National Savings Life Insurance Company v. Commissioner, 84 T. C. 509 (1985)

Life insurance reserves acquired in a merger need not be revalued for tax purposes at the time of acquisition, but only at the end of the year in which the merger occurs.

Summary

In National Savings Life Insurance Company v. Commissioner, the court addressed the revaluation of life insurance reserves after a merger. National Savings acquired reserves from Progressive through a statutory merger, with National Savings having elected to revalue its reserves under section 818(c), while Progressive had not. The court held that National Savings was not required to revalue the acquired reserves as of the merger date for tax purposes, only at the year's end, impacting the calculation of deductible reserve increases for tax purposes. The case also clarified the method of revaluing reserves for policies with both term and permanent insurance components, and confirmed that certain accident and health policies qualified as guaranteed renewable.

Facts

National Savings Life Insurance Company, having elected to revalue its life insurance reserves under section 818(c), merged with Progressive Citizen Life Insurance Company on August 19, 1970. Progressive had not elected to revalue its reserves. National Savings succeeded to Progressive's insurance contracts and reserves, which were computed on a preliminary term basis. The issue arose over whether National Savings needed to revalue Progressive's reserves at the time of the merger or could wait until the end of the tax year. Additionally, National Savings held policies with varying death benefits, and the case involved determining the appropriate revaluation method for these policies and the classification of certain accident and health policies as guaranteed renewable.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in National Savings' federal income taxes for 1972-1974, asserting that National Savings should have revalued Progressive's acquired reserves at the time of the merger. National Savings disputed this, leading to the case being heard by the United States Tax Court. The court's decision focused on the interpretation of sections 381 and 818(c) of the Internal Revenue Code, and relevant regulations.

Issue(s)

1. Whether National Savings must revalue life insurance reserves acquired from Progressive at the time of the merger under section 381.
2. Whether National Savings may utilize the statutory formula for life insurance

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other than term insurance when revaluing reserves for certain contracts.
3. Whether National Savings' renewable accident and health insurance policies in force for two years or less qualify as "guaranteed renewable" under section 1. 801-3(d) of the Income Tax Regulations.

Holding

1. No, because section 381 and its regulations require National Savings to add the unrevalued dollar balance of Progressive's reserves to its opening balance for the year, not the revalued amount.
2. No, because the court determined that National Savings must segregate its contracts into term and permanent insurance components for revaluation purposes, applying different formulas to each component.
3. Yes, because the court followed prior decisions that policies in force for two years or less qualify as "guaranteed renewable" under section 1. 801-3(d).

Court's Reasoning

The court's analysis centered on the interpretation of sections 381 and 818(c) and their regulations. For issue 1, the court found that section 381(c)(4) and its regulations require the acquiring corporation to take into account the dollar balance of reserves as computed by the transferor corporation, not the revalued amount. This decision was based on the need to prevent National Savings from taking a deduction that Progressive had already claimed. For issue 2, the court rejected National Savings' unitary view of its policies, instead adopting a segregated view that requires different revaluation formulas for term and permanent insurance components. This was to align with the policy behind section 818(c), which aims to approximate the difference between preliminary term and net level premium reserves. For issue 3, the court followed its prior rulings in National States Insurance Co. and United Fire Insurance Co. , holding that policies in force for two years or less are "guaranteed renewable" and eligible for revaluation under section 818(c). The court also emphasized that the revaluation formulas under section 818(c)(2) should be applied to the facially discernible components of coverage in force during the tax year, with reserve allocations based on what would have been required for separate policies.

Practical Implications

This decision impacts how life insurance companies should handle reserve revaluations post-merger. Companies must add the unrevalued dollar balance of acquired reserves to their opening balance, only revaluing these reserves at year's end. This affects the calculation of deductible reserve increases, potentially leading to significant tax implications. For policies with both term and permanent insurance components, companies must segregate these components for revaluation purposes, which could influence how such policies are structured and sold. The decision also confirms that certain accident and health policies qualify as guaranteed renewable,

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impacting how reserves are calculated and reported for tax purposes. Subsequent cases have applied this ruling in similar merger scenarios, and it has influenced the drafting of regulations and guidance on reserve revaluation and policy classification.

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