15 T.C. 510 (1950)

Title insurance companies can exclude from their gross income the portion of premiums mandated by state regulatory bodies to be set aside as "unearned premiums" for a specified period, reflecting the time when the risk of loss is greatest.

Summary

Title and Trust Company segregated a portion of its 1945 premium income as an "unearned premium reserve" as required by the Oregon Insurance Commissioner. The Commissioner's directive required the company to set aside 3% of premiums received on title insurance policies issued during 1942-1945 into a reserve, releasing funds after 180 months. The Tax Court addressed whether the company could exclude this reserve from its 1945 gross income for tax purposes. The court held that the petitioner properly excluded the amount set aside as "unearned premiums", aligning with the principle established in *Early v. Lawyers Title Insurance Corp.*, emphasizing that reserves mandated by state authorities are considered unearned premiums for tax purposes.

Facts

Title and Trust Company, an Oregon corporation, derived most of its income from issuing perpetual title insurance policies. The Oregon Insurance Commissioner directed the company to establish an "unearned premium or reinsurance reserve." This reserve was to be 3% of the total premiums received on policies issued during 1942-1945, and 3% of monthly premiums received thereafter. After 180 months, the portion of the reserve older than 180 months could be released for general corporate purposes. The company complied, setting up an "Unearned Premiums" account with a credit of $46,889.63, calculated as 3% of the premiums from 1942-1945.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioner's excess profits tax for 1945, arguing the entire title insurance premiums were earned and the "unearned premiums" deduction was improper. The Tax Court reviewed the Commissioner's decision based on stipulated facts.

Issue(s)

Whether the amount the Title and Trust Company designated as "unearned premiums," as mandated by the Oregon Insurance Commissioner, could be excluded from its title insurance premium income under Section 204(b)(1), (4), and (5) of the Internal Revenue Code.

Holding

Yes, because the reserve was mandated by the Oregon Insurance Commissioner under statutory authority, mirroring the effect of a direct statutory requirement and aligning with the principle that statutorily required reserves are treated as unearned premiums for tax purposes until released for general corporate use.

Court's Reasoning

The Tax Court relied on *Early v. Lawyers Title Insurance Corp.*, which held that title insurance premiums designated as unearned by law or contract should be treated as such for tax purposes. The court distinguished *City Title Insurance Co. v. Commissioner*, where a state statute didn't clearly define when reserves would become free assets. The court emphasized that Oregon law authorized the Insurance Commissioner to issue rulings to enforce the Insurance Code, including rules about insurance reserves. The directive to establish the reserve had the same effect as a statutory mandate. The court rejected the Commissioner's argument that excluding premiums from 1942-1944 distorted the 1945 income, noting the reserve was taken from 1945 income, restricting its availability for corporate use. The court stated, "From our reading of the Oregon statutes and the directive issued to petitioner by the Oregon Insurance Commissioner, we perceive nothing to indicate that the Insurance Commissioner exceeded the bounds of his statutory authority to make rules concerning reserves." The court also cited *Maryland Casualty Co. v. United States*, for the proposition that a valid exercise of discretion entrusted to an Insurance Commissioner should have equal weight and effect as the statutes themselves.

Practical Implications

This case clarifies that reserves mandated by state insurance commissioners, acting within their statutory authority, are treated as "unearned premiums" for federal income tax purposes, allowing title insurance companies to exclude these amounts from gross income until the funds are released for general corporate use. The decision reinforces the principle that state regulatory requirements impacting the timing of when funds become available for a company's use directly impact federal tax treatment. This ruling helps title insurance companies understand and plan for the tax implications of complying with state insurance regulations. Later cases should analyze whether the insurance commissioner's directive is within the scope of their statutory authority and whether the reserve is for a definite period, after which the funds become available for general corporate purposes.

