W.W. Windle Co., v. Commissioner, 12 T.C. 161 (1949)

Premiums paid on life insurance policies are not deductible if the proceeds of the policies, when received, would be excluded from gross income.

Summary

The case addresses whether a company could deduct the premiums it paid on life insurance policies. The company had purchased interests in inter vivos and testamentary trusts and took out life insurance policies on the remaindermen to protect its investment. The court held that the premiums were not deductible because the proceeds from the life insurance policies, if and when received by the company, would be exempt from taxation under Section 22(b)(1)(A) of the Internal Revenue Code of 1939. Therefore, under Section 24(a)(5), the premiums were not deductible because they were allocable to tax-exempt income.

Facts

In 1948, W.W. Windle Co. bought an interest in an inter vivos trust from one of the named remaindermen. In 1950, it also purchased a similar interest under a testamentary trust. In both instances, the company was exposed to a risk of loss if the remaindermen died before the life tenant. To protect its investment, the company took out life insurance policies on the lives of the remaindermen and paid the premiums. The company was the sole owner of the policies and had no investment interest in the insurance other than protecting its investment in the trusts.

Procedural History

The Commissioner of Internal Revenue denied the company’s deduction of the life insurance premiums. The company challenged this decision in the United States Tax Court.

Issue(s)

1. Whether the premiums paid by the petitioner in 1950 on life insurance policies are proper deductions from gross income pursuant to Section 23(a)(2) of the Internal Revenue Code of 1939.

2. Whether such deductions must be disallowed because of the provisions of sections 22(b)(1) and 24(a)(5) of the 1939 Code.

Holding

1. No, the premiums paid by the company are not proper deductions under Section 23(a)(2) of the 1939 Code.

2. Yes, the deductions are disallowed because of sections 22(b)(1) and 24(a)(5) of the 1939 Code.

Court’s Reasoning

The court based its decision on the interpretation of sections 22(b)(1) and 24(a)(5) of the 1939 Code. Section 22(b)(1) excludes from gross income amounts received under a life insurance contract paid by reason of the death of the insured. Section 24(a)(5) disallows deductions for amounts allocable to income wholly exempt from taxation. The court reasoned that because any proceeds received from the life insurance policies would be excluded from the company’s gross income under Section 22(b)(1), the premiums paid on those policies were not deductible under Section 24(a)(5). The court referenced the case *National Engraving Co., 3 T.C. 179*, which established that expenses allocable to exempt income are not deductible. The court noted, “*Once It be determined that an expense is allocable to exempt income, the item is not deductible and there is an end of the matter. Both sides of the equation must be considered. 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 *Higgins v. United States, 75 F. Supp. 252* from this case.

Practical Implications

This case clarifies the relationship between the deductibility of expenses and the taxability of related income, specifically in the context of life insurance. It establishes that if the proceeds from a life insurance policy would be tax-exempt, the premiums paid on that policy are not deductible. This ruling affects business planning by influencing decisions about how to structure financial protections. For example, if a company is considering taking out life insurance to cover a business risk, it must evaluate whether the resulting income (the insurance proceeds) will be taxable. If the income is exempt, the premiums paid are not deductible. This rule is relevant in many areas, including deferred compensation and buy-sell agreements where life insurance may be used to fund payouts. Tax advisors must carefully consider the implications of Sections 22 and 24 of the Internal Revenue Code when advising clients about life insurance.

