

SUPREME COURT OF THE UNITED STATES

Fidelity-Philadelphia Trust Co. et al., Executors v. Smith, Collector of Internal Revenue
356 U.S. 274 (1958) — Argued January 28, 1958 — Decided May 19, 1958

CASE SYLLABUS & DOCKET SUMMARY

Citation: 356 U.S. 274 (1958)

Docket Number: No. 130

Opinion Delivered By: Mr. Chief Justice Warren

Question Presented: Whether proceeds of single-premium life insurance policies, assigned irrevocably by a decedent to her children during her lifetime, are includible in her gross taxable estate under Section 811(c)(1)(B) of the 1939 Code (predecessor to IRC § 2036) because she simultaneously purchased separate single-premium life annuity contracts.

STATEMENT OF FACTS

In 1934, at age 76, the decedent purchased three single-premium life insurance policies on her life. As a condition to issuing the insurance policies without a physical medical examination, the insurance company required the decedent to purchase separate, single-premium nonrefundable life annuity contracts.

The total premium paid for the insurance policies was ,500, and for the annuity contracts was ,000. In 1935, the decedent assigned all ownership rights, title, and interest in the life insurance policies to her children and a trust, retaining no incident of ownership or reversionary interest.

The decedent continued to receive annual annuity payments under the separate annuity contracts until her death in 1946. Upon her death, the IRS included the insurance proceeds in her gross estate, asserting she had retained an income stream for life under IRC § 811(c)(1)(B).

OPINION OF THE COURT & LEGAL ANALYSIS

Mr. Chief Justice Warren delivered the opinion of the Court:

The government contends that the annuity payments represent a retained income interest in the property transferred under the life insurance policies. We cannot agree.

1. Separability of Property Interests: The annuity contracts and the life insurance policies represented distinct, independent property interests. The assignment of the insurance policies completely divested the decedent of all rights and economic benefits in those specific policies.

2. Bona Fide Contractual Obligation Test: Where a transferor receives an independent contractual right to fixed payments (such as an annuity or bona fide debt note) that is not tied directly to or contingent upon the income generated by the transferred assets, the payments do not constitute a retained life estate under IRC § 2036.

HOLDING & APPLICATION TO IDGT INSTALLMENT SALES

Holding: The Supreme Court held that because the decedent had completely assigned all rights in the insurance policies and the annuity payments were an independent obligation, the insurance proceeds were NOT includible in her gross estate.

Estate Planning Precedent for IDGT Sales: In IDGT installment sales, tax practitioners rely on *Fidelity-Philadelphia Trust Co.* to establish that a promissory note issued by a trust constitutes a **bona fide contractual debt obligation**, not a retained income interest under IRC § 2036. To satisfy the Court's test, the trust must possess independent equity (the 10% seed capital benchmark) so note payments are supported independently of the sold asset.