to in Clause (b).").

> If one or more trust advisors are given authority by the terms of a 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).

A "fiduciary" is defined as:

> A trustee or custodian under any instrument, an executor, administrator, or personal representative of a decedent's estate, or any other party, including a trust advisor, a trust protector, or a trust committee, **who is acting in a fiduciary capacity for any person, trust, or estate.**"[144] (Emphasis added).

Mr. Larson is the trustee of the Insurance Trust with respect to the investment of its property. As such, Section 7.5 of the Insurance Trust instrument[145] and South Dakota Codified Laws §§ 55-1B-4 and 55-2-1 (*et seq.*) impose fiduciary and legal duties on Mr. Larson.

C. The Property Interest to be Valued For Purposes of Applying I.R.C. § 2703 is The Split-Dollar Receivables

Respondent argues that the Split-Dollar Agreements contain a restriction on Decedent's right to unilaterally access the funds transferred to the insurance companies for the benefit of the Insurance Trust and, by engaging in the Transaction, Decedent relinquished her right to control the transferred funds

[144] South Dakota Codified Laws § 55-1B-1(4).
[145] Ex. 15-J.

and/or the Life Insurance Policies.[146] As discussed in section I.G.1 of Petitioner's Opening Brief,[147] when considering the application of I.R.C. § 2703, the Court must look to the property interest held by Decedent at the time of her death, which was Decedent's rights under the Split-Dollar Receivables and not the underlying Life Insurance Policies because the policies were owned by the Insurance Trust. Therefore, Respondent's argument should be rejected because Decedent did not own the Life Insurance Policies.

The Transaction did not impose a restriction on something Decedent did not own. Moreover, there are no restrictions in the Split-Dollar Agreements on Decedent's rights with respect to the Split-Dollar Receivables and Decedent is free to sell or transfer the receivables in any manner. Decedent does not have the right to surrender the Life Insurance Policies or receive repayment under the Split-Dollar Receivables until the policies are surrendered or the death of the last surviving Insured. This is not a restriction within the meaning of I.R.C. § 2703(a).

Assuming Decedent's inability to surrender the policies is a restriction, it is not a restriction on any property rights

[146] Resp. Brief pg. 79.
[147] Pet. Brief pg. 120.

held by Decedent because Decedent never owned the Life Insurance Policies. Moreover, this "restriction" is part and parcel of the property interest created by the Transaction because the Split-Dollar Agreements are loan agreements and an inherent provision of a loan agreement is the term or duration of the loan. As Petitioner argued in its Opening Brief,[148] the Split-Dollar Agreements are a $6,500,000 loan with a term equal to the joint lives of the Insureds. Therefore, forgoing the right to recoup the funds and access the cash surrender value of the Life Insurance Policies was an essential element of the Transaction to ensure the Insurance Trust had financing to acquire the Life Insurance Policies for the duration of the Transaction—until the death of the last surviving Insured.

Respondent failed to rebut Petitioner's argument in its Opening Brief that under *Church v. U.S.*,[149] I.R.C. § 2703 does not apply to the terms of the Split-Dollar Agreements because they are "part and parcel" of the property interest created by the Split-Dollar Agreements and are, thus, outside the legislative intent of I.R.C. § 2703.[150] It is well-established that the failure to discuss or mention in brief an issue

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[148] Pet. Brief pg. 94.
[149] 85 AFTR 2d 2000-804.
[150] Pet. Brief pgs. 123-126.

asserted at trial will lead the court to determine that the issue is either conceded or abandoned.[151] Therefore, Respondent's failure to address Petitioner's argument- that *Church v. U.S.* precludes the application of I.R.C. § 2703 to the terms of the Split-Dollar Agreements- should be considered a concession by Respondent.

