20 T.C. 620 (1953)

The phrase “aggregate premiums or consideration paid” in Section 22(b)(2)(A) of the Internal Revenue Code refers only to premiums paid by the taxpayer, not by any other party like an employer, unless those employer payments constituted taxable income to the employee.

Summary

F.E. Card and W.S. Adams, officers of State Securities Company, received cash surrender values from their endowment life insurance policies. State Securities had paid some of the premiums. Card and Adams argued that the total premiums paid by both them and their employer should be considered when calculating taxable income from the proceeds. The Tax Court held that only the premiums paid by Card and Adams themselves could be used in this calculation. The court found the taxpayers failed to prove that the premiums paid by their employer constituted income to them.

Facts

In 1936, Card and Adams each obtained ten-year endowment life insurance policies, payable to them at maturity. State Securities Company, their employer, was the beneficiary. State Securities paid some of the premiums on these policies. Card and Adams possessed all ownership rights, including the right to change beneficiaries and surrender the policies for cash value. In 1945, both Card and Adams surrendered their policies and received cash surrender values. Neither Card nor Adams reported the employer-paid premiums as income on their tax returns, nor did State Securities deduct those premiums.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Card’s and Adams’ income tax for 1945. The taxpayers petitioned the Tax Court, arguing that the employer-paid premiums should be included in the “aggregate premiums or consideration paid” calculation under Section 22(b)(2)(A) of the Internal Revenue Code. The Tax Court consolidated the cases for hearing and opinion.

Issue(s)

Whether the phrase “aggregate premiums or consideration paid” in Section 22(b)(2)(A) of the Internal Revenue Code includes premiums paid by the taxpayer’s employer, in addition to those paid by the taxpayer, when calculating taxable income from the proceeds of an endowment policy.

Holding

No, because the phrase “aggregate premiums or consideration paid” refers only to

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the premiums paid by the taxpayer. However, the employer's payments can be considered if they constituted income to the employee.

Court's Reasoning

The Tax Court relied on its prior decision in *Charles L. Jones, 2 T.C. 924*, stating that the phrase "aggregate premiums or consideration paid" was intended to allow the insured to recover tax-free the cost they paid for the policies. The court acknowledged that the employer's premium payments could be considered if they constituted taxable income to the employees, either through constructive receipt or under Section 22(a). However, the taxpayers failed to provide sufficient evidence to prove that the employer's payments were indeed income to them. The court emphasized that the taxpayers, as controlling officers of State Securities, had the burden of proving the nature of the employer's payments. Because of lack of evidence, the presumption that the Commissioner's determination was correct prevailed.

Practical Implications

This case clarifies that when calculating taxable income from insurance or annuity proceeds under Section 22(b)(2)(A) of the Internal Revenue Code (and similar provisions in subsequent tax laws), only the premiums paid directly by the taxpayer are initially considered. However, attorneys should investigate whether employer-paid premiums or other payments related to the policy were treated as taxable income to the employee. This requires a thorough examination of the facts and circumstances surrounding the payments and the taxpayer's historical tax treatment of those payments. The failure to prove that employer-paid premiums were previously treated as income will prevent the taxpayer from including these amounts in their cost basis for tax purposes. This principle remains relevant for analogous provisions in later tax codes.

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