Estate of Hector E. Skifter v. Commissioner, T.C. Memo. 1970-271

Fiduciary powers over life insurance policies, where the insured-trustee cannot personally benefit, do not constitute incidents of ownership under Section 2042(2) of the Internal Revenue Code; however, discretionary power to accumulate or distribute trust income as a grantor-trustee results in inclusion of the trust assets in the gross estate under Section 2036(a)(2).

Summary

In this Tax Court case, the estate of Hector Skifter contested the Commissioner's determination that proceeds from life insurance policies and assets from three accumulation trusts should be included in Skifter's gross estate. Skifter had previously assigned life insurance policies to his wife, who then placed them in a testamentary trust with Skifter as trustee. The court held that Skifter's fiduciary powers as trustee did not constitute incidents of ownership because he could not benefit personally. However, the court ruled that Skifter's discretionary power as trustee to distribute or accumulate income in trusts he created for his grandchildren resulted in the inclusion of the trust assets in his gross estate under Section 2036(a)(2) because it was a power to designate who enjoys the income.

Facts

Hector Skifter assigned nine life insurance policies on his life to his first wife, Naomi Skifter, making her the owner. Naomi predeceased Hector and her will established a residuary trust, naming Hector as trustee and their daughter, Janet, as the income beneficiary, with remainder to Janet's appointees or issue, or Hector. The nine insurance policies became assets of this trust. Hector also created three irrevocable "accumulation" trusts for his grandchildren, naming himself as trustee. These trusts allowed the trustee discretion to distribute or accumulate income until the grandchild reached 21, and to distribute principal for support, maintenance, or education. Hector died while serving as trustee for both Naomi's trust and the grandchildren's trusts.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Hector Skifter's estate tax, asserting that the proceeds of the life insurance policies and the assets of the grandchildren's trusts should be included in his gross estate. The Estate of Hector Skifter petitioned the Tax Court to contest this determination.

Issue(s)

1. Whether the decedent possessed "incidents of ownership" in nine life insurance policies on his life, solely in his capacity as trustee of his deceased wife's testamentary trust, such that the proceeds are includable in his gross estate under Section 2042(2) of the Internal Revenue Code (IRC).

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2. Whether the value of property in three “accumulation” trusts created by the decedent for his grandchildren is includable in his gross estate under Section 2036(a)(2) or Section 2038(a)(1) of the IRC due to powers retained by the decedent as trustee.

Holding

1. No. The decedent did not possess incidents of ownership in the life insurance policies under Section 2042(2) because his powers were held solely in a fiduciary capacity and could not be exercised for his personal benefit.
2. Yes. The value of the property in the accumulation trusts is includable in the decedent’s gross estate under Section 2036(a)(2) because his discretionary power to distribute or accumulate income constituted the right to designate who shall enjoy the income.

Court’s Reasoning

Life Insurance Policies: The court reasoned that Section 2042(2) requires the decedent to possess “incidents of ownership” at death for the insurance proceeds to be includable. The court emphasized that the decedent’s powers as trustee were strictly limited by the terms of Naomi’s trust and could only be exercised for the benefit of the beneficiaries, not for his own economic benefit. Quoting the Senate Finance Committee report, the court highlighted Congress’s intent to treat life insurance similarly to other property, rejecting a premium payment test and focusing on “ownership” at death. The court distinguished *Estate of Harry B. Fruehauf*, where the trustee’s powers could benefit himself. While acknowledging Regulation 20.2042-1(c)(4), which broadly defines incidents of ownership to include powers as a trustee, the court interpreted it narrowly to align with the legislative purpose of Section 2042, concluding that fiduciary powers without personal economic benefit do not constitute incidents of ownership in this context. The court stated, “*And it seems inconceivable to us that Congress would have intended the proceeds to be included in the insured’s gross estate in such circumstances merely because the third-party owner of the policy had entrusted the insured with fiduciary powers that were exercisable only for the benefit of persons other than the insured*.“

Accumulation Trusts: The court held that Section 2036(a)(2) mandates inclusion when the decedent retains the right to designate who shall enjoy the income from transferred property. The trust instruments gave Skifter, as trustee, discretionary power to either distribute income to the grandchildren or accumulate it and add it to principal during their minority. Citing *United States v. O’Malley*, the court affirmed that the power to control present enjoyment of income is a power to “designate.” The court rejected the estate’s argument that the trustee’s discretion was limited by external standards (like “support, maintenance, or education” for principal distributions), noting that no such standards applied to income distribution. The court concluded that Skifter’s retained discretionary power over income was sufficiently broad to trigger inclusion under Section 2036(a)(2).

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Practical Implications

This case clarifies that holding fiduciary powers over life insurance policies, in a situation where the insured-trustee cannot derive personal economic benefit, generally does not constitute “incidents of ownership” under Section 2042(2). This is significant for estate planning, particularly when insured individuals are asked to serve as trustees of trusts holding policies on their own lives. However, the case also serves as a stark reminder that grantors who act as trustees and retain discretionary powers over income distribution in trusts they create risk having the trust assets included in their gross estate under Section 2036(a)(2). It underscores the importance of carefully considering the scope of retained powers when establishing trusts and the distinction between powers held in a fiduciary capacity versus powers held for personal benefit in the context of estate taxation.

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