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# PAYMENTS BY A CASH BASIS FEDERAL SAVINGS AND LOAN ASSOCIATION TO THE FSLIC: ARE THEY DEDUCTIBLE?

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*The author is an attorney in a Kansas City, Missouri law firm. His topic is the deductibility for federal income tax purposes of certain "premium" payments made by federally chartered savings and loan associations to the Federal Savings and Loan Insurance Corporation (FSLIC). Recently his firm was successful in establishing this point before a federal district court, and more recently the Court of Appeals for the Ninth Circuit, reversing the Tax Court, reached a similar conclusion involving a savings and loan institution chartered under the laws of the state of California. In this article the author urges the correctness of the result in these recent cases while arguing against the reasoning of a published ruling of the Internal Revenue Service which reaches a different conclusion.*

## I. INTRODUCTION

### A. Origin of FSLIC Premium Payments

It is the duty of the FSLIC to insure accounts of all federal savings and loan associations.<sup>1</sup> It is mandatory that a federal savings and loan association (federal association) apply for and carry insurance with the FSLIC and pay the premiums for said insurance as provided by law.<sup>2</sup> A state chartered savings and loan institution whose accounts are insured by the FSLIC may terminate its insurance, but this provision does *not* apply to a federal savings and loan association.<sup>3</sup> Therefore, so long as a federally chartered and insured savings and loan association continues its status as such an association, it must pay the premiums for insurance.

Two kinds of insurance premiums may be levied by the FSLIC against a federal association.<sup>4</sup> These premiums are: (1) a basic premium of one twelfth of one percent of the sum of all accounts of the insured members (account holders) of the federal association plus any creditor obligations of the federal association;<sup>5</sup> and (2) an additional premium (described in section 1727 (d) as "in the nature of a prepayment with respect to future premiums of the institution under subsection (b)") equal to two percent of the net increase in all accounts of insured members during the next

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1. 12 U.S.C. § 1726 (a) (1964).

2. *Id.* § 1726 (b).

3. *Id.* § 1730.

4. *Id.* §§ 1727 (b) (1), (d).

5. It will be assumed the premium described here was annually paid to the FSLIC.

preceding calendar year, less an amount equal to the requirement of the federal association existing at the end of the calendar year to purchase shares of stock in the Federal Home Loan Bank Board (FHLBB).<sup>6</sup> In addition to the two above premiums, a federal association is subject to an assessment of an additional premium for insurance until the amount of all such premiums collected equals the amount of all losses and expenses of the FSLIC, except that the amount so assessed in any one year against any such institution shall not exceed one eighth of one percent of the total amount of the accounts of its insured members and creditor obligations.<sup>7</sup> However, this latter provision is not pertinent to the problem discussed here.

The FSLIC is required to establish a primary and secondary reserve in its accounts.<sup>8</sup> The primary reserve is a general reserve of the corporation and can be used for any and all purposes, expenses, contingencies, and losses. The secondary reserve is available *only* for losses of the FSLIC and is available only to the extent that other accounts (supported by assets) of the FSLIC are insufficient to cover such losses.<sup>9</sup> (The underlying assets representing the secondary reserve are at all times in the hands of the FSLIC). The FSLIC is required to credit to the secondary reserve a return on the outstanding balances of the secondary reserve at a rate equal to the average annual rate of return to the FSLIC on investments held during the year.<sup>10</sup> While no right, title, or interest of any institution with respect to its pro-rata share of the secondary reserve is assignable or transferable whether by operation of law or otherwise, except to the extent that the FSLIC may provide by regulation,<sup>11</sup> it will be assumed that *none* of the limited conditions creating a right to assign or transfer the pro-rata share of the federal association in the secondary reserve has occurred.<sup>12</sup>

### B. Premium Recapture

Hypothetically, a federal association can recapture section 1727 (d) premiums in two situations: (1) voluntary liquidation or dissolution; or (2) assumption of state charter status (in which case it is not mandatory that insurance be carried) followed by withdrawal of insurance. However, to liquidate, a federal association is required to go out of business. Voluntary dissolution or liquidation must be approved by the FHLBB and a majority

6. 12 U.S.C. § 1727 (d) (1964).

7. *Id.* § 1727 (c).

8. *Id.* § 1727 (a).

9. *Id.* § 1727 (e).

10. *Id.*

11. *Id.* The FSLIC may provide regulations governing the transfer of assets in case of a merger or consolidation, transfer of bulk assets, and similar transactions.

12. Transfer of a pro-rata share is severely limited by regulations of FSLIC and/or FHLBB to merger situations involving a transfer of all assets to a surviving association. 12 C.F.R. §§ 546.1-5 (1966) and 12 C.F.R. §§ 563.16-2 (1968).

of the members of the federal association at a duly called meeting.<sup>13</sup> A federal association therefore may not voluntarily terminate its status as an association insured by the FSLIC as long as it is a functioning federal savings and loan association.<sup>14</sup>

The conditions for involuntary termination of insurance coverage are set out in section 1730 (b) and such termination can occur only by action of the FSLIC. Only one case of involuntary termination of insurance has ever occurred in the history of the FSLIC.<sup>15</sup> If status as an insured institution is terminated,<sup>16</sup> if a conservator, receiver, or other legal custodian is appointed for an insured association,<sup>17</sup> or if the FSLIC makes a determination that the insured institution has gone into liquidation, the obligation to pay additional insurance premiums ceases and the FSLIC must either pay the insured association its pro-rata share of the secondary reserve or apply the secondary reserve towards payment of any indebtedness of the particular association to the FSLIC.<sup>18</sup> For purposes of this discussion it will be assumed that none of the conditions entitling a federal association to receive a pro-rata share of the secondary reserve has occurred during the years being considered.

### C. Regulation of Premium Payments

#### 1. By the FSLIC

If on December 31 the aggregate of the primary reserve and secondary reserve alone equals or exceeds two percent of the total amount of all accounts of the insured members (account holders in associations) plus the creditor obligations of all insured institutions, but the primary reserve does not equal or exceed two percent, no insured association shall be obligated to make premium prepayments under section 1727 (d) (the so-called additional premium) during the year beginning May 1 of the next succeeding year.<sup>19</sup> Also section 1727 (b) provides that each insured institution's pro-rata

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13. 12 C.F.R. §§ 546.1-.5 (1966). The number of voluntary dissolutions or liquidations is minimal as noted by the fact that since 1953 only three federal savings and loan associations have dissolved voluntarily. In more recent years (1963-65) no federal savings and loan association has dissolved voluntarily.

