***Estate of Leder v. Commissioner, 89 T. C. 235 (1987)***

Life insurance proceeds are not includable in the decedent's gross estate if the decedent never possessed any incidents of ownership in the policy.

**Summary**

Joseph Leder died in 1983, and his wife Jeanne had purchased a life insurance policy on his life three years earlier. The premiums were paid by Leder's wholly owned corporation. The issue was whether the insurance proceeds should be included in Leder's gross estate under section 2035 of the Internal Revenue Code. The Tax Court held that since Leder never possessed any incidents of ownership in the policy, section 2042 did not apply, and thus the proceeds were not includable in his estate. This decision was based on the plain language of section 2035(d) and Oklahoma law, which did not grant Leder any rights over the policy.

**Facts**

Jeanne Leder purchased a life insurance policy on her husband Joseph's life in January 1981, signing the application as owner. Joseph died in May 1983. The policy's premiums were paid by Leder Enterprises, a corporation wholly owned by Joseph, through preauthorized withdrawals. Jeanne transferred the policy to herself as trustee of an irrevocable trust in February 1983. Upon Joseph's death, the policy proceeds were distributed to the trust beneficiaries, Jeanne and their three children. The estate did not include these proceeds in the gross estate on the federal estate tax return, but the Commissioner of Internal Revenue determined a deficiency, arguing the proceeds should be included.

**Procedural History**

The estate filed a federal estate tax return that did not include the life insurance proceeds. The Commissioner issued a notice of deficiency, asserting that the proceeds should be included in the gross estate. The estate then petitioned the U. S. Tax Court for a redetermination of the deficiency. The case was submitted fully stipulated, and the Tax Court held for the estate, deciding that the proceeds were not includable in the gross estate.

**Issue(s)**

1. Whether the life insurance policy proceeds are includable in the decedent's gross estate under section 2035 of the Internal Revenue Code when the decedent never possessed any incidents of ownership in the policy.

**Holding**

1. No, because the decedent never possessed any incidents of ownership in the policy, section 2042 does not apply, and thus section 2035(d)(2) is inapplicable.

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Section 2035(d)(1) precludes the application of section 2035(a), meaning the proceeds are not includable in the gross estate.

**Court’s Reasoning**

The court’s decision hinged on the interpretation of section 2035(d) of the Internal Revenue Code, enacted by the Economic Recovery Tax Act of 1981. Section 2035(d)(1) generally repealed the 3-year rule for gifts made within three years of death, but section 2035(d)(2) created exceptions for certain transfers. The court found that for section 2035(d)(2) to apply, the decedent must have possessed an interest in the property under sections like 2042, which deals with life insurance proceeds. Since Joseph Leder never possessed any incidents of ownership in the policy under Oklahoma law, section 2042 did not apply, and thus section 2035(d)(2) could not override section 2035(d)(1). The court emphasized the plain language of the statute and rejected the Commissioner’s argument that legislative history supported a different interpretation. The court also noted that payment of premiums by Leder’s corporation did not confer any interest in the policy under Oklahoma law.

**Practical Implications**

This decision clarifies that life insurance proceeds are not automatically includable in the gross estate under the 3-year rule if the decedent never had any incidents of ownership in the policy. Estate planners must carefully structure ownership of life insurance policies to ensure they are not included in the decedent’s estate, particularly when premiums are paid by a third party like a corporation. The ruling emphasizes the importance of state law in determining incidents of ownership and highlights the need to review the specific terms of life insurance policies and applicable state statutes. This case has been influential in later decisions, such as Estate of Kurihara v. Commissioner, where similar issues were addressed. For attorneys, this case underscores the need to consider both federal tax code and state law when advising clients on estate planning involving life insurance.

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