IV. PETITIONER MEETS THE BONA FIDE SALE REQUIREMENTS OF I.R.C. § 2703(b)

Respondent asserts the Transaction is neither a bona fide business transaction nor a sale for full and adequate consideration for purposes of I.R.C. § 2703(b).[152] Respondent claims that the Court must compare the Transaction to split-dollar arrangements used by employers in determining whether the Transaction qualifies as bona fide and full and adequate.[153] Specifically, Respondent assumes that in a bona fide business arrangement, an employer: (1) will not insure someone other than the immediate employee, and (2) will not purchase a paid up policy, or if there is a paid up policy, the employer will be

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[151] *See Mallory v. Commissioner*, T.C. Memo. 2016-110 (issues not addressed in the opening brief are deemed conceded); *Money v. Commissioner*, 89 T.C. 46 (1987); *Moorefield v. Commissioner*, 133 F.3d 928 (9th Cir. 1997), *aff'g* T.C. Memo. 1996-98; *Wilcox v. Commissioner*, 848 F.2d 1007, 1008 n.2 (9th Cir. 1988)(arguments not addressed in a brief are deemed abandoned).
[152] Resp. Brief pg. 80.
[153] *Id.*

able to “access” the employer’s investment (the inside build-up).[154] Respondent provides no factual or legal authority for his assertion on this point. Therefore, the Court should disregard Respondent’s argument.[155]

Nevertheless, if the Court considers Respondent’s argument under I.R.C. § 2703(b), it should be rejected because employer sponsored collateral assignment split-dollar arrangements (where the employee owns the policy but the employer pays the premium and secures its right to repayment via a collateral assignment) are common in the employment context and widely used in the executive compensation setting.[156] In addition, Treasury Regulation § 1.61-22 (the “Split-Dollar Regulations”) specifically contemplate split-dollar arrangements between a life insurance trust and donor, like the one in the instant case.[157]

As discussed in section I.D.4.a of Petitioner’s Opening Brief,[158] the Transaction was undertaken for several legitimate nontax business reasons: (1) as a long-term investment for

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[154] Resp. Brief pg. 81.
[155] *See Milligan v. City of Red Oak, Iowa*, 230 F.3d 355, 360 (8th Cir. 2000).
[156] Ratner and Leimberg, “A Planner's Guide to Split-Dollar After the Final Regulations.” 31 ETPL 3 (Jan. 2004), pg. 3.
[157] Treas. Reg. § 1.61-22(b)(3)(ii)(B).
[158] Pet. Brief pg. 108.

Decedent to recognize guaranteed growth on the $6,500,000 of premiums paid with deferred income tax consequences; (2) to diversify Decedent's assets; and (3) to provide life insurance protection for Decedent's children in order to help them pay their eventual estate tax liabilities without having to sell their interests in the family real estate businesses. Moreover, Decedent received full and adequate consideration in exchange for the premiums paid by her receipt of the Split-Dollar Receivables. Decedent was not only entitled to a return of her initial $6,500,000 investment, but she also stood to receive at least a guaranteed 3% per year return thereon.

Respondent's argument that Decedent received less than full and adequate consideration must also be rejected under the court's rationale in *Church v. U.S.*[159] In *Church*, the decedent contributed assets valued at $1,467,748 to a Texas limited partnership in exchange for a partnership interest therein that was valued (at the date of death) at $617,591. The IRS argued there was a taxable gift on the formation of the partnership equal to the difference between the value of the contributed assets and the partnership interest.[160] The court rejected the IRS's argument despite the fact that the partnership interest

[159] 85 AFTR 2d 2000-804.
[160] *Id.* at 808.

the decedent received contained a term restriction preventing the termination of the partnership without the consent of 80% or more of the partners.[161] This restriction caused the partnership interest to be valued at approximately 42% of the value of the underlying assets and resulted in an approximate 58% discount.[162] Since the court in *Church* found that there was no gift, notwithstanding the discrepancy in value between the assets transferred to the partnership and the partnership interest received by the decedent in exchange, the court recognized that the transfer of assets to the partnership was a bona fide business arrangement and not a device to transfer property to members of the decedent's family for less than full and adequate consideration.[163]

V. THE PARTIES AGREE THAT *ESTATE OF MORRISSETTE* IS NOT RELEVANT TO THE ESTATE TAX ISSUES IN THIS CASE

As discussed in section 1.B of Petitioner's Opening Brief,[164] *Estate of Morrissette*'s holding[165] is limited to the gift tax consequences of split-dollar arrangements. Respondent agrees *Estate of Morrissette* is not relevant to the estate tax issues

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[161] *Id.*
[162] *Id* at 809-810.
[163] *Id* at 808.
[164] Pet. Brief, pgs. 70-73.
[165] *Estate of Morrissette v. Commissioner,* 146 T.C. 171 (2016).

in this case.[166]

