Michigan Law Review

Volume 34 | Issue 8

1936

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Recommended Citation
TAXATION-FEDERAL ESTATE TAX-INCLUSION OF PROCEEDS OF INSURANCE POLICIES IN THE GROSS ESTATE, 34 MICH. L. REV. 1207 (1936).
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TAXATION—FEDERAL ESTATE TAX—INCLUSION OF PROCEEDS OF INSURANCE POLICIES IN THE GROSS ESTATE—It was only natural that the framers of our revenue acts, always on the lookout for new sources of revenue, should have turned their attention to the proceeds of insurance policies when they were dealing with the subject of death duties. It was natural for two reasons: first, the purchase of an insurance policy is nearly always prompted by some vague contemplation of death, and the receipt of the proceeds from a policy is intimately connected with death, in view of the fact that death normally is the event that brings about the maturity of the policy; and second, if the proceeds of insurance are not taxed, great opportunities for tax avoidance are opened to testators who desire to pass their property to special

beneficiaries. The theory of taxation of the proceeds of insurance policies by death duty is that insurance is simply a method of building an estate by the investment of periodic savings.[1]

Yet there is something paradoxical about looking upon an insurance policy as an investment and including it in the gross estate of a decedent. The insured can never fully enjoy the rights he has created. As one early case expressed it, it is a case of "the springing up, upon the death, and the then vesting in another of property which previously had not been existing in anyone." [2] It was undoubtedly consciousness of this paradox, plus a feeling that it was not good public policy to impose a tax upon a man's efforts to take care of his family after his death, that retarded the progress of taxation in this field. The states especially have shown a considerable reluctance "in encroaching on the prerogatives of a privilege looking to the welfare of the family." [3] Where insurance is payable to the estate of the decedent, or to his administrators, there is less difficulty in calling it an investment, and no such question of public policy is raised. Consequently, it has uniformly been held that in the absence of specific exemption statutes, the proceeds of such policies are taxable, as part of the estate of the decedent. No specific statutory provision is required; they are taxable as transfers intended to take effect in possession or enjoyment at or after the death of the decedent.[4] But under the influence, no doubt, of the reasoning suggested above, it has been established that insurance payable to named beneficiaries is not taxable in the absence of special provisions in the statutes relating thereto specifically.[5]

[1] Argument of the Attorney General in Lewellyn v. Frick, 268 U. S. 238, 45 S. Ct. 487 (1924); 44 YALE L. J. 1245 (1935).

[2] Oppenheimer, "Proceeds of Life Insurance Policies under the Federal Estate Tax," 43 HARV. L. REV. 724 at 725 (1930), quoting Attorney-General v. Robinson, [1901] 2 I. R. 67 at 90.

[3] 604 C. C. H., § 1580, p. 16,101 (1936). See also 9 WASH. L. REV. 178 (1934) for discussion of the policy against such taxation.

[4] Oppenheimer, "Proceeds of Life Insurance Policies under the Federal Estate Tax," 43 HARV. L. REV. 724 at 736 (1930); PINKERTON and MILLSAP, INHERITANCE AND ESTATE TAXES, c. 22, § 205, p. 161 (1926); VANCE, INSURANCE, 2d ed., c. 10, § 159, p. 610 (1930); 604 C. C. H., § 1580, p. 16,102 (1936); Matter of Knoedler, 140 N. Y. 377, 35 N. E. 601 (1893); In re Einstein's Estate, 114 Misc. 452, 186 N. Y. S. 931 (1921), affirmed 201 App. Div. 848, 193 N. Y. S. 931 (1922); Fagan v. Bugbee, 105 N. J. L. 85, 143 A. 807 (1928); In re Voorhees' Estate, 200 App. Div. 259, 193 N. Y. S. 168 (1922); In re Fay's Estate, 25 Misc. 468, 55 N. Y. S. 749 (1898); In re Reed's Estate, 243 N. Y. 199, 153 N. E. 47 (1926).

