TAXATION - FEDERAL ESTATE TAX - LIFE INSURANCE PAYABLE TO SPECIFIC BENEFICIARY

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Taxation — Federal Estate Tax — Life Insurance Payable to Specific Beneficiary — Six life insurance policies were taken out by decedent upon his own life between March 19, 1925 and January 2, 1929. On July 20, 1932 the decedent, by an instrument in writing, made an assignment of the policies to his wife and named her the beneficiary under the policies. From the date of the assignment until the date of his death, the decedent did not possess any incidents of ownership of the policies though he continued to pay the premiums. The wife of the decedent sued to recover the amount of the tax, assessed and paid on the net proceeds from these policies in excess of $40,000, under § 302 (g) of the Revenue Act of 1924. Held, that the plaintiff could not recover since the statute was broad enough to cover this situation and the tax was valid, because life insurance is inherently testamentary in character and because there is no absolute right to possession and enjoyment until insured's death. Bailey v. United States, (Ct. Cl. 1939) 27 F. Supp. 617.

In a later case decided on facts similar to those of the above cited case, the United States District Court for the Southern District of New York held that § 302 (g) did not authorize the tax where none of the legal incidents of ownership were retained by the insured. Chase National Bank v. United States, (D. C. N. Y. 1939) 28 F. Supp. 947.

These cases again raise the long mooted question whether § 302 (g) is broad enough to include the proceeds in excess of $40,000 on all policies payable to “all other beneficiaries” regardless whether insured retains any control over the policy until death. This question has never been decided by the Supreme Court, but in Chase National Bank v. United States, in which the Supreme Court held the tax valid where the insured had retained the right to change the beneficiary, there is language which indicates that such a tax would not be applicable if none of the incidents of ownership were retained by the decedent. Two rules of statutory construction are applicable in construing this statutory provision: (1) taxing statutes are not to be extended, by implication, beyond the clear import of the language used, and (2) statutes susceptible of two constructions

1 43 Stat. L. 305, still in effect as 26 U. S. C. (1935), § 411: “The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property . . . (g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.”

2 278 U. S. 327, 49 S. Ct. 126 (1929).

must be construed, if possible, so as to avoid the raising of grave and doubtful constitutional questions.\(^4\) On examination of § 302 (g), the language seems to provide clearly and simply for taxation of the proceeds of the policies designated therein without exception.\(^5\) But the words of a single provision in a statute cannot be read alone; rather they must be read and construed with regard to other parts of the statute. Looking, then, to the other parts of § 302, all of which deal with taxation of property transferred in contemplation of death or property passing out of the control, possession, or enjoyment of decedent at his death,\(^6\) it is apparent that they require retention of some control or interest by the decedent during his life, unless the transfer is made in contemplation of death.\(^7\) In the light of these provisions, it is at least doubtful that the general language of § 302 (g) was used by Congress with the intention of making insurance proceeds the only instance where a death tax could be levied on an inter vivos transfer not in contemplation of death without retention by decedent of some control or interest until death.\(^8\) Furthermore § 301 (a) imposes a tax upon "the interest therein of the decedent at the time of his death."\(^9\) When this section is read in connection with § 302 (g), as it must be, the latter section is limited to policies in which there is some shifting of the decedent's interest as a result of death.\(^10\) Thus, at best, the meaning of § 302 (g) is ambiguous. If this section is given the broader of the two possible constructions, serious constitutional questions will arise; \(^11\) and so, in keeping with the above stated rules of statutory construction, § 302 (g) should not be applied to the proceeds of insurance policies where there was a complete and irrevocable inter vivos transfer of same. Under the other provisions of § 302 the courts have refused to apply the tax to cases in which there was not a substantial degree of interest or control retained by decedent unless the language of the statute clearly


\(^6\) Section 302 (b), dower and curtesy; (c, d), gift in contemplation of or to take effect in possession or enjoyment at or after death; (e), property held jointly or by the entirety; (f), power of appointment.

\(^7\) It is not significant that the statute does not require retention of some interest or control in the case of inter vivos transfers in contemplation of death. Acts done in contemplation of death have always been treated by the law as of a distinct and peculiar nature, not to be controlled by ordinary rules of law, e.g., the distinction of gifts causa mortis from inter vivos gifts.

\(^8\) It would require "plain and compelling language" to subject inter vivos transfers to a death tax. Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929).


compelled it. Of significance, too, is the fact that the Treasury Department interprets § 302 (g) as applicable only if the decedent possessed at the time of his death some of the legal incidents of ownership.

