12 T.C. 280 (1949)

When a decedent elects to receive a reduced annuity in exchange for a survivorship annuity for their spouse, the value of that survivorship annuity is included in the decedent's gross estate for estate tax purposes, regardless of who initially funded the annuity contract.

Summary

The Tax Court held that the value of a survivorship annuity payable to the decedent's widow was includible in his gross estate. The decedent had exercised an option under his employer's retirement plan to receive a reduced annuity during his life, with the provision that upon his death, his wife would receive a portion of that annuity for her life if she survived him. The court reasoned that this arrangement constituted a transfer under Section 811(c) of the Internal Revenue Code, intended to take effect at or after his death, and was thus subject to estate tax.

Facts

William J. Higgs (the decedent) was an employee of Socony-Vacuum Oil Co. He participated in the company's retirement plan. The plan allowed employees to elect a reduced annuity with a survivorship benefit for a designated dependent. Higgs elected to receive a reduced annuity so that his wife would receive $7,000 per year if she survived him. Without this election, he would have received a larger annuity. The employer fully funded the retirement plan. Higgs died in 1943, and his wife began receiving the survivorship annuity.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax, adding $78,036 to the gross estate, representing the cost of the survivorship annuity. The estate petitioned the Tax Court, arguing that the annuity should not be included in the gross estate. The Tax Court ruled in favor of the Commissioner, holding that the value of the survivorship annuity was includible in the gross estate.

Issue(s)

Whether the value of a survivorship annuity payable to the decedent's widow, resulting from the decedent's election to receive a reduced annuity, is includible in the decedent's gross estate under Section 811(c) of the Internal Revenue Code as a transfer intended to take effect at or after his death.

Holding

Yes, because the decedent made a transfer within the meaning of Section 811(c) when he elected to receive a reduced annuity in exchange for a survivorship annuity for his wife, which was intended to take effect at or after his death.

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Court’s Reasoning

The court relied on prior cases such as *Commissioner v. Wilder’s Estate*, *Commissioner v. Clise*, and *Mearkle’s Estate v. Commissioner*, which held that similar transfers were includible in the gross estate. The court rejected the estate’s argument that these cases were distinguishable because the employer, rather than the decedent, funded the annuity. The court reasoned that the decedent possessed a property right in the annuity and exercised an option to surrender a portion of that right in exchange for the survivorship benefit for his wife. This constituted a transfer under Section 811(c). The court stated: “He exercised an option which he had under the paid-up annuity to surrender the right to receive a part of the annuity of $ 21,750 in consideration of the agreement on the part of the insurance company that it would continue to pay $ 7,000 annually to his wife for her life, beginning at his death, should she survive him.” The court upheld the Commissioner’s valuation of the annuity because the estate failed to provide sufficient evidence to challenge that valuation.

Judge Hill dissented, arguing that the decedent’s election did not constitute a transfer of property because the decedent only had a vested option to choose between two annuity plans. Judge Hill argued the exercise of the option did not constitute a transfer as the right to the survivorship annuity arose directly from the original contract. The dissent stated: “The right to a survivorship annuity which Mrs. Higgs acquired when decedent chose the lesser annuity for himself arose directly out of the original contract between the employer and the insurance company and not as a result of any separate transaction between decedent and the insurance company or between decedent and his wife which could be considered a transfer.”

Practical Implications

This case clarifies that the source of funds for an annuity is not determinative of whether a transfer has occurred for estate tax purposes. If a decedent has the power to alter the form of their annuity and chooses to create a survivorship benefit, the value of that benefit will likely be included in their gross estate. Attorneys should advise clients with similar annuity arrangements to consider the estate tax implications of electing a survivorship benefit. This ruling highlights the broad scope of Section 811(c) in capturing transfers with retained life interests, even when those interests are derived from employer-funded plans. Later cases have cited *Higgs* in support of including various forms of annuities and retirement benefits in the gross estate, emphasizing the importance of analyzing the decedent’s control over the disposition of the benefits.

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