[5] 604 C. C. H., p. 16,104 (1936); Matter of Voorhees' Estate, 200 App. Div. 259, 193 N. Y. S. 168 (1922); Tyler v. Treasurer, 226 Mass. 306, 115 N. E. 300 (1917); 9 WASH. L. REV. 178 (1934); 43 HARV. L. REV. 322 (1929); In re Parson's Estate, 117 App. Div. 321, 102 N. Y. S. 168 (1907).

The Federal Government, less moved by considerations of policy, incorporated into the Act of 1918 what is now section 302(g) [6] of the Revenue Act. The state legislatures have been slow to follow this lead, although they are more rapidly moving in that direction today. In some states, by express statutory provision, insurance proceeds are not taxable.[7] However, in other states, about 14 in all,[8] there are statutes providing for such taxation, though with varying limitations.

The pertinent portions of the federal act are as follows:

> "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, real or personal, tangible or intangible, wherever situated . . . (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.
>
> "(h) Except as otherwise specifically provided therein, subdivisions (b), (c), (d), (e), (f) and (g) of this section shall apply to the transfers, trusts, estates, interests, rights, powers and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after the enactment of this act." [9]

The particular purpose of the following discussion is to single out the types of insurance which are taxable under the above quoted provisions. It will be seen that the problem is readily divisible into discussion under three general headings: insurance payable to the estate, insurance payable to named beneficiaries, and the general heading of retroactivity. Before proceeding to a detailed discussion of these topics, a word or two should be said regarding the constitutionality of these provisions. The constitutional attack is based upon the theory that such a tax either violates the Fifth Amendment or amounts to a direct tax, and is therefore void for want of apportionment. The Supreme Court has indicated that not all policies of insurance are to be included in the gross estate, but has wherever possible refrained from

[6] 40 Stat. L. 1098, § 402 (f) (1918).

[7] California, Colorado, Connecticut, Kentucky, North Dakota, and a number of other states, according to 604 C. C. H., p. 16,105 (1936).

[8] Arkansas, California, Colorado, Florida, Georgia, Massachusetts, Montana, New York, North Carolina, Oklahoma, Tennessee, Washington and Wisconsin. 604 C. C. H., § 1580A (1936). These statutes usually provide for a fixed exemption and may also completely exempt certain classes of beneficiaries, such as dependents. The Arkansas statute is an example of the latter type.

[9] 44 Stat. L. 70, § 302 (g), (h), 26 U. S. C., § 412 (g), (h) (1926).

putting its decision on constitutional grounds. The Court in very nearly all of the cases that have come before it has placed its decision on the ground of statutory construction and held that such a policy either does or does not fall within the language of the statute. However, one gets the very definite impression that the question of statutory construction and that of constitutionality are practically identical in the Court's mind. When the Court says a certain type of policy does not come within the terms of the act because there was no real transfer at death, one feels that the Court is definitely implying that if the act did cover such a policy it would be unconstitutional.

I.

The first clause in section 302(g), relating to insurance receivable by the executor, causes us no serious difficulties in view of the fact that insurance payable to the decedent's estate, or to his executors, was considered taxable under the general transfer provisions of inheritance and estate taxes, even in the absence of special provisions.[10] There might be some question as to when insurance is "taken out" by the decedent, but the administrative practice is to include all insurance on which decedent has paid the premiums either directly or indirectly. In fact, if they are paid by any person other than the beneficiary they are considered as paid by the insured indirectly.[11]

The courts have indicated, however, that not all insurance payable to the estate is to be taxable under this provision. In *Commissioner of Internal Revenue v. Jones*[12] the court said: "The term 'receivable by the executor' is in our opinion to be construed as meaning receivable for administration and distribution as an asset of the estate. . . . That act does not, however, determine what property of a decedent constitutes assets of his estate subject to claims and charges against it, and necessarily that question must be determined by the laws of the place where the estate is to be administered." As a consequence of this ruling of the court, whether such insurance may be included depends upon whether by the laws of the state it becomes an asset of the estate. If it does not, it is not taxable under this clause of the act. However, the general rule seems to be that any property receivable by the executor is an asset of the estate, in the absence of a specific statutory declaration to the contrary. Tennessee is an example of a state with such a statute.[13]

[10] See note 4, supra.

[11] Treas. Reg. 80, arts. 25, 26 (1934).