Converting to state charter status followed by a termination of insurance is also subject to severe limitations imposed by 12 U.S.C. § 1464 (1) (1964), and 12 C.F.R. § 546.5 (1961). The fact that conversion to state charter status followed by termination of insurance is unlikely is demonstrated by the fact that from 1935 to 1965 there have been no instances in which a federal savings and loan has done this. See also FHLBB, ANNUAL REPORT 62 (1966) which points out the difficulties a state chartered savings and loan association encounters in competing with a federally insured savings and loan association.

14. 12 U.S.C. § 1730 (a) (1964).

15. See FHLBB ANNUAL REPORT 62 (1966).

16. 12 U.S.C. § 1730 (1965).

17. *Id.* § 1724.

18. See 12 U.S.C. § 1727 (d) (1968).

19. *Id.* § 1727 (g).

share of the secondary reserve shall be used to the extent available to discharge its basic premium obligation.<sup>20</sup>

The suspension of the obligation to make current premium prepayments and the use of the institution's pro-rata share of the secondary reserve continues until the period specified in section 1727 (g). By that section, if on December 31 the *aggregate* of the primary reserve and secondary reserve of the FSLIC is not at least equal to one and three quarters percent of the sum of all accounts of insured members plus creditor obligations of all insured institutions, the obligation of each insured institution to make premium prepayments resumes on the following May 1, and the use of any insured institution's pro-rata share of the secondary reserve terminates with respect to its premium for the premium year beginning during the calendar year.

If on December 31 the primary reserve of the FSLIC equals or exceeds two percent of the sum of all accounts of the insured members of all insured institutions plus all creditor obligations of all such insured institutions, the FSLIC is to pay *cash* to each insured institution equal to its pro-rata share of the secondary reserve and shall not accept or receive further payments of said "prepayments."<sup>21</sup>

Other provisions set out further duties and authority of the FSLIC. Each institution is required to make deposits in FSLIC as may from time to time be requested by the FSLIC.<sup>22</sup> Provision is made for payment of insurance by the FSLIC to savings and loan association account owners or holders (not the institutions).<sup>23</sup> The FSLIC is authorized to facilitate liquidation of insured institutions, including the use of the device of appointment of the FSLIC as conservator or receiver to operate associations in default.<sup>24</sup>

## 2. Legislative Purpose

Congress has indicated the purpose of providing for the payment of the additional premium required under section 1727 (d). The committee report shows that the purpose of the bill was to strengthen the FSLIC which insures savings accounts in savings and loan associations.<sup>25</sup> Under the law

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20. *Id.* § 1727 (b).

21. It will be assumed that none of the conditions which entitle a federal association to discontinue making the additional premium payments, to have its share of the secondary reserve applied to payment of its premium liability, or to receive any part of the secondary reserve in cash or equivalent has occurred.

22. 12 U.S.C. § 1727 (h) (1) (1965).

23. *Id.* § 1728.

24. *Id.* § 1729.

25. The legislative history of Public Law 87-210 adopted in 1961 to amend 12 U.S.C. § 1727 (1964) to provide for payment of additional premiums in the nature of prepayments with respect to future premium payments to be paid to FSLIC and to be credited to FSLIC's secondary reserve, is found in S. REP. NO. 778, 87th Cong., 1st Sess. (1961) to accompany H.R. 7108 and H. REP. NO. 823, 87th Cong., 1st Sess. (1961). The Senate Report is set out at pages 2610-2621 inclusive of 2 U.S. CODE CONG. & AD. NEWS, 87th Cong., 1st Sess. 2610 (1961).

as it existed at date of enactment of the bill, each insured institution was required to pay an annual premium of one twelfth of one percent of the sum of the accounts of its insured members and of its creditor liabilities to the FSLIC. In addition, each member institution was required to purchase stock in its federal home loan bank amounting to two percent of the unpaid principal of outstanding home mortgage loans and other similar obligations.

After revision of the law, each insured institution was required to pay an insurance premium prepayment equal to two percent of the annual net increase of the accounts of its insured members in addition to the usual one twelfth of one percent annual premium. These prepayments were offset in part because the proposed bill reduced the home loan bank stock purchase requirement. The committee report showed that, due to the rapid growth of insured institutions, the ratio of FSLIC reserves to potential liability had dropped. According to the committee report there was general agreement that FSLIC reserves should be built up at a faster rate.<sup>26</sup>

In its final form the bill provided for an annual insurance premium prepayment of two percent of the net increase in accounts during the preceding calendar year less an amount equal to the cost of any stock required to be purchased in federal home loan banks. In addition, the FSLIC was directed to establish a primary reserve to be used as a general reserve and a secondary reserve to which these premium prepayments would be credited on the books of the FSLIC. If the primary reserve and any other accounts available for losses proved insufficient to meet all FSLIC losses, the secondary reserve was available for that purpose. In other words, prepayments served as an additional reserve for losses. When the aggregate of the primary and secondary reserves reached an amount equal to two percent of the sum of all accounts of insured institutions plus creditor obligations of insured institutions, prepayments stopped and each institution's pro-rata share of the secondary reserve would be used, so far as available, to discharge its obligations for regular annual premiums. If the aggregate of the two reserves fell below one and three quarters percent, prepayments would be resumed and use of the secondary reserve would cease. However, if the primary reserve reached two percent of the base figure, the FSLIC would pay an amount in cash to each institution equal to its pro-rata share of the secondary reserve and premium prepayments would cease. The bill also required each insured institution to pay the regular premium of one twelfth of one percent (base premium) for at least twenty years.<sup>27</sup>

### 3. *Lincoln Savings & Loan Ass'n*<sup>28</sup>

The Tax Court in *Lincoln* took the position that regardless of whether section 1727 (d) payments are characterized as prepaid insurance premiums,

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26. *Id.*

27. It will be assumed that the federal association discussed here has paid the premiums to FSLIC for the years under consideration.

28. 51 T.C. 82 (1968).

they are in the nature of a capital outlay and therefore not deductible as a business expense in the year paid.<sup>29</sup>

In reaching the above conclusion the first factor the court relied on was the accounting treatment the FSLIC gives section 1727 (d) payments. A distinction was made between section 1727 (b) payments (regular annual premiums) and section 1727 (d) payments. Section 1727 (b) payments lose their distinctive character as premiums and become part of the FSLIC's gross income and as such can be used to meet operating expenses and insurance losses. If not used, they are transferred to the primary reserve which is available to meet FSLIC insurance losses (the insured institution retains no rights in respect of such sums other than the right to insurance coverage). Section 1727 (d) payments, however, are segregated in the secondary reserve and are not considered income to the FSLIC and, ordinarily, are not available to meet its expenses and losses.

