Estate of Milton L. Levy, Deceased, John Levy, Co-Executor, Jeffrey R. Levy, Co-Executor, Iris Levy, Co-Executrix, Petitioner v. Commissioner of Internal Revenue, Respondent, 70 T. C. 873 (1978); 1978 U. S. Tax Ct. LEXIS 63

Life insurance proceeds payable to a decedent's beneficiary are includable in the decedent's gross estate if the decedent was a controlling shareholder of the corporation owning the policy.

Summary

The Estate of Milton L. Levy contested the inclusion of life insurance proceeds in the decedent's gross estate, arguing that the controlling shareholder rule should not apply since decedent owned only 80. 4% of the voting stock of Levy Bros. The Tax Court upheld the validity of the regulation extending the rule to controlling shareholders, not just sole shareholders, and held that the proceeds payable to decedent's widow were includable in the estate. The court reasoned that a controlling shareholder has significant power over corporate actions affecting the disposition of insurance proceeds, justifying the attribution of corporate incidents of ownership to the decedent.

Facts

At the time of his death, Milton L. Levy owned 80. 4% of the voting stock and 100% of the nonvoting stock of Levy Bros. The corporation owned two life insurance policies on Levy's life, with proceeds payable to his widow, Iris Levy. Levy did not possess any direct incidents of ownership in the policies, but the corporation held rights such as changing the beneficiary of the cash value, assignment, borrowing, and modification of the policies. The Commissioner included the proceeds payable to the widow in Levy's gross estate, asserting that Levy's controlling interest in the corporation attributed its incidents of ownership to him.

Procedural History

The Commissioner determined a deficiency in the estate's federal estate tax, asserting that the insurance proceeds were includable in the gross estate under Section 2042 of the Internal Revenue Code. The estate filed a petition with the U. S. Tax Court challenging the deficiency. The Tax Court upheld the Commissioner's determination and entered a decision for the respondent.

Issue(s)

1. Whether Section 20. 2042-1(c)(6) of the Estate Tax Regulations, extending the attribution of corporate incidents of ownership to controlling shareholders, is valid.
2. Whether the proceeds of life insurance policies owned by Levy Bros. and payable to decedent's widow are includable in decedent's estate under Section 2042 of the Internal Revenue Code.

Holding

1. Yes, because the regulation is a reasonable interpretation of the statute and consistent with its legislative history.
2. Yes, because decedent's controlling interest in the corporation attributed its incidents of ownership to him, justifying the inclusion of the proceeds payable to his widow in his gross estate.

Court's Reasoning

The court upheld the validity of the 1974 amendment to the regulations, which extended the attribution of corporate incidents of ownership to controlling shareholders. The court reasoned that this was a reasonable interpretation of Section 2042, consistent with its legislative history and purpose. The court emphasized that a controlling shareholder has the power to influence corporate actions affecting the disposition of insurance proceeds, just as a sole shareholder would. The court rejected the estate's argument that the attribution should be limited to sole shareholders, stating that Congress did not intend to distinguish between a sole shareholder and one owning nearly all of the stock. The court also noted that the decedent's indirect control through his stock ownership allowed him to affect the exercise of the corporation's incidents of ownership, even if he did not hold a formal position in the company. The court concluded that the legislative history of Section 2042 supported the inclusion of proceeds in the gross estate when a decedent, as a controlling shareholder, could indirectly exercise control over the policy.

Practical Implications

This decision expands the scope of estate tax liability for life insurance proceeds, requiring attorneys to consider a client's indirect control over corporate-owned policies when planning estates. Practitioners should advise clients who are controlling shareholders of corporations owning life insurance policies on their lives to be aware that proceeds payable to beneficiaries other than the corporation may be included in their gross estate. This ruling may encourage the use of alternative estate planning strategies, such as cross-purchase agreements or the purchase of life insurance by a trust, to avoid unintended estate tax consequences. The decision also underscores the importance of understanding the interplay between corporate governance and estate planning, as a decedent's ability to influence corporate decisions can have significant tax implications. Subsequent cases have applied this ruling to various scenarios involving controlling shareholders and corporate-owned life insurance, solidifying its impact on estate tax law.