12 T.C. 380 (1949)

When a life insurance beneficiary elects to receive proceeds under a settlement option, retaining control over the funds and designating beneficiaries for the remainder, the proceeds are included in the beneficiary's gross estate for estate tax purposes.

Summary

Mabel Morton was the beneficiary of life insurance policies on her husband's life. Upon his death, instead of taking a lump sum payment, she elected a settlement option where the insurer retained the proceeds, paid her interest during her life, and then paid the remaining principal to her daughters upon her death. She also retained the right to withdraw principal. The Tax Court held that the insurance proceeds were includible in Mabel's gross estate because she exercised dominion and control over the funds, effectively transferring them with a retained life interest. This triggered estate tax liability under Section 811 of the Internal Revenue Code.

Facts

Mabel E. Morton was the beneficiary of three life insurance policies on her husband's life. Her husband died in 1934, entitling her to $25,131.56. Instead of receiving a lump sum, Mabel elected an optional mode of settlement under the policies. She chose an option where the insurance company retained the funds, paid her interest for life, allowed her to withdraw principal, and upon her death, paid the remaining principal to her daughters. Mabel executed a supplementary contract with the insurance company in 1934 to this effect. She received monthly interest payments but never withdrew any principal. She died in 1944. The estate tax return did not include the insurance proceeds.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Mabel Morton's estate tax, including the insurance proceeds in her gross estate. The Northern Trust Co., executor of Mabel's estate, petitioned the Tax Court contesting this adjustment. The Tax Court ruled in favor of the Commissioner, holding that the insurance proceeds were properly included in Mabel Morton's gross estate.

Issue(s)

Whether life insurance proceeds are includible in a beneficiary's gross estate when the beneficiary elects a settlement option, retains control over the funds (including the right to withdraw principal), receives interest income for life, and designates beneficiaries to receive the remaining principal upon their death.

Holding

Yes, because Mabel Morton exercised dominion and control over the insurance proceeds, and in effect transferred the proceeds to her daughters with a retained life interest, making it includible in her gross estate under Section 811 of the Internal Revenue Code.

Court's Reasoning

The Tax Court distinguished this case from *Brown v. Routzahn*, where a donee renounced a testamentary gift. The Court emphasized that Mabel Morton accepted her rights as the beneficiary and exercised control over the proceeds. She chose a settlement option, directing the insurance company to pay interest to her for life and the principal to her daughters upon her death. The court reasoned that Mabel's actions constituted a transfer with a retained life interest, as she retained the right to receive interest income and the power to withdraw principal. The court stated, "These funds were as much hers as if she had settled with the insurance company by receiving lump sum payments, and by her action she transferred them to those who upon her death were the recipients." The Court cited *Estate of Spiegel v. Commissioner* and *Commissioner v. Estate of Holmes* to support the inclusion of the property in the gross estate, since the decedent retained control and enjoyment of the property for life.

Practical Implications

This case clarifies that electing a settlement option for life insurance proceeds does not necessarily shield those proceeds from estate tax. The key is whether the beneficiary exercises control over the funds, such as retaining the right to withdraw principal or designating beneficiaries. Attorneys should advise clients that electing settlement options with retained control can result in the inclusion of those proceeds in the beneficiary's gross estate. This ruling highlights that substance prevails over form; even though the beneficiary never physically possessed the lump sum, her power to control the funds and direct their distribution triggered estate tax consequences. Subsequent cases will analyze the extent of control retained by the beneficiary when determining if the proceeds are includible in the gross estate.