[12] (C. C. A. 6th, 1932) 62 F. (2d) 496 at 497.

[13] Tenn. Code (1932), § 8456: "A life insurance effected by a husband on his own life shall inure to the benefit of the widow and children; and the money there arising shall be divided between them according to the statute of distribution, without

The insurance may be payable to the executor as trustee. If it is payable to him as trustee for ordinary beneficiaries, it is really not payable to him in his capacity as executor and would be treated like any other insurance payable to a trustee. On the other hand if the policy is payable to the trustee or another than the trustee, and is really for the benefit of the estate, as a policy for the payment of debts or certain legacies named in the will, the proceeds may be included in the gross estate.[14] The insurance may also be payable to the executor or to another for the payment of the inheritance and estate taxes. The federal practice is to include the proceeds of such policies in the gross estate.[15] The general administrative practice of the states is to exclude such insurance, apparently on the theory that the trustee is a specific beneficiary,[16] and as we have seen the common practice of the states is to exclude all policies payable to named beneficiaries. Finally, the insurance may be payable to a specific beneficiary other than the executor, but as collateral security for a loan or other accommodation. In such case if the insured has either directly or indirectly paid the premiums thereon, the proceeds of the policy in excess of the amount of the loan and accrued interest are considered to be receivable for the benefit of the estate.[17]

2.

Our most troublesome problems arise in connection with the clause of the act relating to insurance payable to named beneficiaries. Clearly not *all* policies so payable are to be included. The question is what test we shall apply to decide just what types must be included. The statute sets up only the single test—was the policy "taken out" by the decedent on his own life? The Bureau of Internal Revenue, interpreting these words, states the test as follows:

> "Insurance is considered to be taken out by the decedent in all cases, whether or not he makes the application, if he pays the premiums either directly or indirectly, *or* they are paid by a person other than the beneficiary, *or* decedent possesses any of the legal incidents of ownership in the policy." [18]

It is to be noted that this test is stated in the alternative. By this

being in any manner subject to the debts of the husband." For the effect of this provision on the taxability of such a policy, see Appeal of Lucky and Kelso, Exrs., 2 B. T. A. 1268 (1925); Jones, Exr. v. Commr. of Int. Rev., 20 B. T. A. 441 (1930), affd. (C. C. A. 6th, 1932) 62 F. (2d) 496.

[14] Morton v. Commr. of Int. Rev., 23 B. T. A. 236 (1931).

[15] Treas. Reg. 80, art. 26 (1934).

[16] 604 C. C. H., p. 16,103 (1936).

[17] Treas. Reg. 80, art. 26 (1934).

[18] Treas. Reg. 80, art. 25 (1934).

test insurance would be taxable if the decedent paid the premiums directly or indirectly, *or* if he retained any of the legal incidents of ownership. It would seem that normally it is the latter part of the test that is emphasized. The very phrase "legal incidents of ownership" is taken from the decision of the Court in the case of the *Chase National Bank v. United States*,[19] the first and most important case in point decided by the Supreme Court. In that case and in the case of *Reinecke v. Northern Trust Co.*,[20] decided the same day in relation to the inclusion in the gross estate of the corpus of trusts created inter vivos, the Court very definitely expressed the opinion that the estate tax was upon the transfer of the decedent's property at his death, and was inapplicable to transactions completed inter vivos. The Court indicated that decedent *must* have retained some economic interest, some legal incidents of ownership, the extinguishment of which by his death and the consequential enlargement of the estate of the beneficiary would be a sufficient transfer for the purposes of the taxing act. All that the *Chase* case actually holds is that the retention of the right to change the beneficiary is a sufficient legal incident of ownership. But one gets the impression very definitely that the Court is laying down the legal incidents of ownership test as the proper one for all such cases. That case involved policies taken out subsequent to the taxing act. But strength is lent to the view that the *Chase* case lays down a test applicable for all policies, regardless of when they were issued by the case of *Pennsylvania Co. v. Commissioner of Internal Revenue*.[21] In that case the Supreme Court denied certiorari to a lower federal court decision which had held it to be error to include in the gross estate the proceeds of an insurance policy in which the court felt insufficient incidents of ownership had been retained. It is true that this case involved policies that were taken out prior to the taxing act, so that the Court may have been influenced by the question of retroactivity. However this point was not raised by the court below. The fact that the policies were taken out prior to the act was not even mentioned directly but only appears incidentally from other statements made by the court. The decision was rested entirely upon the ground that no sufficient legal incidents of

