14 T.C. 245 (1950)

When a life insurance beneficiary, entitled to a lump-sum payment, elects to receive the proceeds under an optional settlement method, that election constitutes a transfer of property includible in the beneficiary's gross estate under Section 811(c) of the Internal Revenue Code.

Summary

The Tax Court addressed whether life insurance proceeds should be included in the decedent's gross estate. The decedent's mother had purchased life insurance policies naming her children as beneficiaries. After the mother's death, the decedent, through his guardian, elected to receive the insurance proceeds under an optional settlement, rather than as a lump sum. The court held that this election constituted a transfer of property by the decedent, making the proceeds includible in his gross estate under Section 811(c) of the Internal Revenue Code, relying on the precedent established in *Estate of Mabel E. Morton*.

Facts

Agnes Tuohy obtained two life insurance policies, naming her five children, including John Joseph Tuohy, Jr. (the decedent), as beneficiaries. Prior to her death, Agnes expressed a desire to have the proceeds paid out under Option 1, with interest paid annually until her sons reached age 35. However, she did not finalize the election. Upon Agnes's death, the decedent and his brother became entitled to the policy proceeds. Because they were minors, a bank was appointed as their guardian. The guardian petitioned the court to direct the insurance company to pay the proceeds under Option 1, which involved the company holding the proceeds and making annual interest payments. The court granted the petition, and the insurance company endorsed the policies accordingly.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax, including the decedent's share of the life insurance proceeds in his gross estate. The Executor of the estate challenged this determination in the Tax Court. The Tax Court upheld the Commissioner's determination, finding that the decedent's election of Option 1 constituted a transfer includible in his gross estate.

Issue(s)

1. Whether Agnes Tuohy effectively elected the optional settlement (Option 1) during her lifetime.
2. If Agnes Tuohy did not effectively elect the optional settlement, whether the decedent's election of Option 1, through his guardian, constituted a transfer of property within the meaning of Section 811(c) of the Internal Revenue Code.

Holding

1. No, because Agnes Tuohy's letter expressing her wishes was not considered a binding election by the insurance company, and she recognized that further documentation was needed to effectuate her desired arrangement.
2. Yes, because the decedent was entitled to a lump-sum payment, and his election to receive the proceeds under Option 1 constituted a transfer of property to those who would ultimately receive the proceeds after his death, consistent with the ruling in *Estate of Mabel E. Morton*.

Court's Reasoning

The court reasoned that Agnes Tuohy's letter was merely an expression of intent and not a binding election of Option 1, as evidenced by her statement that the letter should serve in place of a formal document to be prepared later. Since no such document was ever executed, she did not complete the election. The court found that the insurance company's failure to recognize the letter as a sufficient election further supported this conclusion.

Regarding the second issue, the court relied on *Estate of Mabel E. Morton*, which held that when a beneficiary has the right to a lump-sum payment but elects an optional settlement, this constitutes a transfer of property includible in the beneficiary's gross estate. The court found no material difference between the facts in *Morton* and the present case. The decedent, by electing Option 1, effectively transferred the proceeds to his potential heirs, retaining only a limited interest during his lifetime. This act triggered inclusion under Section 811(c).

Practical Implications

This case clarifies that a beneficiary's election of an optional settlement for life insurance proceeds, in lieu of a lump-sum payment, can be treated as a transfer of property for estate tax purposes. Attorneys should advise clients who are beneficiaries of life insurance policies to carefully consider the estate tax consequences of electing optional settlements. This decision emphasizes the importance of understanding that such elections can create a taxable transfer, even if the beneficiary never directly receives the full value of the proceeds as a lump sum. It highlights that retaining control over the disposition of assets after death, even through an insurance company's payment options, can trigger estate tax liability. Later cases will need to distinguish situations where the insured, rather than the beneficiary, makes the election to avoid the transfer argument.