The secondary reserve is treated like a *capital account* in that it may be applied against losses only in the event that regular insurance premiums, other income, and retained earnings have all been depleted. Also, section 1727 (e) directs the FSLIC to credit the outstanding balance in the secondary reserve with a return computed at a rate equal to the average rate of return to the FSLIC on its investments. What is more important, each insured institution maintains an interest in a pro-rata share of the secondary reserve and the FSLIC keeps a separate account for each institution.

A second factor considered by the Tax Court was the likelihood of an insured institution realizing the full value of its pro-rata share of the secondary reserve. The court pointed out that

while petitioner's pro-rata share of the secondary reserve is not, as a general rule, assignable or transferable, 'by operation of law or otherwise,' the value of such share may be fully realized through its transfer to another insured institution in a merger, consolidation, or bulk sale; petitioner may even receive the value of its share from the FSLIC in cash if (1) its insured status is terminated, either voluntarily or involuntarily, (2) it goes into liquidation, voluntarily or involuntarily, or (3) the obligation to make section 1727 (d) payments is permanently terminated and the secondary reserve distributed before the value of its share has otherwise been fully recovered. . . . Moreover, assuming petitioner does not realize the value of its pro-rata share in one of the above ways, it is reasonably assured of receiving full value therefore in the form of insurance coverage in future years when its share of the secondary reserve is used to pay its regular section 1727 (b) (1) premiums.<sup>30</sup>

The Tax Court also considered the history of section 1727 (d) and concluded that payments under this section were regarded by Congress as being

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29. *Id.* at 94.

30. *Id.* at 96.

a substitute for investments in the capital stock of the federal home loan banks which member institutions were theretofore required to make.

The conclusion of the Tax Court was that section 1727 (d) payments do not provide insurance coverage in the year of payment and thus are not an ordinary and necessary expense of that year. Instead, these payments result in the acquisition of an asset which, if held to maturity, will result in a benefit in the form of insurance coverage in future years at which time the taxpayer would be entitled to a deduction from ordinary income.

The Court of Appeals for the Ninth Circuit,<sup>31</sup> however, took issue with the Tax Court's approach to the problem and held that section 1727 (d) premium payments made by a state-chartered<sup>32</sup> savings and loan association using the cash receipts and disbursements method of accounting are deductible as ordinary and necessary business expenses in the year they are paid.

The court based its decision on four considerations. First, issue was taken with the Tax Court's emphasis of the treatment given section 1727 (d) payments by the FSLIC (treated like a capital account). Instead of stressing the treatment given the payments by the FSLIC, the court felt that the proper focus of attention should have been on the taxpayer and his business. When this approach is used, "[t]o treat the payments of premiums to the secondary reserve as the acquisition of a capital asset . . . [would be] . . . a departure from the basic concept of accounting for receipts and disbursements in the year made. . . ."<sup>33</sup>

Second, the Court contended that the Commissioner's consideration of the possibility of reimbursement because of liquidation or receivership ignored the basic taxation assumption that a corporate taxpayer is a "going concern" and will continue indefinitely. The possibility of reimbursement by the taxpayer's voluntary act of termination of insurance coverage also falls under this concept because termination is tantamount to liquidation or receivership since it would cause a mass withdrawal by depositors.<sup>34</sup>

Third, the Tax Court's ruling appeared internally inconsistent.

It declares (1) that the payments to the Secondary Reserve were not deductible until any possibility of their return was precluded; also (2) that earnings on the Secondary Reserve are taxable to the taxpayer only when they become available to it without substantial restriction or are paid out for its benefit. When we consider

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31. *Lincoln Savings & Loan Ass'n v. Comm'r*, —F.2d — (9th Cir. 1970).

32. The court felt that the fact that *Lincoln* was a state chartered savings and loan association and thus was not required to insure its deposits with the FSLIC was of no significance since the evidence showed that, as a practical matter, loss of insured status with the FSLIC would have caused a mass withdrawal of savings by depositors.

33. *Lincoln Savings & Loan Ass'n v. Comm'r*, — F.2d — (9th Cir. 1970).

34. This concept is so basic that Congress has provided a specific exemption for corporations formed or acquired primarily for liquidation. See 26 U.S.C. § 341 (1964).



that under the "claim of right" doctrine, there must be an impossibility of even constructive possession to defeat taxation of income and that a non-contractual obligation of repayment will not defeat it . . . in the context of the "all events" test fixing the accounting period for the allowance of deductions as the one in which all events had occurred which fixed the amount and the fact of the liability . . . there is an incongruity in a ruling that the income credited to the Secondary Reserve allocated to the taxpayer was not then taxable because of the restrictions on its use, while at the same time these same restrictions precluded deduction of the premium payments as business expenses. If there were so many restrictions on the funds paid to FSLIC that the income derived therefrom was not even constructively received and was not taxable when credited, *a fortiori* these same restrictions on reimbursement or recapture of the funds made the payment final and deductible in the year it was made. All events had occurred which fixed the amount and the fact of the liability.<sup>35</sup>

Finally, the court cited a 1964 Senate Report which reaffirmed basic Congressional policy that "the objective of the reporting of items of income and deduction under the internal revenue law generally is to realistically and practically match receipts and disbursements attributable to specific taxable years."<sup>36</sup> This statement was used by the Court to support the recognition of deductions in the year of payment rather than postponing them because of "contingent and sometimes quite illusory possibilities of recapture."<sup>37</sup>

## II. DEDUCTIBILITY OF PREMIUM PAYMENTS

### A. *Business Expense*

Treasury regulations provide that amounts representing allowable deductions by a taxpayer using the cash receipts and disbursements method of tax accounting as a general rule shall be taken into account (deducted) for the taxable year in which paid.<sup>38</sup> There is also a provision which requires a taxpayer who ascertains that deductions should have been claimed in a prior tax year to file a claim for a refund of any overpayment of tax arising therefrom if the statute of limitations has not run.<sup>39</sup>

35. *Lincoln Savings & Loan Ass'n v. Comm'r.*, — F.2d — (9th Cir. 1970).

36. *Id.* citing U.S. CODE CONG. OF AD. NEWS, 88th Cong., 2d Sess. 1773 (1964).

37. *Lincoln Savings & Loan Ass'n v. Comm'r.*, — F.2d — (9th Cir. 1970).

