Estate of Clara M. Morrissette, Deceased, Kenneth Morrissette, Donald J. Morrissette, and Arthur E. Morrissette, Personal Representatives v. Commissioner of Internal Revenue, 146 T. C. 171 (2016)

In Estate of Morrissette, the U. S. Tax Court ruled that split-dollar life insurance arrangements were governed by the economic benefit regime, not the loan regime, as the only benefit provided to the trusts was current life insurance protection. This decision impacts how such arrangements are taxed, potentially reducing the tax burden on estates using similar structures to fund buy-sell agreements within family businesses.

Parties

The petitioners were the Estate of Clara M. Morrissette, deceased, with Kenneth Morrissette, Donald J. Morrissette, and Arthur E. Morrissette acting as personal representatives. The respondent was the Commissioner of Internal Revenue. At the trial level, these were the parties, and the case proceeded directly to the U. S. Tax Court for a motion for partial summary judgment filed by the Estate.

Facts

Clara M. Morrissette established the Clara M. Morrissette Trust (CMM Trust) in 1994, contributing all her stock in the Interstate Group to it. In 2006, three dynasty trusts were created for the benefit of her three sons: Arthur E. Morrissette, Jr. , Donald J. Morrissette, and Kenneth Morrissette. The CMM Trust and the dynasty trusts entered into split-dollar life insurance arrangements on October 31, 2006. Under these arrangements, the CMM Trust contributed a total of $29. 9 million to the dynasty trusts to fund the purchase of universal life insurance policies on the lives of the sons. The agreements stipulated that upon the death of an insured son, the CMM Trust would receive a portion of the death benefit equal to the greater of the cash surrender value (CSV) of the policy or the total premiums paid. The dynasty trusts would receive the remainder to fund the purchase of the deceased son’s Interstate Group stock. The arrangements were intended to be taxed under the economic benefit regime, with the only economic benefit being current life insurance protection.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency to the Estate of Clara M. Morrissette on December 5, 2013, determining a gift tax deficiency of $13,800,179 and a penalty under I. R. C. § 6662 of $2,760,036 for tax year 2006, asserting that the $29. 9 million contributed by the CMM Trust to the dynasty trusts constituted a taxable gift. The estate filed a petition for redetermination in the U. S. Tax Court on March 5, 2014. On January 2, 2015, the estate moved for partial summary judgment under Rule 121 of the Tax Court Rules of Practice and Procedure, seeking a ruling that the split-dollar life insurance arrangements were

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governed by the economic benefit regime as set forth in section 1. 61-22 of the Income Tax Regulations.

Issue(s)

Whether the split-dollar life insurance arrangements between the Clara M. Morrissette Trust and the dynasty trusts should be governed by the economic benefit regime under section 1. 61-22 of the Income Tax Regulations?

Rule(s) of Law

The final regulations governing split-dollar life insurance arrangements, effective for arrangements entered into after September 17, 2003, provide for two mutually exclusive regimes for taxation: the economic benefit regime and the loan regime. The applicable regime depends on the ownership of the life insurance policy. Under the general rule, the person named as the owner in the policy is treated as the owner. However, under a special ownership rule, if the only economic benefit provided to the nonowner is current life insurance protection, the donor is deemed the owner, and the economic benefit regime applies. The economic benefit regime values the benefit as the cost of current life insurance protection less any premiums paid by the nonowner.

Holding

The U. S. Tax Court held that the split-dollar life insurance arrangements between the Clara M. Morrissette Trust and the dynasty trusts were governed by the economic benefit regime under section 1. 61-22 of the Income Tax Regulations because the only economic benefit provided to the dynasty trusts was current life insurance protection.

Reasoning

The court analyzed whether the dynasty trusts had current access to the cash values of the policies or received any additional economic benefits beyond current life insurance protection. The court determined that the dynasty trusts did not have a current or future right to the cash values of the policies, as the split-dollar life insurance arrangements specified that the CMM Trust would receive the greater of the CSV or the total premiums paid upon termination or the insured’s death. The court rejected the Commissioner’s argument that the dynasty trusts had indirect rights to the cash values based on the 2006 amendment to the CMM Trust, as this amendment was not part of the split-dollar agreements and did not confer any enforceable rights during the grantor’s lifetime. Additionally, the court dismissed the Commissioner’s reliance on Notice 2002-59, finding the arrangements did not resemble the abusive reverse split-dollar transactions the notice addressed. The court concluded that the economic benefit regime applied because no additional economic benefits were conferred to the dynasty trusts.

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Disposition

The court granted the estate's motion for partial summary judgment, ruling that the split-dollar life insurance arrangements were governed by the economic benefit regime under section 1. 61-22 of the Income Tax Regulations.

Significance/Impact

The decision in Estate of Morrissette clarifies the application of the economic benefit regime to split-dollar life insurance arrangements, particularly those used to fund buy-sell agreements within family businesses. By confirming that such arrangements can be taxed under the economic benefit regime when the only benefit provided is current life insurance protection, the ruling potentially reduces the tax burden on estates using these structures. Subsequent cases have cited Estate of Morrissette to support the use of the economic benefit regime in similar arrangements, and it serves as an important precedent for estate planning involving life insurance. The decision also underscores the importance of the structure and terms of split-dollar arrangements in determining their tax treatment.

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