VI. PETITIONER IS NOT LIABLE FOR ACCURACY RELATED PENALTIES, PURSUANT TO I.R.C. §§ 6662(h) OR 6662(g)

A. Respondent Has Not Met His Burden of Production For The Assertion of The Gross And Substantial Valuation Misstatement Penalties Under I.R.C. § 6751(b)(1)

Respondent's Answering Brief unconvincingly claims that the Revenue Agent made an "initial determination" of the I.R.C. §§ 6662(h) and 6662(g) penalties because Mr. Ratke's purported "initial determination" was approved by his immediate supervisor, which satisfies the requirements of I.R.C. § 6751(b)(1).[167] However, Respondent's Answering Brief fails to rebut Petitioner's position that Respondent has not met his burden of production with respect to the assertion of either penalty in the Notice of Deficiency.[168]

Petitioner's position in its Opening Brief was clear: Because Mr. Ratke relied upon the assertion of gross and substantial valuation penalties in another unidentified case, he did not make the "initial determination" of the penalty asserted *in this case*.[169] Respondent's Penalty Approval Form confirms

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[166] Resp. Brief, pg. 101.
[167] Resp. Brief, pgs. 102-105.
[168] The parties stipulated to the admission of Respondent's Penalty Approval Form, not that Respondent has met his burden of production under I.R.C. §§ 6751(b)(1) and 7491(c).
[169] Pet. Brief, pgs. 127-130.

this.[170] Nor could the manager, Ms. Baird, have properly approved the assertion of the gross and substantial valuation penalties in this case, since Mr. Ratke could not have made the "initial determination" at all, as it was purportedly made by another revenue agent and a chief counsel attorney in another case.[171] Thus, Respondent has failed to meet his burden of production[172] with respect to the assertion of the gross and substantial valuation misstatement penalties and they should be abated in full.[173]

B. Petitioner Has Reasonable Cause Defenses to The Accuracy Related Penalties

The crux of Respondent's penalty argument is that Petitioner does not have reasonable cause defenses to the accuracy related penalties because the attorney-in-fact's reliance upon Mr. Swanson's advice was not objectively reasonable because his advice was "too good to be true." To support these arguments, Respondent constructs a theory that Mr. Swanson's advice to the attorneys-in-fact should have been independently verified by other tax professionals because Respondent boldly claims Mr. Swanson was a tax shelter promoter.

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170 Ex. 53-R.
171 I.R.C. § 6751(b)(1); *Graev v. Commissioner*, 149 T.C. ___ (December 20, 2017).
172 *Id.*
173 Pet. Brief pgs. 127-130.

Moreover, Respondent asserts that Petitioner did not actually rely upon the advice Mr. Swanson provided to them, which is contrary to the record. As such, Respondent's attempt to nullify Petitioner's reliance upon Mr. Swanson's legal advice fails.

As Petitioner argued in its Opening Brief, no matter what the outcome is in this case concerning the value of the Decedent's ownership interest in the Transaction as of the alternate valuation date, Petitioner is not liable for the gross and substantial valuation misstatement or accuracy related penalties.[174] Petitioner did not undervalue the Split-Dollar Receivables owned by Decedent as of the date of death.[175] Instead, the "value" Respondent asserts should be included in the gross estate, the cash surrender value, is based purely on Respondent's novel legal theories which have never before been applied to a split-dollar transaction for estate tax purposes.[176] Moreover, Petitioner has reasonable cause defenses to the

[174] Pet. Brief pgs. 131-137.

[175] The parties have stipulated that the value of the Split-Dollar receivables, as of the alternate valuation date, were $2,282,195 instead of the $2,137,130 reported on the estate tax return per the Second Stipulation of Settled Issues, filed September 11, 2017.

