Estate of John S. Davis, 27 T.C. 378 (1956)

An annuity is includible in a decedent's gross estate if the decedent retained the power, in conjunction with another party, to alter or revoke the beneficiary designation, even if the other party's consent was required.

Summary

The case concerns the estate tax liability for an annuity contract provided by the decedent's employer. The decedent elected a reduced annuity to provide a survivor benefit for his wife. The court addressed whether the value of the wife's annuity was includible in the decedent's gross estate under sections 811(c) and 811(d) of the Internal Revenue Code of 1939. The court held that the value of the wife's annuity was includible because the decedent, in conjunction with the insurance company, retained the power to alter or revoke the beneficiary designation. The court focused on the existence of the power, not its likelihood of being exercised, or its exercise in this case. The court determined that the right to alter, even with the consent of another, was sufficient to trigger estate tax liability.

Facts

John S. Davis, an employee of F.W. Woolworth Co., participated in a group annuity contract with Aetna Life Insurance Company. This contract allowed employees to elect an optional form of annuity, reducing their payments to provide a survivor annuity for a designated joint annuitant, typically a spouse. Davis elected this option, naming his wife as the joint annuitant. The annuity contract specified that the employee could, with the insurance company's consent, elect an optional form of annuity different from the standard form. Davis died. The IRS included the value of the wife's annuity in Davis's gross estate for estate tax purposes. The estate challenged this inclusion.

Procedural History

The IRS determined a deficiency in the estate tax, including the value of the joint annuity in the gross estate. The estate petitioned the Tax Court to challenge the deficiency. The Tax Court considered stipulated facts and ruled in favor of the respondent, the IRS.

Issue(s)

1. Whether the decedent's election to receive a reduced annuity and provide for a survivor annuity for his wife constituted a "transfer" under section 811 of the Internal Revenue Code of 1939.
2. Whether the decedent retained such a power to alter or amend or designate the persons who shall possess or enjoy the property, arising under the provisions of the annuity contract, as to justify the inclusion in decedent's gross estate of the value of such transferred interest under section 811 (c) (1)

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(B) (ii) or section 811 (d).

Holding

1. Yes, the election to take a reduced annuity and name his wife as joint annuitant constituted a transfer.
2. Yes, the decedent's right, with the consent of the insurance company, to alter or revoke the election justified the inclusion of the value of the annuity in his gross estate.

Court's Reasoning

The court relied on prior case law to establish that the election of the optional annuity form was a transfer by the decedent. The critical issue was whether the decedent had the power to alter or amend the designation of his wife as the joint annuitant. The court focused on the language of the annuity contract, specifically Section VIII-A, which stated that an employee could elect a different annuity form with the consent of the insurance company. The court reasoned that this provision gave the decedent the right, in conjunction with the insurance company, to revoke the election or change the joint annuitant. The court stated that it is the right of the decedent to revoke and to alter quoad the joint annuitant which is important. The court dismissed the estate's argument that the insurance company would not have consented to a change after annuity payments began. The court emphasized that "the existence of the right, rather than the likelihood of its exercise, is the controlling factor." The court's interpretation of the annuity contract's terms determined that the decedent had the power to change the beneficiary with the consent of the insurer, and that this power warranted the inclusion of the annuity's value in the estate. The court found that the power to revoke or alter the annuity, even with the consent of the insurance company, triggered estate tax liability under either section 811(c)(1)(B)(ii) or section 811(d) of the 1939 Code. The court emphasized that the consent of the joint annuitant was not required for any such change.

Practical Implications

This case underscores the importance of carefully reviewing annuity contracts and other instruments to determine whether the decedent possessed any powers to alter, amend, or revoke benefits, even if those powers require the consent of another party. The case highlights that even a limited power to affect the enjoyment of property can lead to estate tax liability. Estate planners must consider the implications of the contract terms and the potential for estate tax liability when advising clients. This case serves as a warning: the IRS will examine whether a power to change a beneficiary exists, and if so, include the asset in the decedent's gross estate. The case emphasizes that it is the existence of the power, and not whether it was likely to be exercised, that matters for estate tax purposes. Later cases may cite this case for the principle that the power to alter, even with the

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consent of a third party, can trigger inclusion in the gross estate. This case has implications for similar situations involving life insurance policies, trusts, or other instruments where the decedent may have retained any control over the disposition of property.

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