Rev. Rul. 56-634

Advice has been requested whether the expiration of the term for which life insurance protection has been provided an employee, from the funds of a qualified employees' pension or profit-sharing trust, will result in a loss deductible by the employee, to the extent of the cost of the insurance.

Revenue Ruling 54-52, C.B. 1954-1, 150, holds that funds used by the trustee of an employees' trust, qualified under section 165(a) of the Internal Revenue Code of 1939 (section 401(a) of the 1954 Code), to pay premiums on a group life insurance contract which affords employee-participants of the trust term insurance protection only, are currently includible in the gross income of the employee-participants under the provisions of section 165(b) of the 1939 Code (section 402 of the 1954 Code).

Plans involving employees' pension or profit-sharing trusts, which qualify under section 401(a) of the 1954 Code (section 165(a) of the 1939 Code), are plans deferring the receipt by the employees of compensation for services rendered by them to their employers. The compensation paid into a qualified trust is not subjected to income tax at the time the employer makes payment thereof into the trust, but taxability thereof is deferred until such time as actual or constructive distribution is made to the respective employees. The use of such funds to procure any current life insurance for covered employees results in a distribution from the trust in the form of life insurance protection and the funds so expended are, therefore, includible in their gross income for the year or years during which so used.

Where amounts contributed to a qualified employees' trust are used by the trustee for procuring life insurance protection for the employee-participants of the trust, the effect is the same for income tax purposes as in a case where an individual purchases life insurance protection for a period with his own funds. The premium paid constitutes a nondeductible personal expense to the employee or other individual in each case. The effect is also the same in both cases after the period covered by the insurance contract has expired and the insurance protection is no longer in force. In both cases, the purchased protection was provided during the years for which the premium was paid so that no loss results. Therefore, there can be no deductible loss.

Accordingly, it is held that an employer's contributions to a qualified employees' pension or profit-sharing trust constitute compensation for services rendered and are subject to income tax when distributed or made available. Life insurance protection is a benefit the cost of which constitutes a personal expense to the employee. The use of trust funds for providing life insurance protection for an employee has the effect of a distribution to the extent of the cost of the insurance. The expiration of the period during which such protection has been provided does not result in a loss deductible by the employee. Rev. Rul. 54-52, SUPRA, amplified.