[176] The parties have stipulated that the cash surrender value of the policies was $6,153,578 as of the alternate valuation date, per the Second Stipulation of Settled Issues, filed September 11, 2017.

accuracy related penalties asserted by Respondent because the estate's representatives, the attorneys-in-fact, exercised ordinary care and business prudence in evaluating the tax treatment of the Split-Dollar Receivable for estate tax purposes by relying upon Mr. Swanson's advice.[177]

1. <u>The attorneys-in-fact relied upon the advice of Mr. Swanson</u>

Respondent's argument that the attorneys-in-fact did not understand the Transaction or Mr. Swanson's advice is disingenuous and misrepresents their testimony. Respondent alleges that "all three attorneys-in-fact confirmed at trial that they entered into the agreements despite the fact that they did not understand the strategy."[178] To support this false statement, Respondent cites to the trial testimony which solely pertains to questions posed by Respondent's counsel regarding Mr. Swanson's January 7, 2008 letter.[179] Respondent misrepresents the attorney-in-fact's testimony regarding the letter.[180] That said, Mr. Swanson's January 7, 2008 letter was not the only advice Mr. Swanson provided regarding the

[177] See Pet. Brief pgs. 133-137.
[178] Resp. Brief Page 109.
[179] Resp. Brief pg. 109; Ex. 13-P.
[180] Resp. Brief pg. 109; Tr. 317:19; Tr. 336:15 through 337:7.

Transaction.[181] Instead, the January 7, 2008 letter was sent in response to questions posed by Ms. Saliterman's accountant and brother-in-law, Mark Saliterman, and was not requested by the attorneys-in-fact at all.[182] Mr. Swanson's January 7, 2008 letter is not an opinion letter.[183] Each of the attorneys-in-fact testified that they understood the Transaction from discussions with Mr. Swanson and Mr. Rubin and, after discussions amongst themselves and with the Decedent, they decided to proceed with the Transaction.[184] Moreover, each of the attorneys-in-fact testified that they relied upon Mr. Swanson's advice and expertise.[185]

Respondent suggests that written advice, or, more specifically, an opinion letter, is required for a taxpayer to have reasonable reliance on a tax professional, which is contrary to the legal authority.[186] Treasury Regulation § 1.6664-4(c), pertaining to reliance or opinion of a tax professional, states: "All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably

[181] Pet. Brief pg. 54.
[182] Ex. 13-P, bates 370; Tr. 110: 21-24.
[183] Tr. 111: 13-14.
[184] Pet. Brief pgs. 32, 53-54.
[185] Pet. Brief pgs. 54-55.
[186] Resp. Brief pg. 109: "Second, Mr. Swanson only wrote one letter that explained the split-dollar strategy."

relied in good faith on advice (including the opinion of a professional tax advisor) as to the treatment of the taxpayer (or any entity, plan, or arrangement) under Federal tax law." For reasonable reliance on the advice of a tax professional, Treasury Regulation § 1.6664-4(c)(2) defines "advice" as follows:

> Advice is any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for the benefit of) the taxpayer and on which the taxpayer relies, directly or indirectly or indirectly, with respect to the imposition of the section 6662 accuracy related penalty. ***Advice does not have to be in any particular form.*** (Emphasis added).

Instead, reliance on a tax adviser may be reasonable and in good faith if the taxpayer establishes: (1) The adviser was a competent professional with sufficient expertise to justify reliance; (2) the taxpayer provided necessary and accurate information; and (3) the taxpayer actually relied in good faith on the adviser's judgment.[187] Petitioner detailed Petitioner's reliance upon Mr. Swanson's advice in its Opening Brief and that it satisfied all of the aforementioned requirements for reasonable and good faith reliance on a tax advisor.[188] There is absolutely no requirement that Mr. Swanson provide written

[187] See *Neonatology Associates, P.A. v. Commissioner*, 115 T.C. 43, 99 (2000), *aff'd.* 299 F.3d 221 (3rd Cir. 2002).
[188] Pet. Brief pgs. 133-137.

advice to the attorneys-in-fact in order for reasonable cause to apply. Accordingly, Respondent's arguments on this point lack merit.

2. **Mr. Swanson's tax advice was reasonable**

Respondent's argument regarding the penalties repeatedly focuses on a statement made by Mr. Swanson to the attorneys-in-fact in an email regarding the discount that could apply at death by virtue of the Transaction to assert that the Transaction was "too good to be true." [189] Based on one statement in Mr. Swanson's email, Respondent claims it was not objectively reasonable for the attorneys-in-fact to rely upon Mr. Swanson's advice regarding the entire Transaction.[190] However, Mr. Swanson's statement (in an email) was not the only advice provided to the attorneys-in-fact and there is substantial evidence in the record regarding what advice Mr. Swanson provided regarding the gift, income and estate tax consequences of the Transaction.[191]

Respondent's Answering Brief completely ignores the gift and income tax aspects to the Transaction and focuses solely on

