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TAXATION — INCOME TAX — INSURANCE — AMOUNTS RECEIVED BY STOCKHOLDERS UNDER LIFE INSURANCE CONTRACT — A corporation took out several policies of insurance on the life of its president, naming itself as beneficiary. Later, reserving the right to hypothecate the policies, it assigned them to a trustee who agreed to distribute the proceeds of the policies to the stockholders of record at the time of the president's death. At the death of the president the proceeds were paid by the insurance companies to the trustee who then paid them pro rata to the stockholders. At this time the corporation had on hand earnings equivalent to the amount of distribution, and there was no showing that any of these earnings were made before March 1, 1913. The stockholders were taxed on the distributions and paid under protest. The board of tax appeals confirmed the findings of the commissioner. *Held*, that the stockholders did not receive the distributions under a contract of insurance, but as dividends of the corporation, and that the proceeds received by the stockholders were therefore not exempt under section 22 (b) (1) of the Revenue Act of 1934.[1] *Golden v. Commissioner of Internal Revenue*, (C. C. A. 3d, 1940) 113 F. (2d) 590.[2]

[1] "The following items shall not be included in gross income and shall be exempt from taxation under this title: (1) Amounts received under a life insurance contract paid by reason of the death of the insured. . . ." 48 Stat. L. 687 (1934), 26 U. S. C. (1934), § 22 (b).

[2] In a dissenting opinion Justice Buffington held that the proceeds in the hands

The practice of a corporation's insuring important executives has been common for many years. It is settled that the corporation has an insurable interest because of the loss it would suffer by the death of one of these men.[3] The main question concerning such policies relates to their taxability, not only to the corporation, but also to the stockholders when the proceeds are distributed to them. Proceeds from life insurance contracts have long been exempt from the federal income tax.[4] The exemption contained in section 22 (b) (1), however, pertains only to the recipient of the proceeds under the contract of insurance.[5] When the proceeds of a life insurance policy are received by a corporation, they become part of the surplus of the corporation, and their distribution to the stockholders is taxable to the stockholders as dividends.[6] It has not been definitely decided whether such proceeds are "earnings or profits" of the corporation within the meaning of the Revenue Acts[7] and, therefore, taxable as dividends when distributed. The cases on the subject so far have not had to answer that question, but have found it settled for them by the conclusive presumption contained in section 115 (b).[8] The principal case presents a situation one step removed from

of the stockholders were not taxable because the policy actually was paid for by the stockholders, and because the corporation ceased to be the real beneficiary by assignment of the policy to the trustee.

[3] 1 COOLEY, BRIEFS ON INSURANCE 396 (1927).

[4] The question whether Congress has the power to tax life insurance proceeds as income under the Sixteenth Amendment to the Constitution has not been decided. The point was raised in United States v. Supplee-Biddle Hardware Co., 265 U. S. 189, 44 S. Ct. 546 (1924), but the Court decided that Congress had not intended to tax such proceeds under the Revenue Act of 1918. See 119 A. L. R. 1195 at 1196-1197 (1939); MAGILL, TAXABLE INCOME 335 (1936), where it is argued that such proceeds are income and can be taxed.

[5] See note 1, supra. This section is the same in the 1939 act. For the history of the section, see Neuhoff, "Gross Income and Deductions Under State Income Tax Laws," 22 IOWA L. REV. 185 at 186 ff. (1937). To the effect that the section pertains only to the recipient of the proceeds, see Paul, "Ascertainment of 'Earnings or Profits' for the Purpose of Determining Taxability of Corporate Distributions," 51 HARV. L. REV. 40 at 48 ff. (1937).

[6] Re May, 20 B. T. A. 282 (1930); Cummings v. Commissioner of Internal Revenue, (C. C. A. 1st, 1934) 73 F. (2d) 477, affg. 28 B. T. A. 1045 (1933); I. T. 2131, IV-4 CUM. BUL. 90 at 91 (1925), wherein the Solicitor of Internal Revenue stated, "It is, therefore, held that where the proceeds of a life insurance policy are paid to a corporation as beneficiary, the fund loses its identity after such payment, and dividends paid by the corporation out of such fund are taxable in the same manner and to the same extent as other dividends."

