Estate of Sidney F. Bartlett, Miriam B. Butterfield, Executrix, Petitioner v. Commissioner of Internal Revenue, Respondent, 54 T. C. 1590 (1970)

The proceeds of life insurance policies are not includable in the decedent's gross estate if the decedent effectively divests all incidents of ownership before death, except for policies with valid anti-assignment clauses.

Summary

Sidney F. Bartlett assigned his life insurance policies to a trust, naming the Northern Trust Co. as beneficiary and trustee. The U. S. Tax Court held that the proceeds of these policies, except for a group term policy, were not includable in Bartlett's estate under Section 2042(2) of the Internal Revenue Code. The court reasoned that Bartlett had effectively transferred all incidents of ownership to the trust, except for the group term policy which had an anti-assignment clause. This decision emphasizes the importance of ensuring that assignments of life insurance policies are valid under both the policy terms and applicable state law to avoid estate tax inclusion.

Facts

On September 22, 1955, Sidney F. Bartlett owned several life insurance policies. On September 23, 1955, he and the Northern Trust Co. executed an irrevocable trust agreement, assigning all rights in these policies to the trust. Bartlett also executed change of beneficiary forms for most policies, naming the Northern Trust Co. as beneficiary. The insurance companies accepted these changes. Bartlett continued paying premiums on the policies, except for a group term policy where he shared costs with his employer. Upon his death on November 3, 1963, the insurance proceeds were paid to the trust.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Bartlett's estate tax, asserting that the proceeds of the policies were includable in his gross estate due to retained incidents of ownership. Bartlett's estate filed a petition with the U. S. Tax Court, challenging this determination. The court heard the case and issued its opinion on August 6, 1970.

Issue(s)

1. Whether the proceeds of the life insurance policies, except the group term policy, are includable in Bartlett's gross estate under Section 2042(2) of the Internal Revenue Code because he possessed incidents of ownership at the time of his death.
2. Whether the proceeds of the group term life insurance policy are includable in Bartlett's gross estate under the same section due to an effective anti-assignment clause in the policy.

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Holding

1. No, because Bartlett effectively transferred all incidents of ownership to the trust before his death, and the assignment was valid under Illinois law despite not being filed with the insurers.
2. Yes, because the group term policy contained a valid anti-assignment clause, rendering Bartlett's attempted assignment void and leaving him with incidents of ownership at death.

Court's Reasoning

The court analyzed the trust agreement's language, which clearly assigned all rights in the policies to the trust. It rejected the Commissioner's argument that the agreement was not intended as an assignment, emphasizing the decedent's intent to divest ownership. The court also considered the effect of state law, noting that under Illinois law, the assignment was effective even without notice to the insurers, as the notice provisions were for the insurers' protection only. For the group term policy, the court upheld the anti-assignment clause as valid under Illinois law, rendering Bartlett's assignment ineffective. The court distinguished this case from others where assignments were upheld because those policies permitted assignment. The court's decision was influenced by the need to interpret incidents of ownership under federal law while considering the impact of state law on policy provisions.

Practical Implications

This decision highlights the importance of carefully reviewing life insurance policy terms and state law when planning estate transfers. Attorneys should ensure that assignments of life insurance policies are valid under both the policy and applicable state law to avoid unintended estate tax consequences. For group term policies, practitioners must be aware of anti-assignment clauses that can invalidate attempted transfers. This case has been cited in subsequent cases dealing with the assignment of life insurance policies and the definition of incidents of ownership, reinforcing the principle that effective divestment of ownership rights can exclude policy proceeds from the gross estate.

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