



## Tax Reduction Letter

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### Revenue Ruling 55-264

Section 61. Gross Income Defined.

January 1955

Where a taxpayer purchases an insurance policy which, in accordance with its terms, would reimburse the taxpayer, to the extent specified in the policy, for certain business overhead expenses incurred by him during prolonged periods of disability due to injury or sickness, any proceeds derived under the terms of such policy constitute and are includible in gross income under the provisions of section 61 of the Internal Revenue Code of 1954 or section 22 (a) of the Internal Revenue Code of 1939. Any premiums paid on such policy constitute business expenses and are deductible from gross income under the provisions of section 162 of the 1954 Code or section 23 (a) of the 1939 Code.

Advice has been requested whether any proceeds derived from a professional overhead expense disability policy, which policy is for the purpose of reimbursing the holders thereof for business overhead expenses incurred by them during prolonged periods of disability due to injury or sickness, is excludable from gross income. Advice has also been requested whether the insurance premiums paid would be nondeductible from gross income as an expenditure attributable to tax exempt income.

Taxpayer purchased an insurance policy under the terms of which he would be reimbursed for overhead expenses incurred by him with respect to his occupation during prolonged periods of disability. The policy provides that if certain specified injuries or sickness, directly and independently of all other classes, shall wholly and continuously disable the insured and prevent him from performing any and every duty pertaining to his occupation for a period of more than x days, the company will pay certain specified monthly expenses actually incurred by the insured up to an amount not exceeding the limitation specified in the policy for the period of such continuous disability, not exceeding a period of 3x months.

The policy further provides that no indemnity shall be paid for the first x days of any period of disability unless such disability continues for more than said x days, nor for any period of disability prior to the first date of medical treatment by a licensed physician or surgeon, other than the insured. The expense benefits payable under the policy shall be the monthly expenses actually incurred by the insured in the operation of his office or, in the event of joint occupancy, the insured's portion of such expenses and shall be limited in the manner set forth in the policy. Such expenses shall include rent, electricity, heat, water, laundry, depreciation, employees' salaries and such other fixed expenses as are normal and customary in the conduct and operation of the insured's office but shall not include salary, fees, drawing account or any other remuneration for the insured or any other member of the insured's profession hired by or working with the insured, or the cost of pharmaceutical products.

The actual questions presented are whether any insurance proceeds received by the taxpayer, in accordance with the terms of the above policy, are excludable from his gross income and whether the insurance premiums paid would be nondeductible under section 24 (a) (5) of the Internal Revenue Code of 1939 as an expenditure attributable to tax exempt income.

Gross income as defined under section 22 (a) of the Internal Revenue Code of 1939 and section 61 of the Internal Revenue Code of 1954, means all income from whatever source derived, unless exempt from tax by law. In general, income is the gain derived from capital, from labor, or both combined.

Insurance policies issued to provide reimbursement for overhead expenses in cases of prolonged disability of the insured do not come within the purview of compensation for personal sickness or injury. Such insurance policies are issued strictly for business purposes and in no way compensate the insured for injuries or sickness within the meaning of section 22 (b) (5) of the 1939 Code. The proceeds of such policies are in the nature of the proceeds of a "Use and Occupancy Contract," which insures against actual loss sustained of net profits, and the proceeds of which are income in the same manner that the profits for which they are substituted would have been. See section 39.112 (f)-1 (c) (8) of Regulations 118.

Section 23 (a) of the 1939 Code and section 162 of the 1954 Code provide that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during a taxable year in carrying on any trade or business. Section 39.23 (a) (1) of Regulations 118, in enumerating deductible expenses, includes premiums against fire, storm, theft, accident, or other similar losses in the case of a trade or business.

Accordingly, it is held that where a taxpayer purchases an insurance policy which, in accordance with its terms, would reimburse the taxpayer, to the extent specified in the policy, for certain business overhead expenses incurred by him during prolonged periods of disability due to injury or sickness, any proceeds derived under the terms of such policy constitute and are includible in gross income under the provisions of section 61 of the 1954 Code or section 22 (a) of the 1939 Code. Any premiums paid on such policy constitute business expenses and are deductible from gross income under the provisions of section 162 of the 1954 Code or section 23 (a) of the 1939 Code.