21 T.C. 377 (1953)

Transfers of life insurance policies and bonds to trusts, structured to primarily benefit beneficiaries upon the grantor's death and lacking significant lifetime benefits, are includible in the decedent's gross estate as transfers made in contemplation of death under 26 U.S.C. § 811(c)(1)(A).

Summary

The Tax Court held that the value of life insurance policies and bonds transferred to trusts by Charles I. Aaron was includible in his gross estate as transfers in contemplation of death. Aaron established irrevocable trusts funded with life insurance policies on his own life and bonds, with income initially used to pay premiums and excess income accumulating until beneficiaries reached 21. The trusts were designed to provide financial security to his grandnieces and grandnephews, but the court found the primary benefit was deferred until Aaron's death when the insurance proceeds would mature. Because the trusts provided no substantial present benefit and functioned as a testamentary substitute, the court concluded the transfers were made in contemplation of death, lacking life-associated motives.

Facts

Charles I. Aaron created four irrevocable trusts in 1931, naming his nephew as trustee and his grandnieces and grandnephews as beneficiaries.

Aaron funded the trusts with life insurance policies on his own life (taken out between 1911 and 1931) and corporate/government bonds.

The trust income was to be used primarily to pay life insurance premiums; excess income could be used for beneficiaries' education and maintenance during minority.

Upon reaching age 21, beneficiaries were to receive excess income. Trusts were to terminate when beneficiaries reached 30 or upon Aaron's death, whichever was later.

Aaron intended the trusts to provide economic security for his grandnieces/nephews, especially after the 1929 stock market crash, viewing life insurance as a secure investment.

The trusts' income was insufficient to cover premiums, requiring the trustee to sell assets.

Aaron died in 1947; the insurance proceeds then totaled $590,181.36.

Aaron had made other substantial lifetime gifts and had a significant estate exceeding $800,000 after establishing these trusts.

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Procedural History

The Commissioner of Internal Revenue determined a deficiency in estate tax, including the value of the trusts in Aaron's gross estate.

The Tax Court proceedings were consolidated for the estate and the trustees/transferees.

The sole issue before the Tax Court was the includibility of the trust assets under 26 U.S.C. § 811(c)(1)(A) as transfers in contemplation of death.

Issue(s)

1. Whether the transfers of life insurance policies and bonds to the four trusts, established by the decedent Charles I. Aaron, were made in contemplation of death within the meaning of 26 U.S.C. § 811(c)(1)(A), thus requiring their inclusion in his gross estate for estate tax purposes?

Holding

1. Yes, because the trusts were structured to provide no substantial economic benefit to the beneficiaries until the decedent's death, and the transfers were primarily motivated by testamentary considerations rather than life-associated motives.

Court's Reasoning

The court emphasized that the justification for including the transfers in the gross estate as being in contemplation of death was found in "the use and the terms of the trusts, the nature and possibilities of the property transferred, and the intent of the settlor…"

The court noted Aaron's awareness that trust income would be insufficient to pay premiums, necessitating the sale of trust assets, and that the beneficiaries were already well-provided for by their parents and grandparents.

The court reasoned, "He knew and intended that the trusts would not provide any economic or other benefits for the children until his death would bring into the trusts the proceeds of the insurance on his life and relieve the trusts of the expense of the premiums. Then, for the first time, would the trusts be holding unrestricted property which would produce income for the beneficiaries and become theirs at the termination of the trusts. That was what the decedent intended and that was the way in which the transfers were made by him in contemplation of his death."

The court distinguished the case from others where funded life insurance trusts were not deemed in contemplation of death, citing the absence of motives like protecting beneficiaries from financial hardship, aiding in business ventures, or

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providing immediate enjoyment.

The court rejected arguments that the transfers were part of a pattern of lifetime giving or motivated by generosity and affection, stating, “But these trusts were unlike other trusts in which current income accumulates for the beneficiaries during the grantor’s life. The similarity begins only when the grantor dies.”

Ultimately, the court concluded, “His dominant motive was to have the gifts ripen at and by reason of his death. No motive associated with life emerges to overcome the determination and evidence of the Commissioner that the transfers were made in contemplation of death.”

Practical Implications

This case highlights the importance of establishing lifetime motives when creating funded life insurance trusts to avoid estate tax inclusion as transfers in contemplation of death.

It demonstrates that trusts structured primarily to hold life insurance and provide benefits only upon the grantor’s death are likely to be viewed as testamentary substitutes.

Practitioners should advise clients to incorporate features that provide present benefits to beneficiaries during the grantor’s life and to document life-associated motives for establishing such trusts, such as providing for current needs, education, or business opportunities, rather than solely focusing on estate tax avoidance.

Later cases distinguish *Aaron* by emphasizing the presence of significant lifetime benefits and demonstrable life-related motives for establishing trusts, reinforcing the principle that the substance of the transfer, not just its form, determines whether it is in contemplation of death.

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