[19] 278 U. S. 327, 49 S. Ct. 126 (1928). For further statement of the test and analysis of this decision, see Cook v. Commr., (C. C. A. 3rd, 1933) 66 F. (2d) 995, certiorari denied 291 U. S. 660, 54 S. Ct. 377 (1934); 5 ST. JOHN'S L. REV. 137 (1930); 10 BOST. UNIV. L. REV. 138 (1930); 43 HARV. L. REV. 322 (1929).

[20] 278 U. S. 339, 49 S. Ct. 123 (1928). This case is here cited to indicate how closely related are the problems of taxing the proceeds of insurance policies and the corpus of trusts created by decedent. For a treatment of the problem of the trust, see 34 MICH. L. REV. 1002 (1936).

[21] (C. C. A. 3rd, 1935) 79 F. (2d) 295, certiorari denied 296 U. S. 651, 56 S. Ct. 310 (1935).

ownership had been retained. This view is clearly expressed in the following words of a federal district court in Kentucky in *Ballard v. Helburn*:[22]

> "If the insured prior to his death, had parted with all power of control over, and the beneficial interest in the proceeds of the policy, then his death did not result in any such shifting of economic benefit, or in any such enlargement of the rights of the beneficiary as to subject the proceeds to estate taxation under the section here involved."

The exact converse of the *Chase* case, which would involve a policy taken out after the passage of the act with no legal incidents of ownership retained, has never come before the Supreme Court. However, in the light of the strong indications of the *Chase* decision and the denial of certiorari in the other case aforementioned, it would seem that the Court is prepared to carry this test to its logical conclusion and deny the right to tax such a policy.

Though we reserve some doubt as to the final result in the last hypothetical case just put, it would appear that the courts have placed their entire emphasis upon the last alternative of the test suggested by the departmental regulations. *Quaere*, whether we should not go one step further and say that the test should not be stated in the alternative but in the conjunctive. That part of the test which relates to whether the insured took out the insurance on his own life "directly or indirectly" assumes small importance except in rare cases. It becomes important when the tax is sought to be avoided upon the ground that the premiums were paid by another than the insured.[23] This point comes up most frequently in connection with the funded insurance trust. Although the federal courts have not spoken definitely upon the matter, it appears pretty certain that the taxing authorities will seek to include the proceeds of such a trust in the gross estate under section 320(g) on the theory it is the decedent who is paying the premiums indirectly.[24] Even here it is by no means certain that the Supreme Court will not insist upon the additional requirement of legal incidents of ownership.[25] We are then led to one more query. Is not the "reten-

[22] Ballard v. Helburn, (D. C. Ky. 1933) 9 F. Supp. 812 at 814.

[23] Bromley v. Commr. of Int. Rev., 16 B. T. A. 1322 (1929) (premiums paid by husband; held taxable); Ballinger v. Commr. of Int. Rev., 23 B. T. A. 1312 (1931) (group policy taken out by company for its employees; held not taxable on death of an employee).

[24] 362 C. C. H., § 2060.07 (1936); Surrey and Aronson, "Intervivos Transfers and the Federal Estate Tax," 32 COL. L. REV. 1332 (1932).

