

PUBLICATION

Tax Court Affirms Use of Intergenerational Split-Dollar Arrangements

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The Tax Court, in its decision earlier this month in *Estate of Morrisette*, examined intergenerational split-dollar arrangements between a mother's revocable trust and three irrevocable dynasty trusts, one established for each of her three sons, and ruled that the split-dollar arrangements should be taxed under the economic benefit regime, not the loan regime, of the Treasury regulations. This decision provides clarity to the estate, gift and income tax consequences of such an arrangement, and opens the door to allowing such arrangements for purposes of passing family assets, such as closely-held businesses, through the generations. It essentially confirms the tax treatment that existed before 2003 with respect to collateral assignment equity split-dollar arrangements for post-2002 split-dollar arrangements following the structure utilized by the Morrisette family.

Since 2003, the income taxation of split-dollar arrangements have been the subject of Treasury regulations, which looks to who is the owner or deemed owner of the insurance policy to determine the mode of taxation. There are two mutually exclusive regimes for taxing split-dollar life insurance arrangements – the economic benefit regime and the loan regime. Generally, the legal owner of the insurance contract (in *Morrisette*, the irrevocable dynasty trusts) is the owner for purposes of the Treasury regulations. An exception to the general rule provides that where the only economic benefit provided is current life insurance protection, the person funding the policy will be deemed the owner of the life insurance contract, regardless of the legal ownership of the policy, and the economic benefit regime will apply. While Mrs. Morrisette's revocable trust did not own the policies and it funded over \$29 million in premiums (in a single lump-sum premium payment for each policy), since the split-dollar arrangements did not provide any economic benefit to the irrevocable dynasty trusts other than current life insurance protection, Mrs. Morrisette's revocable trust was the deemed owner for income tax purposes and the economic benefit regime applied, rather than the loan regime.

The court determined the split-dollar arrangements only provided an economic benefit to each irrevocable dynasty trust because they provided the revocable trust would receive the greater of the cash surrender value of each policy or the aggregate premium payments upon either the termination of the split-dollar arrangement or the death of the insured (the three sons). (This was the prevailing model for pre-2003 collateral assignment equity split-dollar arrangements.) Upon the death of the insured, each irrevocable dynasty trust would receive the balance of the death benefit for the policy insuring that insured. Based on this split of benefits, and subject to other arguments made by the IRS but rejected by the court, the Tax Court held that the irrevocable dynasty trusts received no economic benefit other than current life insurance protection and further ruled the economic benefit regime was the proper tax regime for taxing these split-dollar arrangements.

In this case, Mrs. Morrisette put the irrevocable dynasty trust structure and the split-dollar arrangements in place to allow each trust, and others, to enter into a shareholders' agreement for the stock of the closely-held family business and provide the liquidity for cross-purchases of her three sons' stock in the company at their deaths. This ruling provides clarity and certainty for intergenerational split-dollar arrangements designed to make the passing of family assets, such as the Morrisette family business, through the generations of the family.

Business succession planning involving intergenerational split-dollar arrangements now has guidance from the Tax Court that gives certainty to the family members regarding the estate, gift and income tax consequences of

such an arrangement. If we can assist you or answer any questions about these arrangements, please contact Ross Cohen, or any of the attorneys in the Firm's [Tax Group](#) or Business Succession Planning Group.