

U.S. Tax Court Delivers Blow to One Taxpayer, Potential Victory to Others: Estate of Morrisette and Intergenerational Split Dollar

On May 13, 2021, the United States Tax Court issued its second opinion in the closely watched case *Estate of Morrisette v. Commissioner*. The first, issued in 2016, validated the strategy of “intergenerational split dollar.” The second concerned issues of valuation that are key to the appeal of the strategy.

Background

Intergenerational split dollar involves the wealthiest and oldest members in a family (often aged 80 or more) funding life insurance policies on their adult children’s lives. The insurance is controlled by a split dollar agreement, which in turn is subject to certain highly restrictive terms affecting the value of the right to repayment of the split dollar premiums. Part of the legal controversy is due to the likelihood that the oldest generation (or the oldest generation’s estate) will not recover their premiums for decades: the agreements are structured to repay the premiums at the *children’s* death, to or for the benefit of the family’s grandchildren. Some type of discounting seems appropriate, but the question is what is the right discount under the circumstances?

The Outcome

The elder Morrisettes advanced \$30 million of split dollar premium to trusts benefiting their family. When Mrs. Morrisette died, her executor valued the right to recover that premium at \$7.5 million. This wide discrepancy attracted the attention of IRS auditors, who argued (after losing round one in 2016) that the right to repayment should be valued according to the split dollar Treasury Regulations. For the Morrisette type of agreement, the IRS would value repayment in the Morrisette estate as the greater of the policy contract fund, in this case \$32.5 million, or premiums paid to date, \$30 million.

Without expressly valuing the asset, the Court instead provided the parties with a valuation methodology. Based upon the numbers, it appears the value would not be below \$18.5 million, and also assessed a 40% gross valuation misstatement on the Morrisette estate, a severe penalty.

Conclusion

The Morrisette case is not the final blow or the final lifeline to the intergenerational split dollar strategy. Certain facts of the case influenced the Court’s opinion as much as the relevant law.

(Most damning: the clients' advisors discussed strategies for defeating the federal statute of limitations on audit.) It stands to reason, then, that cases supervised by more prudent advisors could easily withstand analysis under the new precedents set by this case. Certain other cases remain in litigation, potentially further shaping the case law for or against taxpayers. And there is also the avenue of intergenerational split dollar structured with a series of premium loans subject to the applicable federal rate, whose value is easier to determine with far less controversy.

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