[189] Resp. Brief pg. 110.
[190] Resp. Brief pgs. 109-111. Mr. Swanson postulated that the discount that could apply would range between 50 and 90%. Ex. 13-P, Bates pg. 365.
[191] Pet. Brief pgs. 53-56; Tr. 93: 14-19; Tr. 93: 21 through Tr. 94: 7.

the estate tax consequences, which cannot be viewed in a vacuum. As the Split-Dollar Regulations require, gift tax must be paid for the benefit conferred upon the donees by the Transaction.[192] Gift tax was paid by Decedent and Respondent ignores this fact completely in his Answering Brief.[193] Moreover, as Petitioner detailed in its Opening Brief, the Transaction is an income tax deferral.[194] In exchange for the discounted value of the Split-Dollar Receivables reported as of the alternate valuation date for estate tax purposes, the Estate must pay income tax on the difference between Decedent's reduced basis in the receivables, $2,282,195, and the prevailing cash surrender value of the policies upon the deaths of the Insureds.[195] Focusing solely on Mr. Swanson's statement in an email about the anticipated reduced estate tax value of the Transaction misrepresents his advice on the tax treatment of the Transaction as a whole and is disingenuous of Respondent.

Finally, the amount actually reported for estate tax purposes, $2,137,130, is only $145,065 less than the amount

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[192] Treas. Reg. § 1.61-22; Pet. Brief pg. 56.

[193] See Resp. Brief pg. 43, fn. 20: "If the Decedent had made an inter vivos transfer to her children for that purpose, she would have made a taxable gift." See also Pet. Brief pg. 56; Exs. 1-J & 95-J.

[194] Pet. Brief pgs. 109-110.

[195] Pet. Brief pgs. 109-110; I.R.C. § 72 and Treas. Reg. § 1.61-22; Tr. 380: 14-20.

stipulated between Respondent and Petitioner, $2,282,195, if Petitioner prevails at trial.[196] Thus, Mr. Swanson's estimated value to be reported for estate tax purposes in his email is not far from the amount stipulated between the parties, once the correct premium amount[197] is discounted by 65% for the value of the Split-Dollar Receivables owned by Decedent at her death.

Moreover, Respondent's assertion that the attorneys-in-fact should have obtained a second opinion from Mark Saliterman, to second-guess Mr. Swanson's and Mr. Rubin's recommendation that Decedent participate in the Transaction, makes no sense. Mark Saliterman was not retained by the attorneys-in-fact to prepare an estate plan for Decedent and none of the attorneys-in-fact relied upon him for advice regarding the Transaction.[198] Mr. Swanson and Mr. Rubin were retained by the attorneys-in-fact to prepare a comprehensive estate plan for Decedent and the Transaction was recommended once Mr. Rubin and Mr. Swanson evaluated Decedent's financial profile and estate planning

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[196] The discount on the value of the Split-Dollar Receivables is $2,282,195, as stipulated between the parties, which is approximately 65% and is in the range projected by Mr. Swanson in his email at Ex. 13-P, Bates pg. 371.

[197] Decedent purchased $6,500,000 in life insurance, not $15,000,000 as the email at Ex. 13-P postulated.

[198] Ex. 13-P; Tr. 226: 21; Tr. 226: 23; Tr. 232: 10-11; Tr. 277: 23-24.

objectives.[199] Mr. Rubin and Mr. Swanson both testified at trial about their extensive estate planning expertise to provide precisely the advice sought by the attorneys-in-fact for Decedent.[200] To suggest that the attorneys-in-fact should have second-guessed two experienced estate planners is ridiculous. As the Supreme Court has found:

> To require a taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of the presumed expert in the first place. "Ordinary business care and prudence" do not demand such actions.[201]

3. Mr. Swanson is not a tax shelter promoter.

The most incredible argument made by Respondent in his Answering Brief is that Mr. Swanson is a tax shelter promoter, and, as such, Petitioner cannot rely upon his advice regarding the estate tax treatment of the Transaction.[202] Not only is Respondent's accusation irresponsible, it is completely without merit.[203] Because Mr. Swanson participated in structuring the Transaction, including drafting the Transactional documents and

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[199] Ex. 78-J; Tr. 28: 3-5; Tr. 28: 13-15; Tr. 31: 3-4; Tr. 31: 6-13.
[200] Pet. Brief pgs. 19-21; Tr. 372: 1 through Tr. 373: 10.
[201] *U.S. v. Boyle*, 469 U.S. 241, 251 (1985).
[202] Resp. Brief pgs. 111-112.
[203] While Respondent called Howard Rubin to testify at trial and Mr. Rubin confirmed that he also recommended the split-dollar Transaction for Decedent, Respondent does not argue that Mr. Rubin is a tax shelter promoter.

he profited from it, Respondent argues he is a promoter.[204] Under Respondent's theory, every tax and estate planner would be a tax shelter promoter.

