Estate of Eddie L. Headrick, Deceased, Cleveland Bank & Trust Company and Charles L. Almond, Executors, Petitioners v. Commissioner of Internal Revenue, Respondent, 93 T. C. 171 (1989)

Life insurance proceeds are not includable in the decedent's gross estate if the decedent never possessed incidents of ownership in the policy, even if the policy was purchased within three years of death.

Summary

Eddie L. Headrick established an irrevocable trust, which purchased a life insurance policy on his life within three years of his death. The trust agreement allowed the trustee, Cleveland Bank & Trust Company, to acquire life insurance but did not require it. Headrick contributed funds to cover the premiums. The IRS argued that the proceeds should be included in Headrick's estate under IRC sections 2035(a) and 2042 due to his indirect payment of premiums. The Tax Court held that because Headrick did not possess any incidents of ownership in the policy, the proceeds were not includable in his gross estate, following the precedent set in Estate of Leder v. Commissioner.

Facts

Eddie L. Headrick, a tax attorney, established an irrevocable trust on December 18, 1979, with Cleveland Bank & Trust Company (CBT) as trustee. The trust agreement allowed, but did not require, CBT to purchase life insurance on Headrick's life. Headrick contributed $5,900 to the trust on the same day and later made additional contributions totaling $13,400 to cover the premiums of a $375,000 whole life policy purchased by CBT on January 8, 1980. Headrick died in an automobile accident on June 19, 1982, within three years of the policy's purchase. The insurance proceeds were paid to CBT as the policy owner.

Procedural History

The executors of Headrick's estate filed a federal estate tax return, excluding the life insurance proceeds from the gross estate. The IRS issued a notice of deficiency, asserting that the proceeds should be included under IRC sections 2035(a) and 2042. The executors petitioned the U. S. Tax Court, which ruled in their favor, holding that the proceeds were not includable in the estate.

Issue(s)

1. Whether the proceeds of a life insurance policy purchased within three years of the decedent's death by a trust established by the decedent are includable in the decedent's gross estate under IRC section 2035(a).

Holding

1. No, because the decedent never possessed any incidents of ownership in the life insurance policy under IRC section 2042, the proceeds are not includable in his gross estate under IRC sections 2035(d)(2) and 2035(a).

Court’s Reasoning

The court focused on whether Headrick possessed any incidents of ownership in the policy under IRC section 2042. The trust agreement clearly stated that the trustee alone would exercise all incidents of ownership over any policy held by the trust. The court noted that Congress had abolished the payment of premiums as a factor in determining the taxability of life insurance proceeds under section 2042. The court followed Estate of Leder v. Commissioner, which held that proceeds are not includable if the decedent did not possess incidents of ownership. The court rejected the IRS’s agency theory, stating that it was not relevant to the section 2042 analysis. The court emphasized that the trust operated independently of Headrick’s control over the policy.

Practical Implications

This decision clarifies that life insurance proceeds can be excluded from a decedent’s gross estate if the decedent does not possess any incidents of ownership in the policy, even if the policy was purchased within three years of death. This ruling is important for estate planning, as it allows individuals to structure their trusts to exclude life insurance proceeds from their taxable estates. Practitioners should ensure that trust agreements explicitly state that the trustee, not the grantor, holds all incidents of ownership in any life insurance policies purchased by the trust. This case has been influential in subsequent rulings, reinforcing the principle that the focus should be on incidents of ownership rather than premium payments.