[25] The case of Burnet v. Wells, 289 U. S. 670, 53 S. Ct. 761 (1933), may throw some light upon this problem. In that case an irrevocable trust was established

tion of legal incidents of ownership" the *sole test* that should be applied? The only situation in which this question would be important as a practical matter would be the rare case in which legal incidents of ownership are retained by the insured but the premiums paid by another,[26] as where a parent pays the premiums on a policy upon the life of his child. No satisfactory answer can be given to this question at this point. Probably the question who paid the premiums will always be important to the extent of excluding from taxation policies on which the beneficiary has himself paid the premiums, as is the present administrative practice.[27]

Having determined the general test to apply, our next quest must be to discover just what legal incidents of ownership retained by the decedent will render the policy taxable. The Bureau lists the legal incidents of ownership as follows:

> "The right of the insured or his estate to its economic benefits, the power to change the beneficiary, to surrender or cancel the policy, to assign it, to revoke an assignment, to pledge it for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. The decedent possesses a legal incident of ownership if the rights of the beneficiaries to receive the proceeds are conditioned upon the beneficiaries surviving the decedent." [28]

Perhaps the best way to handle the problem is to take up in order and consider separately such of these legal incidents as are most com-

to pay for insurance on the settlor's life, collect the proceeds of the policy upon his death, and apply them to the benefit of named beneficiaries. The Court by a five-to-four decision held that the income from the trust fund used by the trustee in paying for the premiums was taxable to the settlor as part of his own income. The Court laid peculiar emphasis on the point that the trust was just a method of tax avoidance.

[26] For a discussion of the shift in emphasis from the question whether the insured paid the premiums to that of whether he retained the legal incidents of ownership and the possible conflict between article 25 and article 27, see Morton, "Taxability of Life Insurance," 9 TAX MAG. 205 (1931).

[27] Treas. Reg. 80, art. 25 (1934).

Even here the result is by no means certain. In two recent cases the Board of Tax Appeals has held polices includable where the beneficiary at least indirectly contributed to the payment of the premiums. In Dobrzensky v. Commr., 34 B. T. A., No. 52 (1936), insurance was held includable in the gross estate where decedent had retained the right to change the beneficiary, although the premiums had been paid by the decedent's law partnership in pursuance of an agreement that the beneficiary (the wife) should accept the proceeds in lieu of certain interests of the decedent in the firm. Likewise, in Estate of Lang, 34 B. T. A., No. 56 (1936), the right to change the beneficiary was reserved, but the premiums were paid out of the community property and the wife was the beneficiary of most of the policies. The Board held the proceeds includable.

[28] Treas. Reg. 80, art. 25 (1934).

monly retained by decedents, and have come to the attention of the courts and the Board of Tax Appeals.

Right to Change the Beneficiary. Here we are upon sure ground. The *Chase National Bank* case involved policies in which the right to change the beneficiary had been reserved. That case and many others following it have recognized that this is a sufficient legal incident of ownership to render the insurance taxable.[29] The theory here is easy to comprehend. Where the insured retains the right to change his beneficiary, he has a definite economic interest in the policy. He may at any time make the policy payable to his estate. Usually with the right to change the beneficiary go other rights, as the right to assign the policy or to receive its surrender value. Where the absolute right to change the beneficiary is reserved, it cannot be said that the interest of the beneficiary is really vested until the death of the insured. At any rate, the beneficiary's interest is not definite and certain up to this moment. There is authority to the effect that a policy of insurance in which the right to change the beneficiary is reserved is an asset of the estate on the bankruptcy of the insured.[30]

The right to change the beneficiary may be expressly waived, and if the insured retains no other legal incident of ownership, the policy is not taxable.[31] Likewise where the right to change is exercised without again reserving the right to make additional changes, the insured may be held to have waived this right.[32]

Where the insured retains the right to change the beneficiary only with the consent of the existing beneficiary, it is doubtful if this would be considered a sufficient legal incident of ownership in view of the fact that he would have had this right in the absence of such express reservation. Its reservation therefore contributes nothing to his economic interest in the policy.

[29] 5 ST. JOHN'S L. REV. 137 (1930); 43 HARV. L. REV. 322 (1929); Sampson v. United States, (D. C. Mass. 1932) 1 F. Supp. 95; Gaither v. Miles, (D. C. Md. 1920) 268 F. 692; Cook v. Commr. of Int. Rev., (C. C. A. 3rd, 1933) 66 F. (2d) 995, cert. den. 291 U. S. 660, 54 S. Ct. 377 (1934); Ballinger v. Commr. of Int. Rev., 23 B. T. A. 1312 (1931); Liebes v. Commr. of Int. Rev., 20 B. T. A. 731 (1930), affd. (C. C. A. 9th, 1933) 63 F. (2d) 870; Cushman v. Commr. of Int. Rev., 19 B. T. A. 1012 (1930); Richardson v. Commr. of Int. Rev., 20 B. T. A. 728 (1930); Chase Nat. Bank v. United States, 278 U. S. 327, 49 S. Ct. 126 (1928); Feuerbacker v. Commr. of Int. Rev., 22 B. T. A. 734 (1931).

