Estate of Ruthrauff v. Commissioner, 9 T.C. 418 (1947)

A transfer of life insurance policies to a trust is not deemed in contemplation of death if motivated by life-related purposes; however, retaining a possibility of reverter in the insurance proceeds constitutes a legal incident of ownership, causing the proceeds to be includible in the decedent's gross estate under Section 811(g) of the Internal Revenue Code.

Summary

The decedent established irrevocable life insurance trusts, transferring several policies. The Commissioner argued the proceeds should be included in the decedent's gross estate as transfers in contemplation of death and due to the decedent's retained possibility of reverter. The Tax Court found the transfers were not made in contemplation of death because the decedent's primary motive was to secure his family's financial future against life's uncertainties, not to make a testamentary disposition. However, the court held that the decedent's retained reversionary interest—the possibility that the proceeds would revert to his estate if beneficiaries predeceased him—constituted a legal incident of ownership, thus requiring inclusion of the insurance proceeds in his gross estate under Section 811(g) of the Internal Revenue Code.

Facts

The decedent created two irrevocable life insurance trusts in 1935 and transferred life insurance policies to them. At the time, he was in good health and not in apprehension of imminent death. His primary motivation was to protect a fund for his family from potential financial risks and misfortunes during his lifetime, similar to what his father had experienced. The trust instruments provided income benefits to his wife during his life in case of his disability and specified remaindermen for the trust corpus. Critically, the trusts included provisions that if the primary beneficiaries (wife and issue) did not survive the decedent, the trust corpus would pass according to his will or to his intestate heirs, effectively creating a possibility of reverter.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the decedent's estate tax, including the life insurance proceeds in the gross estate. The Estate of Ruthrauff petitioned the Tax Court for review of this determination.

Issue(s)

1. Whether the decedent's transfer of life insurance policies to irrevocable trusts was made in contemplation of death under Section 811 of the Internal Revenue Code?

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2. Whether the proceeds of the life insurance policies are includible in the decedent's gross estate under Section 811(g) of the Internal Revenue Code because of the decedent's retention of a possibility of reverter, which constitutes a legal incident of ownership?

Holding

1. No, because the transfers were primarily motivated by concerns associated with life rather than death.

2. Yes, because the decedent's possibility of reverter constituted a legal incident of ownership under Section 811(g) of the Internal Revenue Code.

Court's Reasoning

Contemplation of Death: The court distinguished this case from others where transfers of life insurance were deemed in contemplation of death, such as *Davidson v. Commissioner* and *Vanderlip v. Commissioner*, noting that in those cases, the motives were directly linked to testamentary disposition or estate tax avoidance. The court emphasized the decedent's stipulated motive: "In making the transfers decedent was concerned with the things of life rather than of death. He sought to protect the fund to be realized from his life insurance policies from encroachment or dissipation by reason of his own actions or misfortune during his lifetime." The court found this life-related motive distinguishable from a testamentary motive, even though life insurance policies are inherently related to death. Referencing *Estate of Paul Garrett*, the court underscored that transfers motivated by protecting family from business hazards are considered life-associated motives.

Incidents of Ownership: The court addressed Section 811(g) of the Internal Revenue Code and Regulation 80, which included in the gross estate insurance proceeds from policies where the decedent retained "legal incidents of ownership." The court noted that while the 1942 Revenue Act clarified that "incident of ownership" excludes a reversionary interest, that amendment was not applicable as the decedent died before its enactment. The court found that the trust provisions, which stipulated that the proceeds could revert to the decedent's estate if beneficiaries predeceased him, constituted a "legal incident of ownership." Quoting Regulation 80, the court highlighted that an incident of ownership exists "if his death is necessary to terminate his interest in the insurance, as for example if the proceeds would become payable to his estate, or payable as he might direct, should the beneficiary predecease him." Citing *Estate of Charles H. Thieriot*, the court concluded that the decedent possessed such an incident of ownership. The court dismissed the argument that New York state law should dictate the definition of "incident of ownership," asserting that federal law governs the interpretation for federal estate tax purposes. The court also referenced *Goldstone v. United States* to reinforce that even if a third party (trustee) had some power over the policies, the decedent's retained "string" (reversionary interest) was still significant for estate

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tax inclusion.

Practical Implications

Estate of Ruthrauff clarifies the importance of distinguishing between life-related and death-related motives when assessing whether a transfer, particularly of life insurance, is made in contemplation of death. It underscores that even with life insurance, a transfer can avoid being classified as in contemplation of death if the dominant motive is demonstrably connected to the decedent's life concerns. More significantly, this case reinforces a broad interpretation of "incidents of ownership" under Section 811(g), predating the explicit statutory treatment of reversionary interests. It serves as a reminder that any retained reversionary interest, where the decedent's death is a condition for determining the ultimate beneficiary, can trigger estate tax inclusion for life insurance proceeds. This case highlights the need for careful drafting of irrevocable life insurance trusts to avoid any possibility of reverter to the grantor or their estate to effectively remove life insurance proceeds from the gross estate for federal estate tax purposes. Later cases and subsequent amendments to estate tax law have further refined the definition of incidents of ownership, but *Ruthrauff* remains a key precedent illustrating the risks associated with reversionary interests in life insurance trusts.

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