38. Treas. Reg. § 1.446-1 (a) (1), (i) (1957). Section 461 of the Internal Revenue Code provides that the amount of any deductions allowed shall be taken for the tax year which is the proper taxable year under the method of accounting used in computing taxable income.

39. It will be assumed that the particular federal association under consideration reports its income on the cash receipts basis, which is a permissible method of tax accounting. Under INT. REV. CODE of 1954, § 162, it is provided that there shall be allowed as a deduction, all ordinary and necessary expense paid for or incurred in carrying on a trade or business. A federal savings and loan association falls under this section of the code.

The regulations also provide that business expenses which are deductible from gross income include ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as basis for a deduction under provisions of law other than section 162 of the Internal Revenue Code.<sup>40</sup> Items included in business expense are management expenses, commissions, labor costs, supplies, and incidental repairs; traveling expenses while away from home related to the business; advertising and selling expenses, together with insurance premiums against fire, storm, theft, accident or other similar losses in the case of a business; and rental of business property.<sup>41</sup>

It would seem that a federal association paying the premium prepayments noted above would come within the provisions of the above described section of the Internal Revenue Code and regulations issued thereunder, and that the disposition of the problem is controlled by prior decisions and the regulations.<sup>42</sup>

### 1. *Weber Paper Co. v. United States*<sup>43</sup>

In *Weber* the plaintiff using the cash receipts and disbursements method of accounting had deducted on its 1956, 1957, and 1958 federal income tax returns as ordinary and necessary business expenses certain premium deposits under an insurance policy for loss occasioned by flood. Upon examination of the returns, the Service disallowed all but one percent of the premium deposits. Under the arrangement with the insurers, a reciprocal inter-insurance exchange, the full amount of the premium deposit was, except for one percent thereof, required to be credited pro-rata to a catastrophe loss account maintained in name of the policyholder-subscriber which was to be used for payment of flood losses of other subscriber-policyholders. The one percent not credited to the catastrophe loss account was credited to a general reserve fund for use if the catastrophe loss account proved insufficient to cover losses. This one percent was non-withdrawable. Funds credited to the catastrophe loss account and the general reserve fund were required to be invested. At the close of each year, the unencumbered balance of earnings on the investments was to be credited on a pro-rata basis to the catastrophe loss account of each subscriber-policyholder subject to a prior deduction for payment of expenses of operation.<sup>44</sup>

The credit balance in the catastrophe loss account of each subscriber-policyholder was subject to withdrawal upon sixty days written notice effective immediately after the end of the current policy year. Under the

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40. Treas. Reg. § 1.162-1 (a) (1965).

41. A wide variety of expenditures have been held deductible as ordinary and necessary business expenses including insurance premiums.

42. The proper treatment of additional insurance premiums paid by a cash basis federal association to FSLIC is that such amounts should be deductible in the year paid under INT. REV. CODE of 1954, § 162.

43. 204 F. Supp. 394 (W.D. Mo. 1962), *aff'd*, 320 F.2d 199 (8th Cir. 1963).

44. *Id.* at 399.

insurance policy, a policyholder suffering flood loss was reimbursed out of his own and other subscribers' catastrophe loss reserve accounts. Thereafter, in the event the subscriber terminated his participation in the plan, he would either be entitled to withdraw an amount equal to the current balance in his catastrophe loss reserve account, or he could use this balance to effect additional policy coverage. Thus a subscriber-policyholder could realize total recovery either through paid losses or eventual refund or credits. On the other hand, if losses were sustained by other subscribers and charged pro-rata to his catastrophe loss account, the amount eventually received by him on withdrawal would be substantially less than the amount of premium deposits paid.<sup>45</sup>

The Service admitted that premiums initially passed beyond the possession and control of policyholder-subscribers and that expenditures by the policyholder-subscriber were connected with his trade or business.<sup>46</sup> Evidence showed that in all mutual insurance companies it was the practice to collect premiums substantially in excess of losses expected during the current term of the policy with the excess constituting a guarantee fund out of which extraordinary losses were met. Evidence also showed that it was expected that eventually a portion of the premium representing the difference between losses and expenses actually sustained and premium deposits collected (sometimes referred to as the "redundancy" of premium deposits) would be returned to the policyholder.<sup>47</sup> Such a "redundancy" factor was early recognized in *Penn Mutual Life Insurance Company v. Lederer*<sup>48</sup> as running as high as ninety percent or more of premiums paid.

The Service had previously taken the position that amounts paid by policyholders as premiums to a mutual insurance company were fully deductible even though there was a likelihood that a part of the premium might be returned to the policyholder.<sup>49</sup> But prior to the litigation in *Weber*, the Service had specifically ruled that annual premium deposits paid under such a flood insurance arrangement were *non-deductible* by policyholders (except to the extent of one percent credited to general reserve fund)<sup>50</sup> on the ground that the payments credited to the catastrophe loss account represented a non-deductible contingent deposit to the extent of the right of withdrawal by taxpayer policyholder-subscriber.

Based on that ruling, the Service disallowed the deduction. Thereafter taxpayer paid the asserted tax, filed a refund claim, and upon disallowance, filed suit for a refund in the United States District Court for the Western District of Missouri.<sup>51</sup> The District Court held that the revenue ruling in

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45. *Id.* at 400.

46. *Id.*

47. *Id.*

48. 252 U.S. 523 (1920).

49. GG.C.M. 10798, XI-2 CUM. BULL. 58 (1932); I.T. 2646, XI-2 CUM. BULL. 59 (1932).

50. Rev. Rul. 60-275; 1960-62 Cum. Bull. 43.

51. 204 F. Supp. 394 (W.D. Mo. 1962). The government based its case on Rev. Rul. 60-275; 1960-62 Cum. Bull. 43.

question did not constitute a correct interpretation of the law applicable to the case and therefore should not be followed. It further held that the annual premium deposit paid for flood insurance was *fully deductible* as an ordinary and necessary business expense.<sup>52</sup>

The government appealed to the Court of Appeals for the Eighth Circuit which affirmed the District Court decision on the ground that the trial court's findings of fact and conclusions of law supported its judgment.<sup>53</sup> The Appellate Court concluded that the insurer was a legitimate insurer of flood risks and that the premiums paid for flood insurance were payments which the taxpayer in the conduct of its business was required to make to obtain the protection desired. This decision has significance because of the classification of the FSLIC as a type of mutual insurance company.

