13 T.C. 1054 (1949)

When a partnership agreement requires a deceased partner's estate to exchange the partner's interest in partnership assets for life insurance proceeds, the gross estate should include the insurance proceeds but not the partnership assets relinquished in exchange.

Summary

In this case, the Tax Court addressed whether the value of a deceased partner's share of partnership assets should be included in the gross estate when a partnership agreement stipulated that the surviving partner would purchase the deceased partner's share with life insurance proceeds. The court held that including both the insurance proceeds and the partnership assets would result in double taxation. The gross estate should only include the life insurance proceeds received in exchange for the partnership interest.

Facts

Ray E. Tompkins was an equal partner with Michael R. Nibler in a business. A partnership agreement stipulated that the partnership would acquire life insurance policies on each partner, payable to the surviving partner. Upon the death of a partner, the surviving partner could purchase the deceased partner's share of the partnership assets for the insurance proceeds. Tompkins died in an accident, and Nibler received $40,271.33 from the insurance policies. Nibler paid this amount to Tompkins' estate in exchange for Tompkins' interest in the partnership assets.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax, increasing the gross estate by the value of Tompkins' share in the partnership assets. Tompkins' estate challenged this determination in the Tax Court.

Issue(s)

Whether the respondent erred in adding to the gross estate the value of a one-half interest in the assets of a partnership when the estate had already included life insurance proceeds received in exchange for that partnership interest.

Holding

No, because including both the life insurance proceeds and the partnership assets in the gross estate would result in double taxation.

Court's Reasoning

The Tax Court relied on its prior decisions in *Boston Safe Deposit & Trust Co.*, *M.W.*

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Dobrzensky, Executor, and *Estate of John T.H. Mitchell*. The court reasoned that the estate's interest in the partnership assets was limited to the amount of the insurance proceeds due to the partnership agreement. As the court stated in *Dobrzensky*, "The double taxation feature does not make it less so. Decedent acquired the insurance policy there involved by purchase or exchange. The consideration therefor was decedent's relinquishment of certain rights in partnership property. After that acquisition decedent no longer had any right, at his death, in the relinquished assets, but, instead, had a taxable interest in an insurance policy." Therefore, including both the insurance proceeds and the partnership assets in the gross estate was erroneous.

Practical Implications

This case clarifies the estate tax treatment of partnership agreements funded by life insurance. It emphasizes that when a valid agreement exists requiring the exchange of partnership interests for life insurance proceeds, the estate should only include the value it actually received – the insurance proceeds. This prevents the government from taxing the same value twice. Attorneys drafting partnership agreements with life insurance buy-out provisions must ensure the agreement clearly defines the exchange to avoid potential disputes with the IRS. Later cases have cited *Tompkins* for the principle that the substance of the transaction, rather than its form, should govern the estate tax consequences. This decision has implications for estate planning involving various business arrangements, not just partnerships.

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