While Petitioner should not have to respond to such a frivolous argument by Respondent, Petitioner will address why Mr. Swanson is not a tax shelter promoter under the applicable legal authority.[205] The cases cited by Respondent in his Answering Brief, *Avrahami v. Commissioner*, 149 T.C. 7 (2017) and *106 Ltd. v. Commissioner*, 136 T.C. 67, 79-80 (2011) *aff'd*, 684 F. 3d 84 (D.C. Cir. 2012), actually support Petitioner's position that Mr. Swanson is not a tax shelter promoter.

As a general rule, for tax advice to fall outside of the definition of a promotion of a tax shelter, "the advice must generally be from a competent and independent advisor unburdened with a conflict of interest and not from promoters of the investment."[206] Respondent has not identified any conflict of interest Mr. Swanson purportedly had in connection with the Transaction, and, thus, Petitioner need not and cannot address

[204] Resp. Brief pgs. 111-112.

[205] The Transaction in the instant case is not a tax shelter and Petitioner does not concede it meets the legal definition of a shelter. Indeed, Respondent does not argue that the Transaction at issue was a tax shelter, as that term is defined in the Code and regulations.

[206] *Mortensen v. Commissioner*, 440 F.3d 375, 387 (6th Cir. 2006), *aff'g.* T.C. Memo. 2004-279.

that here.

In *106 Ltd. v Commissioner,*[207] the Tax Court considered whether the legal advisor and author of the questionable opinion letter was a tax shelter promoter of a now, well-known tax shelter, SON OF BOSS. To determine whether the author of the opinion letter was a promoter, the Court in *106 Ltd.* relied upon C*ountryside Ltd. Partnership v. Commissioner,*[208] which defines a tax advisor (who is not a promoter) as someone who:

> 1. Has a long term and continual relationship with his client;
>
> 2. Does not give unsolicited advice regarding the tax shelter;
>
> 3. Advises only within his field of expertise (and not because of his regular involvement in the transaction being scrutinized);
>
> 4. Follows his regular course of conduct in rendering his advice; and
>
> 5. Has no stake in the transaction besides what he bills at his regular hourly rate.

Mr. Swanson began his professional relationship with Decedent and the attorneys-in-fact in 2007 when he was retained to prepare a comprehensive estate plan for Decedent.[209] Since

[207] *106 Ltd. v. Commissioner*, 136 T.C. 67, 79-80 (2011) *aff'd*, 684 F. 3d 84 (D.C. Cir. 2012).
[208] *Countryside Ltd. Partnership v. Commissioner*, 132 T.C. 347, 352-55 (2009).
[209] Tr. 28: 3-5; Tr. 28: 13-15.

2007, Mr. Swanson has continued his professional relationship with the attorneys-in-fact and is now their estate planning attorney.[210] Thus, Mr. Swanson has a long-term and continual relationship with his clients, which distinguishes him from a promoter. Moreover, he did not "give unsolicited advice" regarding the Transaction. Mr. Swanson and Mr. Rubin recommended the Transaction only after they were retained to prepare a comprehensive estate plan for Decedent.[211]

While Mr. Swanson drafted the Transactional documents (the Insurance Trust, the Collateral Assignments and the Split-Dollar Agreements), he is an estate planner. Estate planners are retained to advise on and implement estate planning techniques for their clients. Mr. Swanson also drafted the GRATs, QPRTs and partnership agreements for the other estate planning he conducted for Decedent. It is difficult to understand how an estate planner can implement estate planning techniques without drafting the very documents his clients hired him to prepare. Moreover, it is ludicrous to claim that Mr. Swanson's recommendation to use Jason Prather, the insurance broker, and McGladry, the appraiser, somehow makes him a tax shelter

[210] Tr. 32: 9 through Tr. 33: 12.
[211] Ex. 78-J.

promoter.[212] There is no evidence in the record that the attorneys-in-fact could not have retained their own insurance broker and appraiser had they chosen to do so.

