

ACTION ON DECISION

Subject: *Machacek v. Commissioner*, 906 F.3d 429 (6th Cir. 2018), *rev'g* T.C. Memo. 2016-55.

Issue: If a corporation provides a compensatory split-dollar life insurance arrangement to an employee who is also a shareholder, are the economic benefits of the arrangement treated as distributions under section 301?

Discussion: In *Machacek*, a corporation entered into a split-dollar life insurance arrangement with an employee who was also a 70% shareholder. The employee's wife held the remaining 30% of the stock of the corporation. The Tax Court held, and the United States Court of Appeals for the Sixth Circuit accepted, that this arrangement was entered into in connection with the employee's performance of services. The Sixth Circuit nevertheless held that, under Treas. Reg. § 1.301-1(q), the economic benefits of the arrangement must be treated as annual distributions under section 301.

The Service's position is that these benefits must be "taken into account based on [their] character." *Split-Dollar Life Insurance Arrangements*, T.D. 9092, 68 Fed. Reg. 54,336, 54,339 (Sept. 17, 2003). Payments that arise from an employer-employee relationship, like those in *Machacek*, are compensation, not distributions subject to section 301. Treas. Reg. § 1.301-1(q) applies only to split-dollar life insurance arrangements between a corporation and a shareholder in his or her capacity as such. *See also De Los Santos v. Commissioner*, 156 T.C. No. 9 at 16-20 (Apr. 12, 2021) (declining to follow the Sixth Circuit's reasoning and conclusion in *Machacek* in a case appealable to a different circuit).

Although the Service disagrees with the decision of the court in *Machacek*, we recognize the precedential effect of the decision to cases appealable to the Sixth Circuit. Therefore, the Service will follow it in cases within that circuit if the opinion cannot be meaningfully distinguished. The Service does not, however, acquiesce in the opinion, and we will continue to litigate our position in cases in other circuits.

In cases appealable to the Sixth Circuit, the Service's position is that taxpayers must adopt consistent reporting positions in light of the opinion in *Machacek*, which may result in unfavorable consequences for some taxpayers. For example, if the economic benefits of a split-dollar life insurance arrangement are treated as distributions, the costs of the arrangement will never be deductible as compensation under Treas. Reg. § 1.83-6(a)(5) or otherwise. Additionally, the Service's position is that adoption of a split-dollar life insurance arrangement by a corporation will terminate the corporation's S election (or invalidate a subsequent S election) if the arrangement provides some shareholders with superior rights to distribution proceeds. *See* section 1361(b)(1)(D); Treas. Reg. § 1.1361-1(l).

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Recommendation: Nonacquiescence

/s/

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