Reinert v. Commissioner, 19 T.C. 11 (1952)

Life insurance premiums are not deductible as non-trade or non-business expenses under Section 23(a)(2) of the Internal Revenue Code when the proceeds of the insurance policy, if received, would be exempt from taxation under Section 22(b)(1).

Summary

The taxpayer purchased interests in inter vivos and testamentary trusts, contingent on the life tenants predeceasing the remaindermen. To protect his investment, the taxpayer took out life insurance policies on the lives of the remaindermen. The Tax Court held that the premiums paid on these policies were not deductible under I.R.C. § 23(a)(2) because any proceeds received from the policies would be excluded from gross income under I.R.C. § 22(b)(1), making the expenses allocable to tax-exempt income. The court relied on the principle that allowing a deduction for expenses related to tax-exempt income would create a double tax benefit, which is prohibited by I.R.C. § 24(a)(5).

Facts

In 1948 and 1950, the taxpayer purchased interests in inter vivos and testamentary trusts. The value of these interests depended on the life tenants' deaths occurring before the remaindermen. To secure his investment, the taxpayer obtained life insurance policies on the remaindermen's lives and became the sole owner of the policies. The taxpayer paid premiums on these policies. The Commissioner of Internal Revenue disallowed the deduction of these premium payments, asserting they were not deductible under I.R.C. § 24(a)(5) because proceeds would be tax-exempt under § 22(b)(1).

Procedural History

The Commissioner of Internal Revenue disallowed the taxpayer's deduction of life insurance premiums. The taxpayer petitioned the Tax Court to challenge the Commissioner's disallowance. The Tax Court sided with the Commissioner, denying the deduction. The taxpayer agreed with the Commissioner on all other points of the deficiency notice, and the Court accepted the Commissioner's adjusted calculations.

Issue(s)

Whether the premiums paid by the taxpayer on the life insurance policies were deductible as non-trade or non-business expenses under I.R.C. § 23(a)(2).

Holding

No, because I.R.C. § 24(a)(5) disallows deductions for expenses allocable to tax-exempt income, and proceeds from the life insurance policies would be exempt from taxation under I.R.C. § 22(b)(1).

Court’s Reasoning

The court centered its reasoning on the interplay between I.R.C. §§ 22(b)(1), 23(a)(2), and 24(a)(5). Section 22(b)(1) excludes life insurance proceeds paid by reason of the insured’s death from gross income. Section 23(a)(2) allows deductions for ordinary and necessary expenses paid for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income, in the case of an individual. However, Section 24(a)(5) disallows any deduction “allocable to one or more classes of income… wholly exempt from the taxes imposed by this chapter.” The court found that the premiums paid by the taxpayer were directly allocable to the life insurance policies, the proceeds of which, if received, would be exempt from taxation under Section 22(b)(1). Therefore, the premiums were not deductible.

The court relied heavily on the principle that the law does not allow for a double tax benefit: “If the income is exempt from taxation expenses allocable to such income are not to be allowed as deductions. Any other treatment would result in double benefits by double exemption.”

The court distinguished the facts of the case from the facts of *Higgins v. United States*, which the taxpayer had cited in support of his argument, noting that sections 22(b)(1) and 24(a)(5) were not applicable in *Higgins*. The court also cited *National Engraving Co., 3 T. C. 179*, in support of its decision, and noted that the difference in the type of payment involved in the two cases made no difference to the principle at issue.

Practical Implications

This case is significant for the understanding of the limits to deductions. It establishes that expenses directly related to income that is, by law, exempt from federal income tax, are not deductible. Taxpayers cannot obtain a double tax benefit by deducting expenses that generate tax-exempt income. In analyzing similar situations, legal professionals must carefully examine the nature of the income generated and whether the related expenses are directly attributable to tax-exempt or taxable income.

Businesses considering taking out life insurance policies to protect investments must understand that the deductibility of premiums depends on the taxability of the proceeds. For example, if a corporation takes out a policy on a key employee, and the corporation is the beneficiary, the premiums are generally not deductible. If an individual takes out a policy for their own benefit the premiums are also usually not deductible. However, if the business is the beneficiary and the proceeds are used to fund a buy-sell agreement, the tax implications become more complex.

Subsequent cases have followed the principle established in *Reinert*, reinforcing that deductions are not available for expenses related to tax-exempt income. This

understanding shapes how tax advisors and businesses structure insurance policies and other financial arrangements.

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