Finally, it is uncontroverted that Mr. Rubin and Mr. Swanson were experienced estate planners when they recommended the full estate plan, including the Transaction, for Decedent.[213] Thus, there can be no argument that the estate planners' recommendation to implement the Transaction was somehow providing advice outside their specialized field.[214]

The attorneys-in-fact retained Mr. Rubin and Mr. Swanson to devise a comprehensive estate plan for Decedent, which included trusts, GRATs, QPRTs, DIGITs, SCINs and partnerships for Decedent's real estate interests for a flat fee of $120,000.[215] The Transaction was not contemplated when Mr. Rubin and Mr. Swanson were retained.[216] Moreover, the $120,000 flat fee was not paid for a tax shelter but was paid for the entire estate plan prepared by the estate planners.[217] Had the attorneys-in-fact decided not to pursue the Transaction, the $120,000 fee

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[212] Resp. Brief pgs. 111-112.
[213] Pet. Brief pgs. 19-21; Tr. 372: 1 through Tr. 373: 10.
[214] Respondent does not claim that Mr. Rubin was a tax shelter promoter, even though he also recommended the Transaction for Decedent.
[215] Ex. 78-J.
[216] Ex. 78-J; Tr. 31: 22; Tr. 31: 24 through Tr. 32: 1.
[217] Ex. 78-J.

paid to the Parsinen law firm would have been due regardless.[218] Thus, there can be no argument that Mr. Swanson and Mr. Rubin "profited" from "promoting" the Transaction for Decedent at all, nor did they have an interest in the Transaction as Respondent claims.[219]

The most important factor Respondent fails to address in his Answering Brief is the limited number of split-dollar transactions the estate planners have constructed in their entire careers. Mr. Rubin testified that he has only recommended one similar split-dollar transaction for a client-Decedent.[220] Mr. Swanson has only recommended four similar split-dollar transactions.[221] The reason the two estate planners have only collectively devised five similar split-dollar life insurance transactions is because the transaction will only work under very specialized facts.[222] Thus, it is difficult to understand how Mr. Swanson can be a promoter when he has only devised four split-dollar life insurance transactions in his

[218] Ex. 78-J.
[219] Resp. Brief pgs. 111-112.
[220] Tr. 381: 22-25.
[221] Tr. 44: 15-18.
[222] Pet. Brief pg. 28.

twenty year career.[223]

For the reasons stated herein, Mr. Swanson is not a tax shelter promoter. As such, Petitioner has established it was objectively reasonable to rely upon Mr. Swanson's advice to implement the Transaction for Decedent.

C. Petitioner Has Substantial Authority And Reasonable Basis Defenses to The Accuracy Related Penalties

Respondent argues that Petitioner does not have substantial authority and reasonable basis defenses to the gross and substantial valuation penalties because those exceptions only apply to income tax transactions.[224] Respondent completely ignores the income and gift tax consequences of the Transaction or that the Split-Dollar Regulations govern an arrangement precisely like the one at issue in the present case. The parties fundamentally disagree on whether the Split-Dollar Regulations are relevant to the instant case. Because Petitioner followed Treasury Regulation § 1.61-22 when structuring and reporting the Transaction for gift, income and estate tax purposes, the substantial authority and reasonable

[223] *Avrahami v. Commissioner*, 149 T.C. 7 (2017). (promoter structured captive-insurance company transactions for more than 100 of her clients for a flat fee of $75,000 and annual flat fees).
[224] Resp. Brief pgs. 112-114.

basis exceptions to the accuracy related penalties apply.[225]

VII. CONCLUSION

Based upon the facts and legal authority cited herein, the value of the Split-Dollar Receivables to be included in the gross estate, as of the alternate valuation date, is $2,282,195 per I.R.C. § 2031 and no accuracy related penalties apply.

[225] Pet. Brief pgs. 137-142.

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Respectfully submitted,

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Docket No. 13370-13

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing AMENDED REPLY BRIEF FOR PETITIONER was served on Counsel for Respondent by mailing the same on April 04, 2018 in a postage paid wrapper addressed as follows:

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