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The Goodman Triangle: Avoiding the Hidden Life-Insurance Tax Trap

QUICK TAKE

When the **policy owner**, **insured**, and **beneficiary** are three different individuals, the IRS refers to it as the **Goodman Triangle**. The death benefit is re-characterized as a **taxable gift** from the owner to the beneficiary — a surprise that can burn lifetime gift & estate exemption or even trigger an immediate gift-tax bill.

What Is the Goodman Triangle?

In the 1946 case *Goodman v. Commissioner*, 156 F.2d 218 (2d Cir. 1946), the Second Circuit Court of Appeals ruled that life-insurance proceeds are treated as a completed gift when:

1. **Owner** — controls the policy, pays premiums.
2. **Insured** — whose life is covered.
3. **Beneficiary** — receives the payout.

If all three roles are held by **three different people**, the owner is deemed to have made a post-mortem gift equal to the entire death benefit.

Why It Matters

- Death benefits often dwarf annual gift limits (the 2026 exclusion is **$19,000** per recipient).
- Anything above the annual limit eats into the owner's **lifetime exemption ($15 million** per individual in 2026, now permanent under P.L. 119-21).
- Even at the higher exemption level, large death benefits can meaningfully erode remaining headroom — and any future policy growth compounds the exposure.
- If the owner's remaining exemption is already used up, a **40% gift tax** can apply.

Bottom line: The policy you bought for family protection could hand your heirs a preventable tax headache.

Common Scenarios That Create the Trap

SCENARIO	OWNER	INSURED	BENEFICIARY	EXPOSURE
Grandparent buys policy on adult child to benefit grandchild	Grandparent	Adult Child	Grandchild	**Gift Risk**
Business owner funds policy on key employee, pays proceeds to employee's spouse	Company	Key Employee	Spouse	**Gift Risk**
Divorced parent keeps policy on ex-spouse for child's benefit	Parent	Ex-Spouse	Child	**Gift Risk**

Even well-advised clients slip here when relationships change — think remarriage, a new child, or business succession tweaks.

QUESTIONS ON A SPECIFIC CASE?

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FOUR WAYS TO STAY OUT OF THE TRIANGLE

1 **Keep It Two-Legged**
Make the owner and beneficiary the same person.
Example: Parent owns the policy and is beneficiary; proceeds replenish the parent's estate for the child's care.

2 **Align Owner with Insured**
The easiest fix is to let the **insured also be the owner**. At death, no gift occurs because you can't gift yourself. Premiums can be reimbursed later through estate equalization if desired.

3 **Use a Trust (ILIT)**
Transfer ownership to an **Irrevocable Life Insurance Trust**. The trust becomes both owner and beneficiary, eliminating the Goodman problem and keeping proceeds outside the taxable estate. Observe the three-year transfer rule (§2035) if moving an existing policy.

4 **Cross-Purchase in Business Settings**
In buy-sell funding, have each shareholder own a policy on the **other** shareholder — owner ≠ beneficiary, but insured is the same as beneficiary, avoiding the three-party mix. Your corporate attorney can map the cleanest structure.

STEPS WHEN UPDATING EXISTING POLICIES

1 **Audit Your Contracts**
Pull every policy and list the current owner, insured, and beneficiary. Highlight any three-party triangles.

2 **Calculate Exposure**
Compare the death benefit to the owner's remaining lifetime exemption. If the gap is large, urgency is high.

3 **Choose a Fix**
Consolidation, ownership change, or trust — pick what meshes with your estate plan.

4 **Paper It Correctly**
Use carrier forms for ownership & beneficiary changes; log gift-tax filings (Form 709) if necessary.

5 **Review Annually**
Life changes fast; keep triangles off the org chart.

IMPORTANT DISCLOSURE

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