## 2. *Waldheim Realty & Investment Co. v. Commissioner*<sup>54</sup>

In *Waldheim* the issue was whether a cash basis taxpayer who had consistently deducted premiums for fire insurance coverage extending over a period of three years or longer, could deduct these payments in the year they were made. The Tax Court held that the taxpayer could not deduct that part of the insurance premiums allocable to coverage for a period beyond the year of payment. The Court of Appeals for the Eighth Circuit reversed the Tax Court and held that prepaid insurance was not a capital asset even though some salvage value could be realized at the end of the tax year by cancellation of the policy. The court further held that a taxpayer reporting on the cash basis *could deduct* the insurance premiums in the year they were paid and that no distortion of income would result therefrom.<sup>55</sup> Thus the holdings in the *Weber* and *Waldheim* cases tend to show that FSLIC insurance premium prepayments are deductible by a cash basis federal association in the year of payment and indicate the invalidity of Rev. Rul. 66-49 discussed below.

### B. *Revenue Ruling 66-49*

In the Treasury Regulations, the Commissioner has taken the position that banking corporations which are required by state law to set aside certain funds as a "depositor's guaranty fund" may deduct the amounts of such funds provided that they cease to be assets of the bank and are subject to withdrawal by state officials to reimburse depositors in insolvent banks and provided that the funds are not subject to return to the assets of the banking corporation under applicable state law. The regulations clearly state that if such funds have simply been "set up" on the books to meet contingent liabilities and do not cease to be assets, they will not be de-

52. *Id.* at 400.

53. 320 F.2d 199 (8th Cir. 1963).

54. 245 F.2d 823 (8th Cir. 1957).

55. *Id.* at 826.

ductible.<sup>56</sup> Relating to the status of the two percent insurance premium prepayments made by a federally chartered and insured savings and loan association to FSLIC and credited by FSLIC to the secondary reserve, the Service issued Rev. Rul. 66-44 which makes these premium prepayments nondeductible by cash basis savings and loan associations.<sup>57</sup> The ruling states that:

[a] savings and loan institution retains at all times an interest in the secondary reserve fund equal to the unexpended portion of its contributions thereto, the amount of which is readily determinable and which is returnable to it, under specified circumstances. Accordingly these additional payments are not deductible until they are used to pay regular premiums or losses, or the possibility of their return to the institutions is otherwise precluded.<sup>58</sup>

. . . .

With respect to cash basis taxpayers, there exists a substantial restriction or limitation on withdrawal of amounts credited to an individual institution's secondary reserve account. Accordingly, earnings credited to such an institution's balance in the secondary reserve account are not deductible in the gross income of that institution until they are used to pay its obligations, such as regular premiums of the institution due to the FSLIC, or until they become available to that institution without substantial restriction or limitation.<sup>59</sup>

### C. Criticism of Revenue Ruling 66-49

The fact that FHLBB or FSLIC rules do not require the insurance premium prepayments to be shown as an asset on the accounts of a reporting federal savings and loan association is not determinative of proper treatment of such payments for federal income tax purposes. The basic rule is that accounting methods required by federal and state regulatory agencies are not binding on the Commissioner if they do not clearly reflect income.<sup>60</sup>

56. Treas. Reg. § 1.162-13 (1965) as amended by TD 6500.

57. Rev. Rul. 66-49 Cum. Bull. 36. The government based its reasoning on an analogy derived by reference to Treas. Reg. 1-162-13.

58. *Id.* at 37.

59. *Id.*

60. In *Old Colony R.R. v. Comm'r*, 284 U.S. 552, 562 (1932) the Court stated: Moreover, the rules of accounting enforced upon a carrier by the Interstate Commerce Commission are not binding upon the Commissioner, nor may he resort to the rules of that body, made for other purposes, for the determination of tax liability under the revenue act.

The same rule is noted in *Citizens Federal Savings & Loan Association*, 30 T.C. 285, 294 (1958), where the court stated:

It has been held by this and other courts that the fact that a taxpayer's books, records, and accounting method meet requirements of other federal or state agencies does not bind the Commissioner, who may independently determine whether they 'clearly reflect income. . . .' There would seem to be no more reason for holding that compliance with the rules and regulations of the federal savings and loan system is determinative of petitioner's method of accounting for income tax purposes.

This general rule was applied in *Kansas City Southern Railway Co. v. Commissioner*<sup>61</sup> to regulations of the Interstate Commerce Commission. Accordingly, for federal income tax purposes, where the accounting rules of the agency are silent, the proper status of insurance premium prepayments should involve the application of established principles of federal tax law.

The conclusion of Rev. Rul. 66-49 that insurance premium prepayments are not deductible and the admission in the ruling that the earnings credited by FSLIC to the secondary reserve were *not* taxable income are basically inconsistent. While the ruling concludes that all events which fix a right to receive income earned on an individual institution's balance in the secondary reserve do not occur when the amounts are credited because of their availability for losses of FSLIC, it overlooks the fact that the entire share of a participating institution, although subject to recapture by the federal association, is likewise available to offset losses of the FSLIC. In fact, any right of recapture of a pro-rata share of the secondary reserve is subject to an absolute right of the FSLIC to appropriate the entire secondary reserve for losses.<sup>62</sup>

As further illustration that Rev. Rul. 66-49 is out of harmony with the law, reference can be made to the history of insurance premiums paid by banks to the Federal Deposit Insurance Corporation (FDIC) which has

61. 52 F.2d 372, 378 (8th Cir. 1931). The court, when considering the power of the ICC to determine the accounting treatment of various items stated that: [T]he Commission has no power to direct how the revenue laws of the United States shall be interpreted or by its orders provide standards to govern the taxing authorities.

62. Concerning this exposure the Comptroller General of the United States in his report to Congress as required by law on an audit made of the FSLIC for the periods ended June 30, 1963 and December 31, 1965 has stated in [1963-1965] Comptroller General Biennial Rep.:

The corporation's primary and secondary reserves established pursuant to law are available to meet future losses. These reserves are not a measure of the insurance risks which is dependent on future economic conditions, and therefore the adequacy of these reserves is not determinable.

None of the severely limited conditions entitling plaintiff to the benefits, if any, of the balance in the secondary reserve on the books of FSLIC would have taken place as of the end of or during the tax year of a going federal association. No right, title or interest of a federal association with respect to any pro-rata share of said secondary reserve is assignable or transferable, by operation of law or otherwise as of the end of or during the normal calendar year, because none of the conditions on which the limited right of assignment depends would have occurred. Any potential right or interest in or future benefits from any such pro-rata share at the close of the calendar year has no effect on the right of a cash basis federal association to deduct the insurance premiums paid in a given year.

