



TaxNewsFlash

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U.S. Tax Court: Split-dollar arrangement distributions; benefits under compensatory arrangement taxable as ordinary income

The U.S. Tax Court today released a “reviewed opinion” holding that economic benefits received by the taxpayer-husband under a split-dollar arrangement were not “distributions” under section 301, but were benefits received under a compensatory arrangement and as such were taxable as “compensation for services” under section 61(a)(1) as ordinary income.

The case is: *De Los Santos v. Commissioner*, 156 T.C. No. 9 (April 12, 2021). Read the [Tax Court opinion](#) [PDF 102 KB] (that does not include any separate concurring or dissenting opinions)

Summary

The Tax Court summarized the facts in this case, as follows:

- The taxpayer-husband (a medical doctor) during 2011 and 2012 was the sole shareholder of an S corporation that employed him and his wife.
- The S corporation adopted an employee welfare benefit plan that provided benefits to the husband, the wife, and four other employees.
- The taxpayers received these benefits in their capacity as employees.
- The benefit plan afforded life insurance protection to the taxpayers and was found in a prior Tax Court memorandum opinion to constitute a compensatory “split-dollar” life insurance arrangement. Thus, the taxpayers were taxable on the economic benefits they realized by participating in the plan.
- In the notice of deficiency, the IRS determined that these economic benefits from the plan were taxable to the taxpayers as ordinary compensation income.
- The taxpayers in the instant action filed a motion for partial summary judgment contending that, because the taxpayer-husband was a shareholder of the S corporation, the economic benefits he realized were taxable to him as a distribution under section 301.
- The taxpayers further claimed that the economic benefits received by a shareholder pursuant to a split-dollar life insurance arrangement constitute a distribution under section 301—regardless of

whether the taxpayer receives the benefits in his capacity as an employee or as a shareholder. In support of this position, the taxpayers looked to the decision of the Sixth Circuit in *Machacek v. Commissioner*, 906 F.3d 429 (6th Cir. 2018), rev'g and remanding T.C. Memo. 2016-55.

The Tax Court held that given that the compensatory split-dollar life insurance arrangement afforded benefits to the taxpayer-husband in his capacity as an employee of the S corporation, the benefits were not characterized as a distribution "by a corporation to a shareholder with respect to its stock."

The court further held that for purposes of taxing employee fringe benefits, the taxpayer-husband was to be treated as a partner of a partnership, and the economic benefits that he realized were therefore taxable under section 707(c) as "guaranteed payments" and thus as ordinary income.

The purpose of this *TaxNewsFlash* is to provide text of the opinion.

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