15 T.C. 637 (1950)

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A title insurance company can deduct additions to a reinsurance reserve as unearned premiums under Section 204(b)(5) of the Internal Revenue Code if the reserve is established and maintained according to a state law that designates it as such.

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Summary

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Home Title Guaranty Company sought to deduct additions to its reinsurance reserve as unearned premiums for the 1945 tax year. The Tax Court addressed whether amounts added to the reserve, as mandated by a 1945 amendment to New York insurance law, qualified as deductible unearned premiums under federal tax law. The court held that the entire amount of the reinsurance reserve on December 31, 1945, including amounts accumulated before the 1945 amendment, represented unearned premiums. Therefore, the Commissioner erred in disallowing the deduction. The key factor was the change in New York law, which specifically designated the reserve as 'unearned' and required it to be segregated for policyholder security.

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Facts

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Home Title Guaranty Company, a New York corporation, engaged in the title insurance business. Prior to June 1, 1945, the company maintained a 'premium reserve' under New York law, but did not deduct additions to this reserve on its federal income tax returns. In 1945, New York law was amended to require the establishment of a 'reinsurance reserve,' which was to include the previously accumulated 'premium reserve.' The amended law explicitly stated that this reinsurance reserve was to be considered an unearned portion of the original premiums. The company deducted the full amount of the reinsurance reserve, including amounts accumulated both before and after June 1, 1945, as unearned premiums in its 1945 tax return.

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Procedural History

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The Commissioner of Internal Revenue disallowed the deduction for the portion of the reinsurance reserve that represented accumulations prior to June 1, 1945, leading to a deficiency assessment. Home Title Guaranty Company petitioned the Tax Court for a redetermination of the deficiency.

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Issue(s)

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Whether the portion of Home Title Guaranty Company's reinsurance reserve, which prior to June 1, 1945, was carried in its premium reserve, constituted unearned premiums on December 31, 1945, within the meaning of Section 204(b)(5) of the Internal Revenue Code.

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Holding

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Yes, because the amendment to New York law in 1945 explicitly designated the entire reinsurance reserve, including amounts accumulated before the amendment, as unearned premiums. This change in state law directly impacted the reserve's status for federal tax purposes.

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Court's Reasoning

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The court emphasized that the crucial factor was the change in New York law. Prior to the 1945 amendment, the 'premium reserve' was considered a 'solvency reserve' and not deductible as unearned premiums. However, the amended law explicitly stated that the 'reinsurance reserve' was deemed an unearned portion of the original premiums. The court cited *Early v. Lawyers Title Insurance Corp.*, noting that the amendment was a

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