[30] Cohen v. Samuels, 245 U. S. 50, 38 S. Ct. 36 (1917).

[31] Reybine, Exr. v. Commr. of Int. Rev., 31 B. T. A. 314 (1934).

[32] Reed, Exr. v. Commr. of Int. Rev., 24 B. T. A. 166 (1931). Note that in the State of Wisconsin it is not necessary to reserve the right to change the beneficiary. The beneficiary's interest does not vest until the death of the insured and up to this time the insured has complete control over the policy and may change his beneficiary at will. The result of this is that all insurance payable to named beneficiaries is taxable in Wisconsin. In re Allis' Will, 174 Wis. 527, 184 N. W. 381 (1921).

If the insured were to retain the right to change the beneficiary to anyone but his own estate, the policy would probably be taxable. To the knowledge of the writer, no such case has come before the tax board. However, in the analogous situation of the trust created by decedent with the right to change the beneficiary to anyone but his own estate, the Court held that he retained a sufficient economic interest to render the trust taxable.[33]

Right to Assign. Where the right to assign a policy is expressly reserved, the interest of the insured in the policy is for all practical purposes as great as if he had the right to change the beneficiary. He may assign to secure a creditor and defeat his beneficiary pro tanto or he may assign absolutely, even to a volunteer, and defeat his beneficiary altogether.[34] In either case he would appear to have a sufficient interest to render the policy taxable.

Right to Revoke an Assignment. When a policy payable to the decedent's estate is irrevocably assigned, it would seem that it should not be includable in the gross estate for two reasons. In the first place, when a policy is so assigned, the decedent is left with practically no rights in the policy at all. The entire interest vests in the assignee.[35] Hence the "legal incidents of ownership" test is not met. But there is another reason why such insurance should not be taxable. The taxing act says that the proceeds of insurance policies are to be included in the gross estate "to the extent . . . of the amount receivable by all other beneficiaries."[36] Now insurance that is paid to an assignee does not fall within the language of the act. This view has been taken by the court of claims when faced with the problem of absolute assignment.[37] Considering the differences between the right of an assignee and those of a beneficiary, such a construction is perhaps justified.[38]

[33] Porter v. Commr. of Int. Rev., 288 U. S. 436, 53 S. Ct. 451 (1933). See also Dexter v. Treasurer, 243 Mass. 523, 137 N. E. 877 (1922).

[34] VANCE, INSURANCE, c. 11, p. 645 (1930). It is generally held that an assignment is distinct from a change of beneficiary. In many states courts have held that a mere assignment though formally made with the consent of the insurer does not effect a change in beneficiary, but the assignee takes only such interest as the insured retained in the policy in excess of those possessed by the beneficiary, such as the right to the proceeds in case he survives the beneficiary. In the majority of cases, however, an assignment of this sort is held to extinguish the interest of the beneficiary on the theory that it amounts to a change of beneficiary. VANCE, INSURANCE, c. 10, p. 566 (1930).

[35] Oppenheimer, "Insurance under the Federal Estate Tax," 43 HARV. L. REV. 724 at 727 (1930).

[36] 44 Stat. L. 70, § 302 (g), 26 U. S. C., § 412 (g) (1926).

[37] Guettel v. United States, 67 Ct. Cls. 613 at 618 (1929). "The language 'all other beneficiaries' used in the statute, cannot be fairly construed as applying to the assignee of a policy payable to a designated beneficiary. Such a construction would be an unwarranted extension of the meaning of the statute here involved."

[38] Oppenheimer, "Insurance Under the Federal Estate Tax," 43 HARV. L. REV.

