Imperial General Life Insurance Company v. Commissioner, 60 T. C. 979 (1973)

A distribution of assets to shareholders, even if indirect, triggers the Phase III tax under the Life Insurance Company Income Tax Act of 1959.

Summary

In Imperial General Life Insurance Company v. Commissioner, the court determined that the transfer of industrial business assets from the petitioner to a third party, Commercial, constituted a distribution to shareholders, triggering the Phase III tax. The court found that although the assets were transferred to Commercial, the payment for these assets was received by the petitioner's shareholders, Green and Johnston, effectively exhausting the shareholders' and policyholders' surplus accounts. The court also rejected the petitioner's claim for a deduction under section 809(d)(7), as the transfer did not involve payment to the reinsurer for assuming liabilities but rather a sale of assets at a premium.

Facts

Imperial General Life Insurance Company (formerly Cosmopolitan Life, Health and Accident Insurance Co.) was engaged in industrial life insurance until 1964. Shareholders Emil Green and Gale F. Johnston planned to transfer the industrial business to Commercial Life Insurance Co. of Missouri, in which they also held stock, and sell the remaining assets (an office building and the company's charter) to Imperial General Corp. for $75,000. Instead, they sold the stock to Commercial for $425,654. 76, which then withdrew the industrial business and resold the stock to Imperial for $75,000. The fair market value of the industrial business was at least $350,000, and the transaction effectively exhausted the company's shareholders' and policyholders' surplus accounts.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioner's federal income taxes for 1965 and 1966, leading to the case being brought before the United States Tax Court. The court ultimately decided in favor of the respondent, affirming the deficiency determination.

Issue(s)

1. Whether the transfer of the industrial business from the petitioner to Commercial constituted a "distribution to shareholders" under section 815, triggering the Phase III tax?
2. Whether the petitioner was entitled to a deduction under section 809(d)(7) for the excess of assets over liabilities transferred to Commercial?

Holding

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1. Yes, because the transfer of the industrial business to Commercial, with the proceeds going to the shareholders Green and Johnston, was effectively a distribution to shareholders, triggering the Phase III tax.
2. No, because the transfer did not involve payment to the reinsurer for assuming liabilities but rather a sale of assets at a premium, and thus did not qualify for a deduction under section 809(d)(7).

Court's Reasoning

The court reasoned that the transaction, although structured as a sale to Commercial, resulted in a distribution to shareholders because Green and Johnston received the payment. The court applied the broad definition of "distribution to shareholders" under section 815, emphasizing that any withdrawal of gains from the policyholders surplus account in any manner triggers the tax. The court rejected the petitioner's argument that no distribution occurred because Commercial was not yet a shareholder at the time of the transfer, finding that the shareholders still received the economic benefit. The court also clarified that the transfer did not qualify for a section 809(d)(7) deduction because it was not an equalizing payment for the assumption of liabilities but rather a sale of assets at a premium.

Practical Implications

This decision underscores the importance of understanding the broad scope of what constitutes a "distribution to shareholders" under the Life Insurance Company Income Tax Act of 1959. It serves as a warning to life insurance companies that indirect distributions of assets can trigger the Phase III tax, even if structured as a sale to a third party. Legal practitioners must carefully analyze the economic substance of transactions to determine tax implications. The ruling also clarifies that section 809(d)(7) deductions are not available for asset sales at a premium, impacting how similar transactions are structured and reported for tax purposes. Subsequent cases involving life insurance companies and asset distributions have referenced this decision to clarify the application of the Phase III tax.

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