Further, insurance coverage with FSLIC is mandatory in the case of a federal association so long as it remains a federal savings and loan association. Insurance coverage with FSLIC is required in order to maintain the confidence of federal association holders. The return on investments held by FSLIC, which is credited to certain outstanding balances of the so-called secondary reserve maintained by FSLIC would not be available to a federal association. The Service has recognized that this return is not taxable income to a federal association. This appears to be inconsistent with the position it has taken as to the availability of the additional premiums paid under law in a normal year. INT. REV. CODE of 1954, § 1727 (d).

a purpose similar to that of the FSLIC. The FDIC was created under the Banking Act of 1933.<sup>63</sup> One of its purposes was the protection of the deposits of all banks entitled to the benefits of the insurance provided. In carrying out the purpose of the FDIC a temporary Federal Deposit Insurance Fund was set up to cover a period of six months from January 1, 1934 to June 30, 1934. Payments into the fund were made by banks in 1933 and 1934. Upon discontinuance of the temporary fund, banks were to obtain the same benefits through the purchase of shares of stock in FDIC and any unused part of the temporary fund was to be ratably distributed to members of the fund. By a subsequent amendment, Congress extended the period of the temporary fund to June 30, 1935 and subsequently to August 31, 1935. In accordance with provisions of the Banking Act of 1935,<sup>64</sup> which provided for permanent insurance of the temporary Federal Deposit Insurance Fund, banks were advised by FDIC that in place of a cash distribution of the reversionary interest in the temporary fund, the banks had the option of having a credit established on the books of FDIC which would be applied toward payment of the assessment next due from the bank.

The Bureau of Internal Revenue stated that the amount actually paid by a bank into the temporary Federal Deposit Insurance Fund upon admission to the fund, as distinguished from amounts subject to call, was *deductible as a business expense* in the tax year in which payment was made, and if any part of the amount paid into the temporary fund was returned to the taxpayer, the amount returned was taxable income in the year received.<sup>65</sup> In another ruling the Service held that the amount paid by a bank into the temporary Federal Deposit Insurance Fund and previously deducted as a business expense, which was later credited by the FDIC to the insured bank's account, constituted taxable income in the tax year in which the credit was actually applied by the FDIC towards payment of an assessment due from the bank.<sup>66</sup> However, the ruling stated that the bank would still be entitled to a corresponding *deduction* in the year of credit. In the case of a bank which had capitalized the amount of assessments paid in 1933 and 1934, the ruling took the position that the amount the FDIC applied in any given year as an assessment on account of losses sustained could be taken as a deduction in 1935 and that the bank would not be required to return as income any amount realized from a later crediting against assessment.

Additional arguments contrary to Rev. Rul. 64-49 can be found in the provisions relating to insurance of holders of bank accounts (comparable to but not entirely parallel to the provisions of section 1727 dealing with insurance of holders of accounts in savings and loan associations).<sup>67</sup> Under these provisions banks insured by the FDIC are required to pay annual as-

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63. Banking Act of 1933, 12 U.S.C. § 227 (1964).

64. Banking Act of 1935, 12 U.S.C. § 228 (1964).

65. I.T. 2764, XIII-1 CUM. BULL. 45 (1934).

66. I.T. 2940, XIV-2 CUM. BULL. 63 (1935).

67. 12 U.S.C. § 1817 (1950).

assessments to the FDIC, and the FDIC must transfer one third of its net assessment income to its capital account. The balance of the net assessment income is credited pro-rata to insured banks based on assessments due during the calendar year. Each year such credit is applied by the FDIC toward payment of the semi-annual assessment due for the period beginning the next July 1, and any excess credit is applied upon the assessment next due thereafter. Net assessment income is defined as the total assessments due during the calendar year (from all banks), less operating costs, *additions to reserve* to provide for insurance losses, and insurance losses actually sustained in said earlier year, plus losses of preceding years in excess of net reserves. A national bank is prohibited from terminating its status as an insured bank by a provision<sup>68</sup> which is comparable to the provision which prohibits a federally chartered savings and loan association from terminating its status as an insured association as long as it continues operation. The same section of the law relating to the FDIC contains provisions for involuntary termination of status as an insured bank. This similarity takes on significance when one looks at the law with respect to the crediting of assessment income to capital accounts. Concerning the treatment of the credit to insured banks provided for by current law, the Commissioner has taken the following position:

Section 42 (a) of the Internal Revenue Code provides, as a general rule, that 'The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.' Section 41 of the Code provides, in part, for the computation of 'net income . . . in accordance with the method of accounting regularly employed in keeping the books of such taxpayer.' Under sections 29.42-2 and 29.42-3 of Internal Revenue Regulations, income credited to a taxpayer is considered 'received' by him, within the meaning of section 42, when it is available to him for withdrawal without any substantial conditions. Constructive receipt by a taxpayer of income also occurs when it becomes available for application to his liability.<sup>69</sup>

The ruling of the Commissioner related to the FDIC concerning credit contemplates that the assessments themselves shall have been deducted in the year paid. Otherwise, the credit when paid or constructively available to the cash basis taxpayer would be simply a return of capital.

The above position does not support the Government's statements in

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68. 12 U.S.C. § 1919 (1950).

69. Rev. Rul. 62; 1953-1 CUM. BULL. 71. See *Acer Realty Co. v. Comm'r*, 132 F.2d 512 (8th Cir. 1942), *aff'g* 45 B.T.A. 333 (1941). In *Comm'r v. Security Flour Mills Co.*, 321 U.S. 281, 284 (1944) the Court stated that under the accrual method, income is not properly returnable for a year other than the year in which the right to receive has become final and definite in amount.



Rev. Rul. 66-49 that the payments due to FSLIC and paid by an association on the cash basis are not deductible because there is a theoretical possibility of recapture at a future date of some portion thereof, but that the earnings generated by the assets underlying the reserves to which such insurance premium payments were credited, are not taxable to a cash basis association because they are not available to the association in cash or equivalent. This inconsistency exists because the additional premiums paid are neither more nor less available to the cash basis association than the earnings on the underlying assets of FSLIC invested in United States Government obligations, etc. The right of the cash basis association to these amounts whether they be additional insurance premiums that have been paid or earnings on reserve assets in FSLIC, is not absolute. The risk of loss to the FSLIC is always present and the possibility of such a loss cannot be predicted with any degree of accuracy because it depends upon uncertain economic conditions.

