9 T.C. 418 (1947)

Life insurance proceeds are includible in a decedent's gross estate under Section 811(g) of the Internal Revenue Code if the decedent retained any legal incidents of ownership in the policies, even if those incidents arise from a trust instrument rather than the policy terms themselves.

Summary

The Tax Court addressed whether life insurance proceeds transferred to irrevocable trusts were includible in the decedent's gross estate. The decedent created trusts, assigning life insurance policies to them. The trusts provided income to his wife for life, with the remainder to his issue, and a reversionary clause if no issue survived. The court found the transfers not made in contemplation of death. However, it held that because the decedent retained a possibility of reverter (a legal incident of ownership), the proceeds exceeding $40,000 were includible in his gross estate under Section 811(g) of the Internal Revenue Code to the extent the policies were taken out by the decedent. The court also addressed and allowed certain deductions for administration expenses.

Facts

Wilbur Ruthrauff created two irrevocable life insurance trusts in 1935. The first trust provided income to his wife for life, remainder to his issue, and a reversion to his estate if no issue survived. The second trust covered policies on his and his business partner's lives, with proceeds split between their wives, and similar reversionary provisions. Ruthrauff transferred various life insurance policies to these trusts. He was in good health and actively engaged in business and social activities. His primary motive for creating the trusts was to protect his family's financial security from business risks and prevent dissipation of the insurance proceeds.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax, arguing that the life insurance proceeds held by the trusts should be included in the decedent's gross estate. The Estate of Ruthrauff petitioned the Tax Court for a redetermination of the deficiency. The Tax Court considered the case based on stipulated facts, documentary evidence, and oral testimony.

Issue(s)

1. Whether the transfers of life insurance policies to the trusts were made in contemplation of death, thus includible in the decedent's gross estate?

2. Whether the life insurance proceeds are includible in the decedent's gross estate because of the decedent's retained possibility of reverter in the trust agreements?

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Holding

1. No, because the decedent's dominant motive was associated with life concerns, namely protecting his family's financial security from business risks, not with testamentary disposition.

2. Yes, because the decedent retained a legal incident of ownership (a possibility of reverter) in the insurance policies, the aggregate proceeds of the insurance in excess of $40,000 are includible in decedent's gross estate under Section 811(g) of the Internal Revenue Code, to the extent the policies were taken out by the decedent.

Court's Reasoning

The court reasoned that the transfers were not made in contemplation of death because the decedent was in good health and his primary motive was to protect his family from business risks, a motive associated with life. The court distinguished cases like *Davidson v. Commissioner* and *Vanderlip v. Commissioner*, where the dominant motive was testamentary or tax avoidance. Regarding the possibility of reverter, the court noted that the trust instruments provided that if no issue survived the decedent's wife (or the decedent if he predeceased her), the trust corpus would revert to his estate or as he directed in his will. The court cited *Estate of Charles H. Thieriot* to support its conclusion that this reversionary interest constituted a legal incident of ownership, making the proceeds includible in the gross estate under Section 811(g). The court emphasized that Section 811(g) could not be avoided by creating insurance trusts where the insured retained incidents of ownership through the trust terms.

Practical Implications

This case highlights the importance of carefully drafting life insurance trusts to avoid retaining any incidents of ownership that could cause the insurance proceeds to be included in the grantor's gross estate. It demonstrates that even a remote possibility of reverter can trigger inclusion under Section 811(g). Attorneys must advise clients to relinquish all control and beneficial interest in the policies. It also clarifies that the source of the incident of ownership can be the trust agreement itself, not just the insurance policy. Later cases have cited *Estate of Ruthrauff* as precedent for interpreting the scope of "incidents of ownership" under federal estate tax law, emphasizing the need for grantors to completely relinquish control over life insurance policies held in trust to achieve estate tax benefits.

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