Minnis v. Commissioner, 71 T. C. 1049, 1979 U. S. Tax Ct. LEXIS 154 (1979)

Policy loans against employee annuity contracts are not taxable income when received, even if premiums were excluded from the employee's gross income.

Summary

Mary Minnis, a school counselor, took a $5,000 loan against her employer-purchased annuity, which was excluded from her income under section 403(b). The IRS argued the loan should be taxable under section 72(e)(1)(B). The Tax Court held that policy loans are not taxable income when received, as they are not considered amounts received under the contract for tax purposes. This decision was based on the court's interpretation of the relevant statutory provisions and the legislative history indicating that policy loans are generally treated as debts, not income.

Facts

Mary Minnis, employed by the Denton Independent School District, entered into an annuity purchase plan with her employer on September 30, 1966. The employer paid the premiums on the deferred annuity policy from Northwestern National Life Insurance Co. , which qualified for exclusion from Minnis' gross income under section 403(b). On October 10, 1974, Minnis borrowed $5,000 against the policy at a 4. 8% interest rate to remodel a house. The loan was repaid in full by July 31, 1975. The IRS issued a Form 1099, treating the loan as taxable income, leading to the dispute.

Procedural History

The IRS determined a deficiency of $1,670 in Minnis' 1974 income tax, arguing that the policy loan was taxable under section 72(e)(1)(B). Minnis and her husband, Robert, filed a petition with the U. S. Tax Court challenging the deficiency. The Tax Court, in a decision filed on March 26, 1979, ruled in favor of the petitioners, holding that the policy loan was not taxable income.

Issue(s)

1. Whether a policy loan obtained under an employee annuity contract is includable in the employee's gross income under section 72(e)(1)(B) when the premiums paid by the employer were excluded from the employee's income under section 403(b).

Holding

1. No, because a policy loan is not considered an "amount received under the contract" within the meaning of section 72(e)(1)(B), and there is no statutory basis to distinguish such loans from other policy loans for tax purposes.

Court's Reasoning

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The Tax Court reasoned that policy loans are generally treated as valid forms of indebtedness for tax purposes, not as income. The court cited its prior decisions recognizing interest on policy loans as deductible under section 163, indicating a debtor-creditor relationship. The court also noted that section 72(e)(2) defines "amounts not received as an annuity" in terms of contract termination scenarios, which do not apply to policy loans. The legislative history of section 264 further supported the court's view that policy loans are considered debts. The court rejected the IRS's position as expressed in Rev. Rul. 67-258, stating that revenue rulings are not binding on the court. The court emphasized that the loan was treated as a conventional loan in ordinary parlance, consistent with the principle that common understanding guides revenue law interpretation.

Practical Implications

This decision clarifies that policy loans against section 403(b) employee annuity contracts are not taxable when received, aligning their treatment with other policy loans. Attorneys should advise clients that such loans are not income events, but they should be aware of the potential for future tax liability if the loan remains unpaid at the contract's maturity. This ruling may influence IRS policy regarding the taxation of policy loans and could affect how financial institutions and employers structure annuity contracts. Subsequent cases, such as Coors v. United States (1978), have continued to treat policy loans as debts for tax purposes, reinforcing this decision's impact.

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