***Central Life Assurance Society v. Commissioner, 63 T. C. 669 (1975)***

Deferred and uncollected premiums, including loading, must be included as assets and gross premiums for tax computation under the Life Insurance Company Income Tax Act of 1959.

**Summary**

Central Life Assurance Society challenged the IRS's inclusion of deferred and uncollected premiums, including loading, in its taxable income calculation under the 1959 Life Insurance Company Income Tax Act. The Tax Court, influenced by decisions from multiple Courts of Appeals, ruled that such premiums must be included in the company's assets for phase I tax computation and in gross premiums for phase II computation. The court also addressed the treatment of mortgage escrow funds, interest on delinquent mortgage loans, unearned policy loan interest, and the deductibility of legal fees related to a subsidiary's liquidation, emphasizing the accrual method's application to these items.

**Facts**

Central Life Assurance Society, a Colorado-based life insurance company, contested IRS determinations of tax deficiencies for the years 1965-1968. The IRS included deferred and uncollected premiums, including loading, in the company's assets and gross premium income under sections 805(b)(4) and 809(c)(1) of the Internal Revenue Code. The company also disputed the inclusion of mortgage escrow funds as assets, interest on delinquent mortgage loans, and unearned interest on policy loans as gross investment income. Additionally, Central Life challenged the non-deductibility of legal fees paid in 1967 related to the liquidation of a subsidiary.

**Procedural History**

The IRS determined tax deficiencies against Central Life Assurance Society for the years 1965-1968. The company filed a petition with the Tax Court, which heard the case and issued its decision in 1975. The court considered prior cases and appellate court decisions on similar issues.

**Issue(s)**

1. Whether deferred and uncollected premiums, including loading, must be included as assets under section 805(b)(4) and as gross premium income under section 809(c)(1)?
2. Whether mortgage escrow funds constitute assets under section 805(b)(4)?
3. Whether interest on mortgage loans more than 90 days past due must be included as assets under section 805(b)(4) and as gross investment income under section 804(b)(1)?
4. Whether unearned interest on policy loans must be included in gross investment income under section 804(b)(1)?

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5. Whether legal fees paid in connection with the liquidation of a subsidiary are deductible as ordinary and necessary business expenses?

## Holding

1. Yes, because the Courts of Appeals have consistently held that deferred and uncollected premiums, including loading, must be included as assets and gross premiums for tax computation.
2. No, because mortgage escrow funds are held in trust and not available for investment, thus not constituting assets under section 805(b)(4).
3. Yes, because the company failed to prove reasonable grounds for non-accrual of the interest.
4. No, because unearned interest on policy loans added to principal is not properly includable in gross investment income until earned.
5. No, because legal fees related to the acquisition of capital assets are capital expenses and not deductible as ordinary and necessary business expenses.

## Court's Reasoning

The Tax Court, influenced by appellate court decisions, ruled that deferred and uncollected premiums, including loading, must be included in the tax computation due to the accrual method of accounting mandated by section 818(a) and the recognition of the statutory assumption used in computing life insurance reserves. The court applied the accrual method to mortgage escrow funds, interest on delinquent mortgage loans, and unearned policy loan interest, focusing on the right to receive income and the availability of funds for investment. For legal fees, the court followed Supreme Court precedent treating acquisition-related expenses as capital expenditures. The court's decision reflects a balance between statutory requirements and the practicalities of insurance company operations, with direct quotes from appellate court opinions emphasizing the accrual method's application.

## Practical Implications

This decision requires life insurance companies to include deferred and uncollected premiums, including loading, in their tax computations, impacting how they report income and manage reserves. The ruling on mortgage escrow funds clarifies that such funds held in trust are not taxable assets, affecting how companies structure their escrow accounts. The treatment of interest on delinquent mortgage loans and unearned policy loan interest emphasizes the importance of accrual accounting principles in determining taxable income. The non-deductibility of legal fees related to acquisitions may influence how companies approach the costs of business expansion. Subsequent cases, such as those cited in the opinion, have followed this precedent, reinforcing its impact on tax practice for life insurance companies.

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