Finally, Rev. Rul. 66-49 is inconsistent, at least in part, with the apparent position of the Commissioner relating to assessments under FDIC. This position, as noted above, seems to be that these assessments are deductible, but that the credits of net assessment income when made available, actually or constructively, are taxable income. In both situations (FDIC & FSLIC) there is a possibility of recapture because in each case the premiums paid to the insuring corporation may not ultimately be necessary to pay losses. Yet, the position of the Commissioner relating to the deduction of the two types of premiums is different. On the other hand the position of the Commissioner relating to the credits equivalent to the earnings on the invested assets of the FSLIC and the credits under the FDIC appears to be that in both cases these credits and earnings are not available as income until actually or constructively paid to the taxpayer.

#### D. *Lack of Justification for 66-49*

The Commissioner in Rev. Rul. 66-49 attempts to justify his seemingly inconsistent position by relying on a position taken in a prior treasury regulation.<sup>70</sup> This reliance, however, is not justified. The provisions of this regulation state that an amount set aside and carried to the credit of a state banking board which ceases to be an asset of the bank and which may be withdrawn in whole or in part upon demand by such banking board is deductible, provided that no portion of the amount thus set aside and credited is returnable to the assets of the banking corporation under the laws of the state. The reason the Commissioner's reliance is not justified is that this regulation appears to be in conflict with the Commissioner's own position on assessments paid to the FDIC and because it fails to define the circumstances under which the amount set aside and credited would be

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70. Rev. Rul. 66-49; 1966 CUM. BULL. 36, 37. Here the government relied on Treas. Reg. 1.162-13 (1965).

returnable. This conflict and the lack of completeness of the regulation can be demonstrated by an examination of *past rulings* of the Service and *cases* pertaining to the status of deposits into state depositors' guarantee fund accounts.

In *General Counsel Memorandum No. 8474* an opinion was requested as to the proper action to be taken in connection with requests on behalf of insolvent Texas banks to reopen claims for a refund of income tax.<sup>71</sup> These requests were based on the contention that amounts assessed against the banks to maintain the depositors' guaranty fund should be allowed as a deduction from gross income. These claims had been previously rejected by the Service. However, since rejection of the claims, two decisions of the Board of Tax Appeals<sup>72</sup> held that the amount collected by the state of Texas from a Texas bank for maintenance of the depositors' guaranty fund was deductible by the bank as a business expense. The General Counsel ruling held that in view of the fact that the government voluntarily had its petition for appeal dismissed in the above two cases, the claims in the case before it would be reopened and *allowed* to the extent covered by the board's decision.

Reference therefore should next be to these two decisions. In one<sup>73</sup> a deficiency resulting from disallowance of a deduction which represented the regular annual assessment paid into a depositors' guaranty fund of the State of Texas by the taxpayer-bank was proposed by the Commissioner for the calendar year 1920. Petitioner's reversionary interest in said fund, if any, was not known as of the end of the year.<sup>74</sup> The Board of Tax Appeals

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71. IX-2 CUM. BULL. 281 (1930).

72. First State Bank of Brackettville, 9 B.T.A. 975 (1927), and First State Bank of Welmer, 10 B.T.A. 396 (1928).

73. First State Bank of Brackettville, 9 B.T.A. 975 (1927).

74. Under the laws of Texas as they then existed, every banking institution, except savings banks incorporated under laws of Texas, was required to protect its depositors either by availing itself of the depositors' guaranty fund or by another method called the Depositors' Bond Security System. The petitioner bank had elected to operate under the depositors' guaranty fund. Under that fund the bank was required to pay an initial sum equal to one percent of its average daily deposits for next year preceding November prior to the year involved and annually thereafter one quarter of one percent of its average daily deposits for the preceding year. When the amount available in the guaranty fund reached \$5,000,000 the banking commissioner was to notify the banks of that fact and thereafter the banks were not required to pay further amounts into the guaranty fund until it was reduced to a sum below \$5,000,000. In the event of an emergency, the bank board had authority to require payment for the current year of a sum not exceeding the two percent of the average daily deposit or such part thereof as might be necessary to restore the fund to \$5,000,000. Twenty-five percent of the amount otherwise payable was to be paid in cash to the state treasurer as bailee for the banking board. The remaining seventy-five percent of the payment was to be placed on the individual bank's books as a demand deposit to the credit of the banking board.

In the event of a voluntary liquidation of any bank operating under the depositors' guaranty fund, the board was to return to the bank its pro-rata part of the fund where all depositors had been paid in full. If a bank that had been operating under the guaranty fund ceased to operate as a guaranty fund bank and instead adopted a bond security system (the alternate system), the board was to return a

reversed the Commissioner and held that amounts paid to the banking board were fully deductible by the bank in 1920. In the course of its opinion the court stated:

The ultimate facts concerning the amount paid in 1920 into the fund by the petitioner are these: There was a fixed and definite liability on the part of the petitioner to pay into the fund a definitely ascertainable amount, as prescribed by law. Upon the happening of a specified contingency, namely, voluntary liquidation, or . . . after 1925, voluntary liquidation or change to the bond security system, the petitioner might recover all or part of the amount paid in, the amount recovered being dependent upon the condition of the fund at that time. . . . We are of the opinion that the petitioner having paid the amount in question pursuant to a definite liability fixed by law, the contingent possibility of a refund of some or all of the amount so paid does not render the amount a nondeductible item. It seems clear that if the right to the deduction is denied the petitioner, its net income for the year in question could not be rightly determined. We are of the further opinion, therefore, that the amount paid into the fund was an expense incurred and properly attributable in and to the conduct of petitioner's business during the year 1920.<sup>75</sup>

The same issue was presented in the other case. The Board of Tax Appeals, relying on the earlier decision held that the amounts levied and collected from petitioner bank for maintenance of the depositors' guaranty fund were deductible as ordinary necessary business expenses for the year in which paid.<sup>76</sup>

Finally, in *Wichita State Bank & Trust Company v. Comm'r*,<sup>77</sup> again involving an interpretation of the status of payments made into a depositors' guaranty fund under the laws of the State of Texas, the plaintiff had failed to report as income moneys returned to it from the depositors' guaranty fund. Upon audit of the bank's returns, the Bureau of Internal Revenue (now Internal Revenue Service) assessed a deficiency based upon the amounts received from the depositors' guarantee fund. The Board of Tax Appeals held that both the annual assessments for the purpose of building up the depositors' guaranty fund and the special assessment to restore that fund when bank

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pro-rata part of the fund to the bank. In other words, to obtain a refund a bank was required to voluntarily liquidate and pay in full all of its outstanding obligations to its depositors. There was no statutory authority for a refund so long as the bank continued to do business as a bank. It was also clear that as long as a bank continued to do business, the fund might become depleted to such an extent that the bank's reversionary interest would be entirely extinguished by reason of failure of member banks.

