Towne v. Commissioner, 74 T. C. 110 (1980)

Individual life insurance cannot be combined with group term life insurance to qualify as a plan of group insurance under Section 79 if it results in individual selection of insurance amounts.

Summary

In Towne v. Commissioner, the Tax Court ruled that an employer's attempt to integrate an individual term life insurance policy with an existing group term life insurance policy did not qualify as a plan of group insurance under Section 79 of the Internal Revenue Code. The case centered on whether the individual policy purchased for the company president, combined with the group policy, constituted a group insurance plan. The court found that the individual policy's provision of extra insurance to the president violated the regulation's requirement to preclude individual selection, hence it was not group term life insurance. This ruling clarifies the strict boundaries of what constitutes a group term life insurance plan for tax purposes.

Facts

M & T, Inc. provided a group term life insurance policy to its employees through Crown Life Insurance Co. , with coverage up to $25,000 based on salary. In 1975, M & T purchased an additional $500,000 individual term life insurance policy from Manufacturers Life Insurance Co. for its president, William S. Towne. The company attempted to integrate this policy with the Crown policy into a single plan to qualify under Section 79, which would allow for tax benefits. The individual policy's premium was significantly higher due to Towne's health rating.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Towne's 1975 income tax, claiming that the individual policy did not qualify under Section 79. Towne petitioned the U. S. Tax Court to challenge this determination. The case was initially tried before Judge Cynthia H. Hall, but reassigned to Judge Meade Whitaker for disposition following Hall's resignation.

Issue(s)

1. Whether the individual term life insurance policy purchased for William S. Towne, when combined with the existing group term life insurance policy, constitutes a plan of group insurance under Section 79 of the Internal Revenue Code.
2. Whether the requirement that a plan of group insurance must preclude individual selection is a valid regulatory interpretation of Section 79.

Holding

1. No, because the combination of the individual policy with the group policy resulted in individual selection of insurance amounts, which violates the regulations under Section 79.
2. Yes, because the requirement to preclude individual selection aligns with the traditional definition of group term life insurance within the insurance industry and state laws.

Court’s Reasoning

The court applied Section 79 and its regulations, focusing on the requirement that a plan of group insurance must preclude individual selection in both the availability and the amount of insurance protection provided. The court found that providing an additional $500,000 to the president was individual selection, as it did not fit within the general formula based on salary used by the Crown policy. The court rejected the argument that the combination of salary and position constituted a valid formula, emphasizing that a formula must apply to more than one individual to avoid individual selection. The court also upheld the validity of the regulations, noting that the requirement to preclude individual selection was consistent with the traditional definition of group term life insurance as recognized by the insurance industry and state laws. The court cited historical industry standards and state regulations to support its conclusion that individual selection is incompatible with group term life insurance. The court also referenced prior case law, such as Commissioner v. South Texas Lumber Co. , to affirm the validity of the regulations.

Practical Implications

This decision has significant implications for employers seeking to structure life insurance benefits to gain tax advantages under Section 79. It reinforces the strict interpretation of what constitutes a plan of group insurance, particularly the requirement to preclude individual selection. Employers must ensure that any life insurance plan uniformly applies to all eligible employees without favoring specific individuals. This ruling may lead to increased scrutiny of employer insurance plans by the IRS to ensure compliance with Section 79 regulations. Furthermore, it may influence how insurance companies structure their policies to align with the legal definition of group term life insurance. Subsequent cases, such as those challenging similar arrangements, will likely cite Towne v. Commissioner to argue the necessity of adhering to the prohibition on individual selection.