Our Country Home Enterprises, Inc. et al. v. Commissioner of Internal Revenue, 145 T. C. 1 (2015).

The U. S. Tax Court ruled that the Sterling Benefit Plan, a purported welfare benefit plan, was a compensatory split-dollar life insurance arrangement, disallowing corporate deductions for contributions and requiring shareholders to recognize income from economic benefits. The decision impacts the tax treatment of similar plans, affirming the IRS's position on the economic benefit regime for split-dollar arrangements.

Parties

Plaintiffs were Our Country Home Enterprises, Inc. (Our Country), Thomas P. Blake and Cynthia S. Blake, Netversity, Inc. , Juan Carlo Mejia and Yvette Mejia, Code Environmental Services, Inc. (Environmental), Richard J. Abramo and Catherine S. Abramo, Robert V. Brown and Andrea Yogel-Brown, and John A. Tomassetti and Cathy C. Tomassetti. The defendant was the Commissioner of Internal Revenue.

Facts

The Sterling Benefit Plan (Sterling Plan) was established by Ronald H. Snyder in October 2002 as a welfare benefit plan, allowing employers to fund and receive greater benefits than traditional pension plans. Participating employers, including Our Country and Environmental, made payments to the Sterling Plan, which were used to purchase life insurance policies on employees' lives. The plan allowed employers to customize benefits and vesting schedules. Shareholders of participating corporations were the primary beneficiaries of the life insurance policies, with the plan promising death, medical, and disability benefits. The corporations claimed deductions for these payments, and shareholders did not report income from their participation in the plan.

Procedural History

The Commissioner of Internal Revenue disallowed the deductions claimed by Our Country, Environmental, and Netversity and determined that shareholders must recognize income from the economic benefits provided by the Sterling Plan. The taxpayers petitioned the U. S. Tax Court for a redetermination of the deficiencies and penalties. The cases were consolidated for trial, briefing, and opinion, with the parties agreeing to be bound by the final decisions.

Issue(s)

1. Whether the life insurance policies issued on the lives of the shareholder/employees incident to their participation in the Sterling Plan were part of a split-dollar life insurance arrangement.
2. Whether the corporate employers may deduct their payments to the Sterling Plan.
3. Whether the shareholder/employees must recognize income from their

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participation in the Sterling Plan.
4. Whether petitioners are liable for accuracy-related penalties under section 6662(a).
5. Whether Our Country, the Abramos, the Browns, and the Tomassettis are liable for accuracy-related penalties under section 6662A.

Rule(s) of Law

A split-dollar life insurance arrangement is defined under section 1. 61-22(b)(1), Income Tax Regulations, as any arrangement between an owner and a non-owner of a life insurance contract where one party pays the premiums and is entitled to recover all or a portion of the premiums from the proceeds of the life insurance contract. Compensatory arrangements, as defined in section 1. 61-22(b)(2)(ii), Income Tax Regulations, are considered split-dollar arrangements even if they do not meet the general rule of section 1. 61-22(b)(1). The economic benefit regime under section 1. 61-22(d) through (g), Income Tax Regulations, applies to split-dollar arrangements and requires non-owners to recognize income from the economic benefits received.

Holding

The court held that the life insurance policies issued on the lives of the shareholder/employees were part of split-dollar life insurance arrangements. The corporate employers were not allowed to deduct their payments to the Sterling Plan. The shareholder/employees were required to recognize income from their participation in the plan, based on the economic benefits they received. The court also upheld the accuracy-related penalties under sections 6662(a) and 6662A, finding no reasonable cause or good faith on the part of the petitioners.

Reasoning

The court determined that the Sterling Plan met the three-prong test for a compensatory arrangement under section 1. 61-22(b)(2)(ii), Income Tax Regulations, as it was entered into in connection with the performance of services, the employer paid the premiums, and the employees designated the beneficiaries or had an interest in the cash value of the policies. The economic benefit provisions were upheld as a valid interpretation of section 61(a) of the Internal Revenue Code, requiring the recognition of income from the economic benefits provided by the plan. The court rejected the petitioners' arguments that the economic benefit provisions were invalid and that the life insurance policies were part of a group term life insurance plan. The court also found that the petitioners did not have reasonable cause or act in good faith, as they relied on advice from promoters and insiders without seeking independent professional guidance. The court upheld the accuracy-related penalties, finding that the petitioners negligently disregarded the rules and regulations applicable to welfare benefit plans and failed to disclose their participation in the Sterling Plan.

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Disposition

The court affirmed the Commissioner's determinations, disallowing the corporate deductions and requiring the shareholders to recognize income from the economic benefits. The court also upheld the accuracy-related penalties under sections 6662(a) and 6662A.

Significance/Impact

The decision reinforces the IRS's position on the tax treatment of split-dollar life insurance arrangements in the context of welfare benefit plans. It clarifies the applicability of the economic benefit regime and the requirements for recognizing income from such arrangements. The case also highlights the importance of seeking independent professional advice when investing in tax shelters and the potential consequences of relying on promoters and insiders. The decision may impact the use of similar welfare benefit plans and the tax treatment of life insurance policies in these arrangements.

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