In the case of a policy payable to a named beneficiary and assigned irrevocably, the same argument could be made as to that part of the proceeds payable to the assignee. Moreover, since the insured retains none of the legal incidents of ownership, it would seem that such a policy would not be taxable at all.

But suppose in either of the above cases that the decedent does not make an absolute irrevocable assignment, but reserves certain rights, as the right to revoke the assignment. In this case it would seem that he has retained legal incidents of ownership of equal economic benefit and importance to the right to change the beneficiary of a policy. Death terminates this right in the decedent and frees the assignee of the possibility of its exercise. This would clearly be a sufficient transfer for the imposition of a tax; but the question remains, is it taxable under this particular taxing act? Does not the argument that the statute does not include insurance receivable by assignees apply here? It would seem not. Though not within the express language of the act, such a transfer is clearly within its spirit and should be taxable.[39] The courts and the Board of Tax Appeals seem to make no distinction between reservation of the right to change beneficiaries and the right to revoke assignments.[40]

Right to Receive Surrender Value or to Pledge the Policy for a Loan. These two rights may be considered together for they are usual if not necessary concomitants. At any rate it would appear that the retention of either or both rights by the decedent up to the point of death renders the proceeds of the policy taxable. It is apparent that by the exercise of these rights the insured may secure an economic benefit to himself and that until his death, the beneficiary's rights are subject to being defeated pro tanto or absolutely. This is the view that the Board of Tax Appeals has adopted,[41] largely on the authority of the *Chase National Bank* decision, which expressly included these rights in its enumeration of the legal incidents of ownership.[42] The lower federal courts have affirmed this view.[43]

Whether or not the right to receive the surrender value on a day

724 at 743 (1930); Surrey and Aronson, "Intervivos Transfers and the Federal Estate Tax," 32 COL. L. REV. 1332 (1932).

[39] Idem.

[40] Ballard v. Helburn, (D. C. Ky. 1933) 9 F. Supp. 812; Cushman v. Commr. of Int. Rev., 19 B. T. A. 1012 (1930); Ballinger v. Commr. of Int. Rev., 23 B. T. A. 1312 (1931).

[41] Ballinger v. Commr. of Int. Rev., 23 B. T. A. 1312 (1931); Edwards v. Commr. of Int. Rev., 31 B. T. A. 879 (1934); McKelvy v. Commr. of Int. Rev., 31 B. T. A. 1206 (1935).

[42] 278 U. S. 327, 49 S. Ct. 126 (1928).

[43] Sampson v. United States, (D. C. Mass. 1932) 1 F. Supp. 95; Ballard v. Helburn, (D. C. Ky. 1933) 9 F. Supp. 812.

certain is a sufficient incident of ownership is more questionable. The Board of Tax Appeals has evidently taken the view that if the last fixed day on which the decedent could have received the surrender value had passed prior to the death of the insured, the proceeds of such insurance are not taxable.[44] We cannot quarrel with this view. But the Board has held that if the insured dies prior to the last fixed day on which he could receive the surrender value the insurance will be taxed.[45] This result is more questionable. It would seem that up to this date there is nothing that the insured can do to divest the beneficiary of his rights. For practical purposes the situation of the insured here is the same as that of an insured with an endowment policy payable to himself if he survives the maturity of the policy. In either case he might assign his interest in the policy, thus giving his assignee the right to the value of the policy on the date fixed for the surrender or the maturity of the policy. But in either case the assignee's interest would be contingent upon the insured's surviving this date. This interest, then, is of some economic benefit to the decedent, but is it enough to permit the court to call its termination a transfer? The Supreme Court has not yet had to face this problem, so we will have to await our final answer. However, as we shall see later, the Court has very definitely held that the mere retention by the insured of the right to the proceeds, if he survives the beneficiary, is not sufficient to permit the proceeds of the policy to be included in the gross estate.[46] This may furnish the Court with an analogy in dealing with the present situation. If the retention of the right to have the proceeds of the policy paid to the estate of the insured if he survives the death of the named beneficiary, a time uncertain, is not a sufficient incident of ownership, it is conceivable that the Court may say that the right to the proceeds if he survives a date fixed and certain is likewise insufficient. A contrary result may possibly be reached on the ground that right to the cash value on a date certain is of greater economic worth, since on or after this date the insured can receive the cash himself, while if he retains but a right of reverter only his estate as assignee will benefit, for enjoyment of the actual cash will be postponed until his death. This, it is submitted, is a distinction without a difference. If the insured survives the beneficiary, he will probably be able to assign the policy for an amount equal to its cash surrender value.[47]

[44] Parker v. Commr. of Int. Rev., 30 B. T. A. 342 (1934).