[7] "The term 'dividend' when used in this title . . . means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913." 48 Stat. L. 711 (1934), 26 U. S. C. (1934), § 115 (a). An addition was made to this section in the act of 1936, and retained in the 1939 act, which includes distributions made out of earnings and profits of the taxable year. 53 Stat. L. 46 (1939), 26 U. S. C. (Supp. 1939), § 115 (a). See MAGILL, TAXABLE INCOME 335 ff. (1936), where it is argued that insurance policy proceeds are "earnings or profits" within the meaning of these statutes.

[8] "For the purposes of this Act every distribution is made out of earnings or profits

the previous cases on the subject. Here the stockholders argued that they received the proceeds under the contract of insurance, as beneficiaries of the trust, and did not receive them as dividends from the corporation.[9] Although the court found that a valid formal trust had been created by the assignment of the policies to the trustee, it still held the proceeds taxable as dividends because the corporation had lost an interest in the policies which under existing corporate law it could give away only as dividends.[10] This decision leaves open the problem what kind of trust must be set up before the stockholders are deemed to receive the proceeds under the insurance contract as provided in the treasury regulations.[11] Even if the policies in this case had been irrevocably assigned to the trustee, the proceeds received by the stockholders would be taxable under the reasoning of the court, for there would still be a transfer of assets from the corporation to the stockholder. In that situation, however, the base of the tax would be the surrender value of the policy at the time of the assignment instead of its face value.[12] The treasury regulations would then apply to make the difference between the cash surrender value and the face value of the policy tax-free as money received under a contract of insurance; and if the policy were assigned shortly after it was taken out by the corporation the amount of the tax would be small. Perhaps the only other way of bringing the stockholders within the contract of insurance would be to follow closely the suggestion of the court in *Cummings v. Commissioner of Internal Revenue*[13] and take the policy out in the name of the corporation as trustee for the stockholders.

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to the extent thereof, and from the most recently accumulated earnings or profits." 48 Stat. L. 711 (1934), 26 U. S. C. (1934), § 115 (b). In the instant case, and in the others cited in note 6, supra, it was found that the corporation had sufficient surplus on hand to have been able to make the same distribution without use of the insurance proceeds.

[9] The stockholders relied on a dictum in Cummings v. Commissioner of Internal Revenue, (C. C. A. 1st, 1934) 73 F. (2d) 477 at 479: "This intention could have been fulfilled in two ways: (1) By taking out the policies in the name of the company as trustee for such stockholders, in which case there would be no question but the amounts received by the petitioners were received under the life insurance contracts. . . ." The board of tax appeals distinguished the instant case from that suggestion, saying that by paying for the policies the corporation gained an asset, and by only revocably assigning it to the trustee retained the asset until the death of the president, when it was given to the stockholders. Re Golden, 39 B. T. A. 676 (1939). The circuit court did not mention the dictum.

[10] The court reasoned that the policies were assets of the corporation; that by assigning them revocably to the trusteee it retained the assets, and was not wholly divested of them until the president's death; that since the stockholders then had what the corporation owned until that event, the distribution of the proceeds by the trustee was a dividend by the corporation and therefore taxable.

[11] Treas. Reg. 86 (1935), art. 22 (b) (1)-1; Treas. Reg. 94 (1936), art. 22 (b) (1)-1.

[12] "If the transfer occurred immediately upon the execution of the distribution agreement, the dividend would be measured by the then cash surrender value of the policies, and not, as the Commissioner has done at bar, by the amount of their proceeds." Principal case, 113 F. (2d) 590 at 592.

[13] (C. C. A. 1st, 1934) 73 F. (2d) 477.