But even though the ambiguity in § 302 (g) is resolved in favor of the broadest possible interpretation, there is still the constitutional hurdle which must be "cleared" before the tax can be validly enforced. In the Bailey case the question of the constitutionality of an estate tax upon the proceeds of insurance which has been completely and irrevocably assigned before death was decided in favor of the tax for the first time. There are a number of possible bases for upholding the constitutionality of the tax, none of which seem too convincing: (1) that the act conclusively presumes that the assignment was in contemplation of death, (2) that the transfer is designed to take effect in possession and enjoyment at or after death, (3) that the tax is in the nature of a "deferred" gift tax, (4) that an insurance policy is a testamentary disposition. To say that § 302 (g) conclusively presumes that the assignment was in contemplation of death stretches both the intent of Congress and that of the decedent. A conclusive presumption, to be constitutional, must be reasonable, and there is little reason in this presumption, which pays no heed to the usual meaning given the words "in contemplation of death." Theories (2) and (4) are an attempt to satisfy the contention that a tax on completed inter vivos transfers

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12 Sec. 302 (d) provides for death tax where the right to "alter, amend, or revoke" is reserved to the settlor. But the Supreme Court in Helvering v. Helholz, 296 U. S. 93, 56 S. Ct. 68 (1935), and White v. Poor, 296 U. S. 98, 56 S. Ct. 66 (1935), held that a retention of the power to "terminate" was not within the purview of the statute. By amendment in the Revenue Act of 1936 the word "terminate" was added to sec. 302 (d), 49 Stat. L. 1744 (1936).

Likewise under § 302 (c) the Supreme Court consistently held that retention of a life interest in the income of a trust was not sufficient to satisfy the statute until § 302 (c) was amended specifically to include a life interest in income. See also Knouff, "Death Taxes on Completed Transfers Inter Vivos," 36 Mich. L. Rev. 1284 at 1293, 1301 (1937).


14 The question of the constitutionality of a tax under the circumstances of the principal case has never been decided by the Supreme Court. However, there is language in Chase Nat. Bank v. United States, 278 U. S. 327, 49 S. Ct. 126 (1929), which indicates that the Court felt that such a tax would be unconstitutional. In the recent case of Chase National Bank v. United States, (D. C. N. Y. 1939) 28 F. Supp. 947, the district court never reached the constitutional question since it held the tax statute inapplicable. See also Helburn v. Ballard, (C. C. A. 6th, 1936) 85 F. (2d) 613; Walker v. United States, (C. C. A. 8th, 1936) 83 F. (2d) 103; Boswell v. Commissioner, 37 B. T. A. 970 (1938).

of insurance is a direct tax \(^{16}\) rather than a tax on the transfer of property. The statute purports to be a tax on "transfers" but a direct tax cannot be made into an excise tax by calling it such.\(^{17}\) There must be some transfer of property at death to which the tax can attach.\(^{18}\) Using property in the ordinary legal sense, i.e., a "bundle of rights," it is clear that, by a complete inter vivos assignment of all of the rights incident to the ownership of the policy, there is no property in the insurance policy to be transferred at death.\(^{19}\) The advent of death simply makes the rights which decedent transferred inter vivos more valuable, but transfers nothing.\(^{20}\) But the court may choose to view property in a practical manner, i.e., as "economic benefits."\(^{21}\) However, a tax on economic benefits passing at death appears to be a direct tax, for it is a tax on property not transferred, but created by death. The insured never owned the property created by his death, so how can he be taxed for the transfer of something he never had? Furthermore, conceiving of property as "economic benefits" converts a tax designed by the statute as a transfer tax into a succession tax. A transfer tax is a tax on the transfer of decedent's estate, while a succession tax is a tax on the completion of the shifting of the economic benefits and burdens of property. To say that this is a transfer taking effect in possession and enjoyment at or after death is inconsistent with the fact that every right of enjoyment incident to the insurance policy, e.g., the right to surrender the policy for its cash value, etc., is vested in the assignee before the death of the insured.\(^{22}\) If this is, in fact, a gift tax [theory (3)] on an inter vivos transaction\(^{23}\) and deferred till death for

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\(^{16}\) A tax "imposed upon property solely by reason of its ownership" is direct. Knowlton v. Moore, 178 U. S. 41 at 81, 20 S. Ct. 747 (1900); Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 S. Ct. 673 (1895). See also 39 HARV. L. REV. 888 at 889 (1926).


\(^{21}\) 44 YALE L. J. 1245 at 1247 (1935).


\(^{23}\) Indicating that this may be like a gift tax: Helvering v. Bullard, 303 U. S.
collection, as of what time should the value of the property be ascertained for purposes of the tax? The gift is actually made at a time when the insurance policy is of comparatively little cash value so if the tax is levied on the basis of the greatly enhanced value of the insurance policy at the death of the insured, it would seem to be an arbitrary and capricious classification of property for tax purposes. However, opposed to all the foregoing arguments is the very practical argument that life insurance offers an attractive method of escaping death taxes, and that this consideration should be sufficient to warrant the inclusion of the proceeds of all policies in the decedent’s estate for death tax purposes. Certainly the Supreme Court’s decision in Helvering v. Bullard\(^\text{24}\) indicates considerable liberality in permitting Congress to classify certain inter vivos transactions as taxable under the estate tax law.\(^\text{25}\)

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\(^{24}\) 303 U. S. 297, 58 S. Ct. 565 (1937), reversing (C. C. A. 7th, 1937) 90 F. (2d) 144. How far the Supreme Court will follow its language in the Bullard case is problematical. It is important to note, however, that there the tax was assessed under § 302 (c) and not § 302 (g) and there was retention of the life income from the trust in the settlor. For a complete analysis of the ramifications of the Bullard case, see Knouff, “Death Taxes on Completed Transfers Inter Vivos,” 36 Mich. L. Rev. 1284 (1937).