10 T.C. 766 (1948)

Payments received from contracts with insurance companies are not considered annuities for tax purposes if the contracts are essentially investments where the principal is returned and the payments are based on a presumed interest rate, rather than on mortality tables.

Summary

J. Giltner Igleheart purchased nine contracts from three insurance companies, paying a single premium for each. These contracts provided annual payments and a return of the principal sum upon surrender or death. Igleheart argued that these payments should be taxed as annuities, with a portion excluded from gross income under Section 22(b)(2) of the Internal Revenue Code. The Tax Court disagreed, holding that the contracts were not true annuities but rather investment vehicles, and the payments were fully taxable as income under Section 22(a) of the Code because they did not represent a return of capital based on mortality calculations.

Facts

Igleheart entered into nine contracts with Equitable Life Assurance Society, Penn Mutual Life Insurance Co., and Sun Life Assurance Co. of Canada between 1928 and 1935.

He paid a single premium for each contract. The premium amount was generally the principal sum plus 5% or 6%, without regard to Igleheart’s age, sex, or mortality tables.

The contracts provided for annual payments to Igleheart and a return of the principal sum upon surrender or at death to his beneficiaries.

The annual payments were based on a presumed interest rate (3% to 5.5%) on the principal sum, which was similar to or less than the interest rates offered by the insurance companies for policy proceeds left on deposit.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Igleheart’s income tax for 1941, arguing that the payments from the contracts were fully includible in gross income. Igleheart challenged this determination in the Tax Court. The Commissioner also requested an increased deficiency.

Issue(s)

Whether the payments received by Igleheart under the nine contracts should be treated as annuities under Section 22(b)(2) of the Internal Revenue Code, allowing a portion to be excluded from gross income, or as income from an investment, fully taxable under Section 22(a) of the Code.

Holding

No, because the contracts were not true annuities based on mortality calculations but rather investment vehicles where the principal was returned, and the payments represented earnings on an invested fund.

Court's Reasoning

The court distinguished the case from *Bodine v. Commissioner*, noting that the relevant tax law (Revenue Act of 1934) had been amended since that decision.

The court relied on its prior decision in *George H. Thornley*, which interpreted "amounts received as an annuity" to mean amounts computed with reference to the age and sex of the insured, or payee, and with reference to life or lives.

The court emphasized that true annuities are calculated to return the consideration paid plus interest over the annuitant's life expectancy, implying a return of capital. The contracts in this case did not exhaust the consideration paid because the principal sum remained available to Igleheart or his beneficiaries.

The court noted that the annual payments were based on a presumed interest rate similar to deposit rates, indicating that no part of the payment represented a return of capital.

The court concluded that the contracts were essentially agreements where Igleheart deposited money with the insurance companies in exchange for annual payments until certain contingencies occurred, when the principal would be repaid.

The dissenting judge argued that the contracts were similar to those in *Bodine v. Commissioner* and *Commissioner v. Meyer*, where the taxpayer's position was upheld.

Practical Implications

This case clarifies the distinction between true annuity contracts and investment contracts for tax purposes. Legal professionals should analyze the substance of such contracts, focusing on whether the payments are based on mortality calculations and whether the principal is at risk.

When advising clients, attorneys should carefully structure annuity contracts to align with the criteria established in *Igleheart* to ensure the desired tax treatment.

Tax advisors must carefully review the terms of any contracts labeled as annuities to determine whether they qualify for favorable tax treatment or are merely investments subject to ordinary income tax rates. This case remains relevant when distinguishing between investment products and genuine annuity contracts for tax purposes.

