***Tax Court Memo Decision (1945)***

Dividends and interest accumulated on an endowment life insurance policy are taxable as ordinary income when received at maturity, even if the face value of the policy is excludable from gross income.

**Summary**

The decedent purchased a 20-year endowment life insurance policy in 1925. After ten years of premium payments, the decedent became disabled, and subsequent premiums were waived. Upon the policy’s maturity in 1945, the decedent received the $10,000 face value and $1,648.19 in accumulated dividends and interest. The Commissioner conceded that the $10,000 face value was excludable from gross income but argued the $1,648.19 was taxable. The Tax Court agreed with the Commissioner, holding that while policy dividends might initially represent a reduction of premiums, they become taxable income when the policy matures and the policyholder has recovered their cost basis. The court rejected the petitioner’s argument that waived premiums should be considered constructively received disability benefits.

**Facts**

In 1925, the decedent obtained a 20-year endowment life insurance policy with a $10,000 face value.

The policy required 20 annual premium payments of $568.60.

After 10 years of payments, the decedent became totally disabled, and all subsequent premiums were waived under a policy provision.

Upon the policy’s maturity in 1945, the decedent received $10,000 as the face amount and $1,648.19 labeled as accumulated dividends and interest.

**Procedural History**

The Tax Court was tasked with determining the taxable gain realized by the decedent upon the maturity of the insurance policy.

The Commissioner conceded part of the proceeds were excludable but determined the accumulated dividends and interest were taxable income.

The petitioners challenged the Commissioner’s determination in Tax Court.

**Issue(s)**

1. Whether the $1,648.19 received by the decedent, representing accumulated dividends and interest on the endowment policy, is includible in the decedent’s gross

income.

2. Whether the premiums waived due to disability should be considered constructively received by the decedent as disability benefits and thus excludable from gross income.

## Holding

1. Yes, because the $1,648.19 constituted accumulated mutual insurance dividends and interest, representing earnings on the policy fund, and is taxable as ordinary income.

2. No, because the waived premiums were not actually received as disability benefits but were instead a contractual benefit under the insurance policy, and do not alter the taxability of dividends at maturity.

## Court's Reasoning

The court referenced Section 22(b)(2)(A) and (5) of the Internal Revenue Code, noting the Commissioner's concession that the $10,000 face value was excludable under these provisions as either a return of capital or a disability benefit.

The court focused on the taxability of the $1,648.19, labeled as "accumulated mutual insurance dividends and interest."

The court cited Treasury Regulations, specifically Regs. 111, sec. 29.22(a)-12 and sec. 29.22(b)(2)-l, which indicate that while dividends can reduce premiums when periodically paid, they become taxable income when the amount paid for the policy has been fully recovered.

The court stated, "While 'dividends' may be excluded from income as a reduction of premium, at the time of the periodic payment of premiums, they, nonetheless, become a taxable income item when the amount paid for the policy has been fully recovered."

The court rejected the petitioner's argument that waived premiums should be treated as constructively received disability benefits, finding no basis to consider them as such for tax exclusion purposes upon policy maturity.

## Practical Implications

This decision clarifies the tax treatment of accumulated dividends and interest from endowment life insurance policies upon maturity.

It establishes that while the face value of such policies may be excludable from gross income under specific provisions of the Internal Revenue Code, any accumulated dividends and interest are generally taxable as ordinary income when received at maturity.

This case highlights the importance of distinguishing between the return of capital (premiums paid), disability benefits, and investment earnings within life insurance policies for tax purposes.

Legal practitioners and taxpayers must recognize that the tax-free nature of life insurance proceeds often does not extend to the investment gains embedded within endowment policies, especially when received at maturity rather than as death benefits. This ruling informs tax planning related to life insurance and endowment policies, particularly concerning the taxable implications of accumulated dividends and interest.

 