Union Cent. Life Ins. Co. v. Commissioner, 77 T. C. 845 (1981)

A portion of a state franchise tax paid by a life insurance company may be deductible as an investment expense, and unimproved land around a company's home office may be considered an asset for tax purposes.

Summary

The Union Central Life Insurance Company challenged the IRS's disallowance of deductions for a portion of the Ohio franchise tax as an investment expense and the inclusion of unimproved land surrounding its home office as an asset. The Tax Court held that a portion of the franchise tax was deductible under Section 804(c)(1) as an investment expense, based on the allocation method used by the company. Additionally, the court ruled that the unimproved land was an asset under Section 805(b)(4), as it was not used in the company's insurance business. The decision emphasizes the distinction between direct investment expenses and general expenses that can be allocated to investment activities, and the importance of actual use of property in determining its status as an asset.

Facts

The Union Central Life Insurance Company, a mutual life insurance company organized under Ohio law, paid an Ohio franchise tax based on its surplus during the tax years 1972, 1973, and 1974. The company allocated a portion of this tax to its investment department and deducted it as an investment expense under Section 804(c)(1). Additionally, in 1958, the company purchased a 189. 2-acre tract of land in Hamilton County, Ohio, for its new home office. By the tax years in question, the company had developed only 60 acres of this land, leaving 130 acres unimproved and unused for any direct business purpose.

Procedural History

The IRS disallowed the deductions for the franchise tax as an investment expense and included the 130 acres of unimproved land in the company's assets, leading to a deficiency determination. The Union Central Life Insurance Company petitioned the U. S. Tax Court for a redetermination of the deficiencies. The Tax Court heard the case and issued its opinion on October 13, 1981.

Issue(s)

1. Whether any portion of the Ohio franchise tax paid by the petitioner is deductible as an investment expense under Section 804(c)(1)?
2. Whether the 130 acres of unimproved land surrounding the petitioner's home office building are includable in the petitioner's 'assets' under Section 805(b)(4)?

Holding

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1. Yes, because the Ohio franchise tax is a general expense that can be allocated to the investment department based on the ratio of gross investment income to total gross income, and thus a portion is deductible as an investment expense under Section 804(c)(1).
2. Yes, because the unimproved land was not used by the petitioner in carrying on its insurance business during the years in question, and therefore must be included in the petitioner's 'assets' under Section 805(b)(4).

Court's Reasoning

The court analyzed the deductibility of the Ohio franchise tax under Section 804(c)(1) by distinguishing between 'investment expenses' and 'general expenses. ' The court found that the franchise tax, although not directly related to investment income, was a general expense attributable to both investment and underwriting activities, and thus could be allocated to investment expenses. The court rejected the IRS's argument that only expenses directly related to investment income were deductible, citing regulations and case law that allowed for the allocation of general expenses.

Regarding the unimproved land, the court applied the definition of 'assets' under Section 805(b)(4), which excludes only property used in carrying on an insurance business. The court determined that the unimproved land was not used for any business purpose during the tax years in question and was held for future development, thus qualifying as an asset. The court emphasized the importance of actual use over intended use in determining whether property is an asset.

The court's decision was influenced by the legislative history and policy considerations underlying the Life Insurance Company Income Tax Act of 1959, which aimed to allocate income and expenses between the company and policyholders based on their respective interests.

Practical Implications

This decision has significant implications for life insurance companies in determining the deductibility of state franchise taxes and the classification of property as assets for tax purposes. Companies should carefully allocate franchise taxes between investment and underwriting activities based on an appropriate method, such as the ratio of gross investment income to total gross income. The decision also clarifies that unimproved land held for future use, rather than current business operations, should be included in a company's assets, potentially increasing its tax liability.

Legal practitioners advising life insurance companies should consider the allocation of general expenses to investment activities and the actual use of property in their tax planning. The decision may also influence future cases involving the deductibility of other types of general expenses and the classification of various types of property

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as assets under the tax code.

Subsequent cases have applied this ruling in determining the deductibility of franchise taxes and the treatment of unimproved land, reinforcing the importance of proper allocation and actual use in life insurance company taxation.

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