



TERRITORY OF HAWAII  
DEPARTMENT OF THE ATTORNEY GENERAL  
HONOLULU

46

April 9, 1942

OPINION NO. 1812

TAXATION, NET INCOME;

Deductions from gross income:

Deductions for payments made by an employer to an insurance company under a group annuity contract retirement plan are not limited to five per cent of net income.

Honorable William Borthwick  
Tax Commissioner  
Territory of Hawaii  
Honolulu, T.H.

Dear Sir:

You have presented to this office the following questions:

"1. Whether payments by an employer (together with payments by employees) to a life insurance company under a group annuity contract retirement plan issued by the insurance carrier to the employer, providing annuities in which the employee member receives unconditional title even though his service terminates before the annuity is scheduled to commence, come within the limitation of five per centum of net income payments referred to in Section 2034-1 (d) or whether such payments are operating and business expenses deductible under Section 2034-1 (e) of Chapter 65.

"2. If, such payments are limited to the five per centum of net income under Section 2034-1 (d), the question then arises as to whether net income means the net income for the taxable year in the trade or business of such employer determined in accordance with the provision of Chapter 65, Revised Laws of Hawaii, 1935, or whether not income

of the employer includes non-taxable income, such as government bond interest and dividends from another corporation."

The statutory provisions involved are paragraphs (d) and (e) of subsection 1, Section 2034, R.L. 1935, which read as follows:

"Sec. 2034. 1. Gross income; deductions from. In computing net income there shall be allowed as deductions:

" \* \* \*

"(d) Employees' pension fund, etc. Amounts, not exceeding however five per centum of the net income for the taxable year in the trade or business of such employer, transferred or paid into an employees' pension or benefit fund or trust by any individual or corporation to provide for the payment of reasonable pensions or benefits to his or its employees.

"(e) Expenses. All actual operating and business expenses paid or incurred or accrued during the taxable year in carrying on any trade or business including reasonable amounts for salaries or other compensation for personal Service or attributable to personal services actually rendered, traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business and rentals or other payments required to be made as a condition to the continued use or possession for the purpose of the trade or business, of property to which the individual or corporation has not taken or is not taking title, or in which the individual or corporation has no equity;"

The plan involved, as set forth in a booklet issued by the insurance carrier, a copy of which you have furnished us, briefly stated is as follows: Contributions

are made by both employer and employee. Upon retirement, or if his service terminates before the retirement date but after five years membership in the plan, the employee receives an annuity based on the employer's contributions as well as his own, but in case of death or termination of service within the five years no benefit is received by the employee from the employer's contributions.

I am of the opinion that the payments made by the employer are not "transferred or paid into an employees' pension or benefit fund or trust" within the meaning of paragraph (d) of subsection 1, Section 2034, R.L. 1935. The payments are made to purchase the contractual obligation of the insurance carrier. There is nothing in the plan to suggest that the contributions made shall be held in a special fund or in trust. The distinction between a benefit bestowed through an insurance contract and a benefit bestowed through a transfer in trust is illustrated in Thomson v. McGonagle, 33 Haw. 594, where the court held a life insurance trust subject to inheritance tax although the proceeds of a life insurance policy paid directly to the beneficiary would not have been. In the present instance the legislature might have treated payments to an insurance carrier the same as payments into a fund of trust but did not do so.

Had paragraph (d) been applicable the five per cent limitation could not have been avoided by resorting to paragraph (e). Spring City Foundry Co. v. Commissioner, 292 U.S. 182. Since paragraph (d) is not applicable, however, the full payment made may be deducted if it is classifiable as an "actual operating and business expense" under paragraph (e). Under similar plans it has been held that such payments are deductible as expense items, in the nature of additional compensation to employees, where such payments do not make the total compensation of each employee unreasonable in amount. Elgin National Watch Co., 17 B.T.A. 339; Hibbard, Spencer, Bartlett & Co. 5 B.T.A. 464; see Scarborough v. United States, 8 Fed. Supp. 736. In my opinion this rule is applicable in the present situation.

In view of the answer to the first question the second question does not require an answer.

Respectfully,

(s) Rhoda V. Lewis

Rhoda V. Lewis  
Deputy Attorney General

APPROVED:

(s) J. Hodgson  
Attorney General