



## Federal Tax ADVISORY ■

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### Investor-Owned Life Insurance

*Webber v. Commissioner, 144 T.C. No. 17 (2015)*

Investor-owned life insurance is sort of an oxymoron because every owner of a whole life policy owns an investment: that is part of the sales pitch of the insurance company. However, there are limits on the investment features of life insurance and annuity policies. The recent decision of the U.S. Tax Court in the *Webber* case enforces one such limit: the policy owner cannot actually control the investments inside the policy—because he has no legal right to exercise such control.

#### **Facts**

Webber bought a large single premium life insurance policy on his aunt, aged 78. The issuer reinsured the annual risk and deposited the balance in a segregated fund. Webber did not have a legal right to tell the fund manager how to invest it, but in practice he did. Over several years, the fund bought into many startups that Webber was involved with or knew about as good investments. The IRS asserted that Webber should be taxed on the income of the segregated fund.

#### **Ruling**

The court agreed, applying the investor control doctrine that began with Rev. Rul. 77-85. The idea is that if the policy owner can control the fund investment, he must own the fund and its income.

Practitioners had not been sure of the vitality of the investor control doctrine, although they knew the IRS was sure of it. Subsequent to the ruling's issuance, Congress had completely rewritten the insurance tax rules and addressed in two ways the issue the investor control doctrine had aimed at. First, the Code imposed limits on the amounts that could be contributed to insurance and annuity contracts. Second, it required diversification of the policy investments.

Webber's facts skirted these limits because the fund was diversified: it just wasn't diversified in publicly traded stocks, but in private investments that the fund manager would not have known about without Webber's advice.

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## Significance

Webber's policy's paperwork did not literally grant him power to direct the investments. He could make suggestions. However, in practice over several years and many investments, the court could see that the investment manager did virtually everything it was told to do.

This type of scenario comes up with some frequency in tax practice: a counterparty may be so anxious to get your client's business that it is willing to wink at formal limits on various acts. The *Webber* ruling is a reminder that what you do rather than what you say you will do sometimes governs the tax outcome.

Of course, that principle was applied here in a very contentious area that has been under stress for 60 years: pushing the envelope on the investment features of life insurance. That is why the IRS felt the need to address it in 1977 with a newly minted doctrine.

However, the doctrine should be understood for what it rightly is: an application of standard agency or master/servant law. The IRS should not have needed a special doctrine to prove that a person under your control is your agent; and when the principal's income is received by your agent, it is still taxed to the principal. Otherwise, all that interest and dividends received by brokers would not be taxed to us.

**For additional information, call [Jack Cummings](#) at 919.862.2302.**

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