75. *First State Bank of Brackettville*, 9 B.T.A. 975, 979 (1927). See *American National Co. v. United States*, 274 U.S. 99 (1927); *Hibbard, Spencer, Bartlett & Co.*, 5 B.T.A. 464 (1926).

76. *First State Bank of Weimer*, 10 B.T.A. 396 (1928).

77. 69 F.2d 595 (5th Cir. 1934).

failures occurred, were *ordinary expenses of business* in the year paid and therefore *deductible* as business expenses. All subsequent receipts by the banks, as a result of either type of payment, were held to be taxable income. The taxpayer asserted that all payments, both original and special assessments, were investments which produced valuable interests in the depositors' guaranty fund and that the special assessments were in effect purchases of an interest in the assets of banks that had failed by way of subrogation to their depositors. Therefore, the taxpayer argued, any return from the depositors' guaranty fund was not income until the amount of the investment was exceeded. Texas banks carried these assessments as assets, charging off the losses as they were ascertained after liquidation of banks that had failed.<sup>78</sup>

The Court of Appeals held that the special assessments were *fully deductible* and that therefore any return of a part of these special assessments represented income to taxpayer. It held, however, that contributions to the permanent depositors' guaranty fund were in the nature of investment of capital in an insurance company and that therefore they were essentially capital investments to be dealt with as such.<sup>79</sup> It is important to note that the Court of Appeals held the special assessment to be in the nature of a premium paid for by insurance even though there was a possibility of return since this contingency would have been deferred long beyond the tax year and was wholly uncertain. The court further said that, similar to the situation involving collection payment of a bad debt, such assessments could be treated as a present expense with any return to be treated as income.

Following the above decision, the General Counsel for the Bureau of Internal Revenue issued *Memorandum 13290* in which it modified *General Counsel Memorandum 8474* discussed above.<sup>80</sup> In this modified memorandum the General Counsel took the position that amounts paid into the permanent depositors' guaranty fund under the laws of Texas are essentially capital investments to be dealt with as such.

To the extent that it held that contributions to the permanent depositors' guaranty fund are in the nature of an investment in the capital of an insurance company, *Wichita State Bank* is of course not applicable to FSLIC insurance premium prepayments. The capital of FSLIC comes from the Home Owners Loan Corporation and FSLIC insurance premium prepayments are not intended to be capital contributions but instead are considered an "additional premium in the nature of a prepayment with respect to future premiums." However, the balance of the opinion in *Wichita State Bank* supports the deductibility of FSLIC insurance prepayments by a cash basis insured association.

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78. *Wichita State Bank & Trust Co. v. Comm'r*, 27 B.T.A. 822 (1933).

79. 69 F.2d 595, 596 (5th Cir. 1934).

80. XIII-2 CUM. BULL. 313 (1934).

## III. CONCLUSION

The preceding arguments that insurance premiums which are paid to FSLIC by a cash basis federal association, independently of any specific ruling or decision are deductible are further supported by the decision of the United States District Court for Western District of Missouri in *First Federal Savings & Loan Association v. United States*.<sup>81</sup> Here, in a case in which appeal by the Government to the Eighth Circuit Court of Appeals was voluntarily dismissed, the district court stated:

Regardless of whether or not the fund was consumed or the plaintiff had a right to recapture the fund, the fact remains that plaintiff was subject to the basic liability to pay 'an additional premium in the nature of a prepayment.' This premium, regardless of what kind of a fund the premium proceeds were applied to, was paid with respect to insurance coverage and was based, to a certain extent, upon the risk of loss. . . . Further, and of even more significance, is the fact that all of the premium proceeds were subject to being completely consumed in the event of a loss. The only real difference between the application of the premium proceeds paid under § 1727 (b) (2) and those paid under § 1727 (d) is the fact that the secondary reserve fund was not to be used to cover losses of the FSLIC until it was determined that other accounts available for loss were insufficient for that purpose.

. . . Nevertheless, a premium was paid for insurance which covered a specified risk the proceeds of which were subject to payment of losses with respect to that risk, and although there existed the remote possibility that the premium payment could be recovered or utilized to prepay other premium liabilities, that fact should not affect the deductibility of the premiums but should be considered only when those contingencies arise and then, should it be determined that plaintiff has realized income, appropriate taxes should be levied thereon.<sup>82</sup>

A similar conclusion as related to a *state chartered* association was reached in *Lincoln Savings & Loan Assoc. v. Commissioner*<sup>83</sup> where deduction of section 1727 (d) premiums by the association in computing its federal income tax was upheld and in *Equitable Savings & Loan Assoc. v. State Tax Comm'n*<sup>84</sup> involving the deductibility of section 1727 (d) payments by a *state chartered* association for *state* income tax purposes.<sup>85</sup>

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81. 288 F. Supp. 477 (W.D. Mo. 1968).

82. *Id.* at 484.

83. — F.2d — (9th Cir. 1969).

84. 444 P.2d 916 (1968).

85. The holdings in the *First Federal Savings & Loan Assoc. of St. Joseph*, *supra*, note 81 and *Equitable Savings & Loan Assoc. supra*, note 84 reached a result similar to that found in I.T. 22-319, 1-1 CUM. BULL. 283 (1922) relating to the status of payment of assessments which banks and building and loan associations in the state of North Dakota were required to pay or credit on their books to a de-

Based on the above analysis of the regulations, revenue rulings, and existing case law, it is asserted that payments by a cash basis federal savings and loan association to the FSLIC of premium prepayments required under section 1727 (d) are fully deductible in the year paid.<sup>86</sup> In the unlikely event that some portion of these premium prepayments would be refunded to a federal association, the amounts so repaid should be ordinary income to the association.

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positor's guarantee fund and which, upon liquidation or conversion to national bank status, were to be refunded to the bank or building and loan association. There the IRS held that such assessments ceased to be assets of the banks (or building and loan associations) and that since no portion of the amounts in question were refundable to such banks while they were doing business under the act, they were deductible as necessary business expenses.

86. This conclusion is supported by the recent decision in *Washington Federal Savings & Loan Ass'n v. United States*, 304 F. Supp. 1072 (S.D. Fla. 1969) which followed *First Federal Savings & Loan Ass'n*, 288 F. Supp. 477 (W.D. Mo. 1968).