

Western and Southern Life Insurance Co. v. Commissioner, 55 T. C. 1036 (1971)

The loading portion of deferred and uncollected premiums and due and unpaid premiums may be excluded from assets and gross premiums in computing a life insurance company's taxable income.

Summary

Western and Southern Life Insurance Co. contested the Commissioner's inclusion of the loading portion of deferred and uncollected premiums and due and unpaid premiums as assets and gross premiums in computing taxable income under the Life Insurance Company Income Tax Act of 1959. The Tax Court held that the loading could be excluded, rejecting the Commissioner's argument for symmetry between the numerator and denominator of the investment income fraction. The decision was based on the statutory requirement to use accrual accounting, except where modified, and the absence of a legal right to collect these premiums. This ruling impacts how life insurance companies calculate their taxable income by allowing the exclusion of loading from certain premium categories.

Facts

Western and Southern Life Insurance Co. , a mutual life insurance company, filed federal income tax returns for 1958-1962. The company's returns did not include due and deferred premiums as assets but conceded that net valuation premiums should be included. The dispute centered on whether the loading portion of these premiums should be included in assets under IRC section 805(b)(4) and gross premiums under IRC section 809(c)(1). The company's reserves were calculated assuming premiums were paid one year in advance, a method required by state law and the National Association of Insurance Commissioners (NAIC).

Procedural History

The Commissioner determined deficiencies in the company's income taxes for the years in question. The company petitioned the U. S. Tax Court, which held in favor of the company, allowing the exclusion of the loading portion from assets and gross premiums. This decision contrasted with rulings by three Circuit Courts of Appeals, but the Tax Court chose not to follow those precedents.

Issue(s)

1. Whether the loading portion of "premiums, deferred and uncollected" and "premiums, due and unpaid" is excludable from assets within the meaning of IRC section 805(b)(4).
2. Whether the increase in loading on "premiums, deferred and uncollected" and "premiums, due and unpaid" is excludable from premium income under IRC section 809(c)(1), or deductible from such income under IRC section 809(d).

Holding

1. Yes, because the loading portion of due and deferred premiums should be excluded from assets as that term is used in IRC section 805(b)(4), consistent with the accrual method of accounting specified in IRC section 818(a).
2. Yes, because the loading portion of due and deferred premiums should be excluded from gross premiums as that term is used in IRC section 809(c)(1), for the same reasons as in the first issue.

Court's Reasoning

The court reasoned that the Life Insurance Company Income Tax Act of 1959 required the use of the accrual method of accounting, as stated in IRC section 818(a), except where otherwise provided. Since the company had no legal right to collect due and deferred premiums, they should not be included as assets or gross premiums under normal accrual accounting rules. The court rejected the Commissioner's argument that the inclusion of reserves in the numerator of the investment income fraction required the inclusion of the corresponding premiums in the denominator for symmetry. The court also noted that the NAIC's treatment of premiums did not bind them but was considered in light of the statutory requirement for accrual accounting. The court respectfully declined to follow the contrary decisions of three Circuit Courts of Appeals, emphasizing its duty to interpret the law according to its best judgment.

Practical Implications

This decision allows life insurance companies to exclude the loading portion of deferred and uncollected premiums and due and unpaid premiums from their taxable income calculations. This can result in a lower tax liability for these companies. The ruling underscores the importance of accrual accounting in tax computations and may influence how similar cases are analyzed in the future. It also highlights a divergence between the Tax Court and several Circuit Courts of Appeals, which could lead to further litigation and potential Supreme Court review. Life insurance companies should review their tax calculations in light of this decision and consider the potential for different interpretations by appellate courts.