Estate of William Perl, Deceased, Sidney Finkel and Helen W. Finkel, Executors, Petitioner v. Commissioner of Internal Revenue, Respondent, 76 T. C. 861 (1981)

Life insurance proceeds are includable in the gross estate if the decedent possessed an incident of ownership, even if the policy was part of an employee benefit program.

Summary

William Perl, employed by the New Jersey College of Medicine and Dentistry, died while in service, triggering a life insurance payout from a policy purchased by his employer under the Alternate Benefit Program (ABP). The issue was whether these proceeds should be included in Perl's gross estate. The Tax Court held that they were includable under section 2042(2) because Perl retained the power to designate the beneficiary, an incident of ownership. The court rejected the estate's argument that section 2039(c) excluded these proceeds, ruling that the ABP was not a pension plan or retirement annuity contract as required by that section.

Facts

William Perl was employed by the New York University Medical Center from December 1964 to September 1969, and subsequently by the New Jersey College of Medicine and Dentistry until his death in 1976. As part of his employment, he was enrolled in the New Jersey Alternate Benefit Program (ABP), which included life and disability insurance purchased by the State of New Jersey from Prudential Life Insurance Co. Upon Perl's death, his designated beneficiaries received $139,062, representing 3 1/2 times his annual salary. Perl had the power to change the beneficiary designation until his death.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Perl's estate taxes, arguing that the life insurance proceeds should be included in the gross estate. The estate filed a petition with the U. S. Tax Court, contesting the inclusion under section 2039(c). The Tax Court upheld the Commissioner's determination, ruling in favor of the respondent.

Issue(s)

1. Whether the proceeds of the life insurance policy purchased under the ABP are includable in the decedent's gross estate under section 2042(2).
2. Whether section 2039(c) excludes these proceeds from the gross estate because they were part of an employee benefits program.

Holding

1. Yes, because the decedent retained the power to designate the beneficiary of the insurance policy, which is an incident of ownership under section 2042(2).
2. No, because the life insurance and disability policy did not meet the requirements of a pension plan or retirement annuity contract as specified in section 2039(c).

Court's Reasoning

The court applied section 2042(2), which includes in the gross estate the proceeds of any life insurance policy where the decedent possessed incidents of ownership at death. The power to change the beneficiary was deemed an incident of ownership. The court rejected the estate's argument that section 2039(c) excluded the proceeds, emphasizing that the ABP was not a pension plan or retirement annuity contract. The court cited Treasury Regulations defining a pension plan as one primarily providing post-retirement benefits, with life insurance being only an incidental benefit. The ABP's life insurance and disability benefits were not incidental but the primary features, disqualifying it as a pension plan. Similarly, the policy was not a retirement annuity contract as it did not provide for retirement benefits. The court's decision was influenced by the need to prevent tax avoidance by including in the estate assets over which the decedent retained control.

Practical Implications

This decision clarifies that life insurance proceeds from employer-provided policies are taxable in the decedent's estate if the decedent retains control over beneficiary designations. It underscores the importance of carefully structuring employee benefit plans to avoid unintended tax consequences. For estate planners, it is critical to review and possibly restructure life insurance policies to minimize estate tax liability. This ruling also impacts how similar cases involving employee benefits are analyzed, requiring a focus on the nature of the plan and the decedent's control over policy features. Subsequent cases have applied this principle, emphasizing the tax treatment of incidents of ownership in life insurance policies within employee benefit programs.

