Whitcomb v. Commissioner, 81 T. C. 505 (1983)

Life insurance premiums are not deductible as compensation unless paid with the intent to compensate for services, and group-term life insurance must preclude individual selection of coverage amounts to qualify for tax exclusion.

Summary

Arthur Whitcomb, after retiring as president of a family-controlled corporation, continued to receive services from the company without formal compensation. The company purchased a $1 million term life insurance policy on Whitcomb's life, aiming to provide liquidity for his estate. The IRS challenged the company's deduction of the premiums and the exclusion of these premiums from Whitcomb's income. The Tax Court held that the premiums were not deductible because they were not intended as compensation, and the insurance did not qualify as group-term life insurance under IRS regulations due to individual selection of coverage amounts, thus the premiums were includable in Whitcomb's income.

Facts

Arthur K. Whitcomb founded and ran Arthur Whitcomb, Inc. , a family-controlled corporation, until his retirement in 1971. Post-retirement, he continued to provide services to the company during part of the year. In 1973, the company purchased a $1 million whole life insurance policy on Whitcomb's life, with the company as beneficiary, to fund estate tax liabilities upon his death. In 1974, this was replaced with a $1 million term policy, with Whitcomb's son and daughter as beneficiaries, intended to purchase stock from his estate. Concurrently, a group life insurance plan was adopted, offering $1 million coverage to an active or retired president with 25 years of service, which only Whitcomb qualified for at the time.

Procedural History

The IRS issued a deficiency notice disallowing the company's deduction of the insurance premiums and requiring Whitcomb to include the premiums in his income. The case was brought before the U. S. Tax Court, which upheld the IRS's determinations.

Issue(s)

1. Whether the company can deduct the premiums paid on the term life insurance policy on Whitcomb's life as an ordinary and necessary business expense under Section 162 of the Internal Revenue Code.
2. Whether the premiums paid by the company for the term life insurance policy on Whitcomb's life are includable in Whitcomb's gross income under Section 61 of the Internal Revenue Code.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. No, because the premiums were not paid with the intent to compensate Whitcomb for services rendered either before or after his retirement.
2. Yes, because the term life insurance policy on Whitcomb's life did not qualify as group-term life insurance under Section 79 of the Internal Revenue Code, as it allowed for individual selection of coverage amounts.

Court's Reasoning

The court found that the premiums were not deductible under Section 162 because they were not intended as compensation but rather to provide liquidity for Whitcomb's estate. The court cited the lack of evidence showing an intent to compensate Whitcomb and emphasized that the premiums were not linked to services rendered. Regarding the inclusion in gross income under Section 61, the court determined that the insurance did not qualify as group-term life insurance because the plan allowed for individual selection of coverage amounts, contrary to IRS regulations. The court noted that while the plan theoretically allowed for more than one person to qualify for the $1 million coverage, it was designed solely for Whitcomb, indicating individual selection. The court also reinforced its decision by citing regulations stating that group-term life insurance must be provided as compensation for personal services to qualify for exclusion.

Practical Implications

This decision clarifies that life insurance premiums are not deductible as business expenses unless they are intended as compensation for services rendered. Companies must ensure that such premiums are clearly linked to compensation for services to claim deductions. Additionally, to qualify for tax exclusion under Section 79, group-term life insurance plans must preclude individual selection of coverage amounts, even if the plan is structured to appear general. This ruling impacts estate planning strategies involving life insurance, requiring careful structuring to meet tax requirements. Later cases, such as Towne v. Commissioner, have further refined the application of these principles, emphasizing the need for plans to be genuinely non-discriminatory to qualify for favorable tax treatment.

© 2025 SCOTUSreports.com. All rights reserved.