***Postal Mut. Indem. Co. v. Commissioner, 40 B.T.A. 1009 (1942)***

For federal tax purposes, an insurance company is considered a 'life insurance company' only if more than 50% of its total reserve funds are true life insurance reserves, actuarially computed and required by law.

**Summary**

Postal Mutual Indemnity Company, operating on a mutual assessment plan in Texas, sought to be classified as a life insurance company for tax purposes. The company maintained a "mortuary fund" as its only reserve for life insurance claims, mandated by the state to be 60% of its gross income. The Board of Tax Appeals ruled that the mortuary fund, not being actuarially computed or specifically required for life insurance reserves, did not qualify the company as a life insurance company under Section 201 of the Internal Revenue Code. Consequently, the company was taxed as a non-life insurance company.

**Facts**

Postal Mutual Indemnity Company (the "Company") operated on a mutual assessment plan in Texas. The Texas Board of Insurance Commissioners required the Company to maintain a "mortuary fund." The mortuary fund consisted of 60% of the Company's gross income after either the payment of a membership fee, or the first three monthly premiums or assessments, paid by each member. This mortuary fund served as the Company's only reserve for paying life insurance claims. The fund was not computed using mortality tables, assumed interest rates, or any actuarial principles. The Company sought to be treated as a life insurance company for federal tax purposes.

**Procedural History**

The Commissioner of Internal Revenue determined that Postal Mutual Indemnity Company did not qualify as a life insurance company under the relevant provisions of the Internal Revenue Code. The Company appealed this determination to the Board of Tax Appeals.

**Issue(s)**

1. Whether the Company's mortuary fund qualifies as a "life insurance reserve" under Section 201 of the Internal Revenue Code.
2. Whether the net additions to the mortuary fund can be excluded from the Company's gross income as trust funds held for specific purposes.
3. Whether the Company's tax should be computed under Section 204 (insurance companies other than life or mutual) or Section 207 (mutual insurance companies other than life) of the Internal Revenue Code.

**Holding**

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1. No, because the mortuary fund was not computed using actuarial principles or mortality tables and therefore does not constitute a “life insurance reserve” as defined under federal tax law.
2. No, because the premiums are received in the ordinary course of business and dedicated to claim payments after receipt, not as trust funds from the outset.
3. The tax computation remains the same under either section, so the specific section is inconsequential in this case, though the Company does not meet the requirements of a mutual company.

**Court’s Reasoning**

The Board reasoned that under Section 201 of the Internal Revenue Code, an insurance company must have at least 50% of its total reserve funds held as true life insurance reserves to qualify as a life insurance company for tax purposes. The mortuary fund, comprising 60% of gross income, was not computed using actuarial methods or mortality tables, failing to meet the definition of a “life insurance reserve.” The Board emphasized that “the word ‘reserve’ has a technical meaning peculiar to the law of insurance and is not anything which a state statute or officer may so designate.” The court distinguished *Lamana-Panno-Fallo Industrial Insurance Co. v. Commissioner*, noting that the reserves there were still based on actuarial principles, even if partially waived. The court also rejected the argument that the mortuary fund constituted excludable trust funds, as the premiums were received in the ordinary course of business and only later dedicated to specific purposes. The court noted that the Company’s structure, where 40% of gross income was paid to operators, preventing policyholders from sharing excess proceeds, undermined its claim as a mutual company, stating, “It is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder.”

**Practical Implications**

This case clarifies the criteria for an insurance company to be classified as a “life insurance company” for federal tax purposes. It emphasizes the importance of actuarially computed reserves, as required by law, to meet this classification. The decision reinforces that state regulations alone cannot define “reserves” for federal tax purposes; they must adhere to accepted actuarial principles. This ruling impacts how insurance companies structure their reserves and manage their funds to optimize their tax liabilities. Later cases would need to consider not just the designation, but the actual basis of the reserve calculation. The case highlights that the substance of the reserve, not just the label, dictates its treatment for federal income tax purposes.

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