Estate of Miran Karagheusian, Walter J. Corno, Leila Karagheusian, and Minot A. Crofoot, Executors, Petitioners, v. Commissioner of Internal Revenue, Respondent, 23 T.C. 806 (1955)

When a decedent does not possess incidents of ownership in a life insurance policy, even if the decedent has the power to affect a trust holding the policy, the policy proceeds are not includible in the decedent's gross estate under the incidents of ownership test; however, the proceeds are includible to the extent that the decedent indirectly paid the premiums.

Summary

The Estate of Miran Karagheusian challenged the Commissioner's determination of an estate tax deficiency. The key issue was whether the proceeds of a life insurance policy on the decedent's life were includible in his gross estate. The policy was taken out by his wife and assigned to a trust. Although the decedent had to consent to alterations or revocations of the trust, the court held that he did not possess incidents of ownership in the policy itself. The court determined that the insurance proceeds were includible in the decedent's gross estate only to the extent that the premiums were paid with funds indirectly attributable to the decedent's contributions to the trust. The court also ruled that the transfers made by the decedent to the trust were includible at a valuation based on a percentage of the total trust corpus at the date of the decedent's death in proportion to his contributions to the trust corpus.

Facts

Miran Karagheusian's wife, Zabelle, applied for a $100,000 life insurance policy on his life. She was the owner of the policy. Zabelle transferred the policy to a trust, along with securities, for the benefit of herself, their daughter, and eventually, a charitable foundation. The trust agreement allowed Zabelle, with the consent of her husband and daughter, to alter, amend, or revoke the trust. Both Miran and Zabelle made additional transfers of cash or securities to the trust over time. The income from the trust was primarily used to pay the insurance premiums. At Miran's death, the insurance proceeds were paid to the trust. The IRS included the insurance proceeds in Karagheusian's gross estate, claiming he possessed incidents of ownership and paid premiums indirectly. The IRS valued his transfers to the trust based on the value of the original securities transferred by him. At the time of Karagheusian's death, the original securities were no longer in the trust.

Procedural History

The Estate of Miran Karagheusian filed an estate tax return. The Commissioner determined a deficiency, which the estate contested. The case was brought before the United States Tax Court. The Tax Court heard the case and issued a decision.

Issue(s)

1. Whether the insurance proceeds are includible in the decedent's gross estate under section 811(g)(2)(A) or (B) of the Internal Revenue Code of 1939.
2. Whether any part of the proceeds of the policy are includible as being derived from transfers in contemplation of death.
3. What is the proper valuation of transfers of cash and securities made to the trust by the decedent?

Holding

1. No, the decedent did not have incidents of ownership in the policy at his death requiring inclusion of the insurance proceeds in his gross estate.
2. Yes, the insurance proceeds are includible only insofar as the trust income used to pay the premiums was attributable to trust assets contributed by the decedent.
3. No, the decedent made no transfer of the policy in contemplation of death or otherwise.
4. The decedent's transfers to the trust are includible at a valuation based on a percentage of the total trust corpus exclusive of the policy and proceeds at the date of the decedent's death in proportion to his contributions to the trust corpus.

Court's Reasoning

The court first addressed whether the decedent possessed any "incidents of ownership" in the insurance policy itself. The court explained that the policy was applied for and owned by the decedent's wife and assigned to a trust, with the trustee holding all rights under the policy. The trust agreement required the decedent's consent for amendments, but the court determined that this power related to the trust, not the policy. The court distinguished this from cases where the decedent directly held powers over the policy. "By the terms of the statute, the incident of ownership must be with respect to the life insurance policy… In the case before us, the policy was assigned to the trustee." Because the decedent did not possess any incidents of ownership in the policy, the court found that the full value of the policy proceeds should not be included under this test. The court then addressed whether the premiums were paid indirectly by the decedent. The court decided that to the extent that the premiums were paid by funds that came from the decedent, they would be included. The Court stated, "We think, therefore, that it is reasonable to consider the premium for each year allocable between decedent and Zabelle in proportion to their respective contributions to the trust corpus as of that year." The court also rejected the argument that the transfers were made in contemplation of death because the decedent never owned the policy. Finally, the court found that the valuation of the assets transferred to the trust should be based on the value of the assets in the trust at the time of death rather than the original assets transferred.

Practical Implications

This case emphasizes the importance of carefully structuring life insurance arrangements to minimize estate tax liability. If a decedent is not the owner of the policy and does not retain incidents of ownership, the policy proceeds may not be included in the gross estate. However, the IRS will look closely at whether the decedent indirectly paid the premiums, and if so, the proceeds will be included in proportion to the premiums deemed paid by the decedent. The court also highlights that when determining the value of transfers in trust, the relevant value is that of the assets in the trust at the time of death, not the value of the original assets. This case is a reminder that a power to change a trust is not the same as a power over the life insurance policy itself. This case provides a foundation for the analysis of estate tax consequences of life insurance policies held in trust, which is still relevant today. It illustrates how the IRS might attempt to include insurance proceeds in the gross estate under different theories. Attorneys should carefully advise clients on the ownership and control of life insurance policies and on the tax implications of trust structures.