28 T.C. 19 (1957)

When a corporation pays life insurance premiums on policies insuring the lives of its stockholders, and the stockholders are the beneficiaries or have a beneficial interest in the policies, the premium payments constitute taxable income to the stockholders.

Summary

In Prunier v. Commissioner, the U.S. Tax Court addressed whether corporate-paid life insurance premiums were taxable income to the insured stockholders. The corporation paid premiums on policies insuring the lives of its two principal stockholders, with the stockholders themselves initially named as beneficiaries. Agreements were in place to use the policy proceeds to purchase the deceased stockholder's shares. The court found that the stockholders were the beneficial owners of the policies, and thus, the premiums paid by the corporation were taxable income to them, as they were the ultimate beneficiaries. The court reasoned that the corporation was merely a conduit for transferring funds to the stockholders for their personal benefit.

Facts

Joseph and Henry Prunier were brothers and the primary stockholders of J.S. Prunier & Sons, Inc. The corporation paid premiums on life insurance policies insuring the lives of Joseph and Henry. Initially, the brothers were designated as beneficiaries of the policies on each other's lives. Agreements were made to have the corporation use the policy proceeds to buy the deceased brother's shares in the corporation. The corporation was never directly named as a beneficiary in the policies or endorsements until after the tax year in question. The brothers intended that the corporation should use the proceeds to purchase the stock interest of the deceased.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Pruniers' 1950 income taxes, arguing that the corporate-paid insurance premiums constituted taxable income to the brothers. The Pruniers contested the assessment, leading to the case in the U.S. Tax Court.

Issue(s)

1. Whether the corporation was the beneficial owner or beneficiary of the life insurance policies, despite the brothers being the named beneficiaries.

2. Whether the premiums paid by the corporation on the life insurance policies constituted taxable income to Joseph and Henry Prunier.

Holding

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1. No, because the corporation was not the beneficial owner or beneficiary of the insurance policies, even though the corporation was obligated to use the proceeds to purchase stock.

2. Yes, because the premiums paid by the corporation on the life insurance policies constituted taxable income to the Pruniers.

Court's Reasoning

The court applied the principle that premiums paid by a corporation on life insurance policies for officers or employees are taxable to the insured if the corporation is not the beneficiary. The court emphasized that while the corporation was obligated to use the proceeds to purchase the insured's stock, the brothers were ultimately the beneficiaries. The court found that the corporation was not enriched by the insurance arrangement and that Joseph and Henry each had interests in the policies of insurance on their lives that were of such magnitude and of such value as to constitute them direct or indirect beneficiaries of the policies. The brothers intended that the corporation should be the owner of the proceeds of the policies on the life of the deceased party and that such ownership should be for the sole purpose of purchasing the stock interest of the deceased party in the corporation at a price which had been agreed upon by them prior to the death of either.

The court distinguished situations where the corporation is directly or indirectly a beneficiary, in which case the premiums are not deductible by the corporation and not taxable to the employee. The court noted that the corporation was not named as beneficiary until after the tax year at issue.

The court cited several cases, including *George Matthew Adams*, *N.Loring Danforth* and *Frank D. Yuengling*, where premiums were taxable income to the employee when the corporation was not a beneficiary. The court also referenced O.D. 627, which states that premiums paid by a corporation on an individual life insurance policy in which the corporation is not a beneficiary, the premiums are taxable income to the officer or employee.

The dissenting judge argued that the corporation should be treated as the beneficiary because the corporation paid the premiums and the agreement indicated the proceeds were to be used for a corporate purpose.

Practical Implications

This case is significant because it clarifies the tax implications of corporate-owned life insurance, especially in the context of buy-sell agreements. It emphasizes that the substance of the transaction, not just the form, determines tax liability. If a corporation is merely acting as a conduit to provide a benefit to the insured, the premiums will likely be treated as taxable income to the insured. It warns that when

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stockholders have a beneficial interest in the policies and control the ultimate disposition of proceeds, the premiums are taxable. This case is often cited in tax planning, particularly when structuring buy-sell agreements or executive compensation packages involving life insurance.

Subsequent cases often cite Prunier when analyzing similar situations. Taxpayers must carefully structure life insurance arrangements to ensure the intended tax treatment. Businesses often revisit policies to ensure they are the direct beneficiaries of the policies to potentially receive favorable tax treatment.

Taxpayers should also consider who has the right to change the beneficiary. In this case, Henry had the exclusive right to change the beneficiary in some of the policies on Joseph's life and Joseph had the exclusive right to change the beneficiary in some of the policies on Henry's life.

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