[45] Blood v. Commr. of Int. Rev., 22 B. T. A. 1000 (1931).

[46] See notes 49 and 50, infra.

[47] It has been held that an endowment policy is primarily a contract of investment and only incidentally of insurance, and that money so invested belongs to the investor, and that "the mere act of filtering it through the insurance company will not transmute it so that it becomes the property of the beneficiary free from the claims of the cred-

Where the right to borrow upon the policy is conditioned upon securing the consent of the sole beneficiary, this would not be a sufficient legal incident of ownership, since it would give the insured no more right than he had without the special reservation.[48] However, if there were several beneficiaries and the decedent reserved the right to borrow upon the policy with the consent of any one beneficiary, on the analogy of trust cases it may be predicted that the Supreme Court would say that such insurance could be included on the gross estate.[49]

Right to Have the Proceeds Paid to Insured's Estate in Case He Survives the Beneficiary. That such a retained right is not a sufficient legal incident of ownership to warrant inclusion of a policy in the gross estate, we have the Supreme Court's last word on any question of the taxability of insurance. The Court said, "No interest passed to the beneficiary as a result of the death of the insured. His death merely put an end to the possibility that the predecease of his wife would give a different direction to the payment of the policies." [50] Even before this it had been apparent that the retention of such a right was insufficient to render a policy taxable.[51] There is a considerable authority, which is growing stronger yearly, to the effect that even where this right is not expressly reserved, if the beneficiary dies before the insured, a trust results in favor of the insured.[52]

Minor Rights. In addition to the more important rights that we have discussed, the insured may retain minor rights of one sort or another, of varying degrees of importance. Where the insured retained

itors" of the insured. But the better opinion refuses to make any distinction in this respect between endowment policies and other kinds, and recognizes the rights of the beneficiary as vested, even when the amount of the policy is payable to the insured if he survives the endowment period and to the beneficiary only in case of his earlier death. VANCE, INSURANCE, c. 10, pp. 547-548 (1930).

[48] Parker v. Commr. of Int. Rev., 30 B. T. A. 342 (1934). For the trust analogy, see Helvering v. Helmholz, 296 U. S. 93, 56 S. Ct. 68 (1935).

[49] Helvering v. City Bank Farmers Trust Co., 296 U. S. 85, 56 S. Ct. 70 (1935). Section 302 (d) of the Revenue Act might conceivably be held to cover this situation. This section provides for the inclusion in the gross estate of any interest of the decedent, to the extent "of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power either in the decedent alone or in conjunction with any person, to alter, amend or revoke."

[50] Bingham v. United States, 296 U. S. 211, 56 S. Ct. 180 (1935). See also Industrial Trust Co. v. United States, 296 U. S. 220, 56 S. Ct. 182 (1935).

[51] Ballard v. Helburn, (D. C. Ky. 1933) 9 F. Supp. 812; Matter of Barstow, 230 App. Div. 371, 244 N. Y. S. 588 (1930), affd. 256 N. Y. 647, 177 N. E. 177 (1931); Parker v. Commr. of Int. Rev., 30 B. T. A. 342 (1934). For analogous cases in the field of trusts, see May v. Heiner, 281 U. S. 238, 50 S. Ct. 286 (1930); Helvering v. St. Louis Union Trust Co., 296 U. S. 39, 56 S. Ct. 74 (1935); Becker v. St. Louis Union Trust Co., 296 U. S. 48, 56 S. Ct. 78 (1935).

[52] VANCE, INSURANCE, c. 10, § 154 (1930).

the right to change the contingent beneficiaries and to alter the mode of settlement, the court held the proceeds were not properly included in the gross estate.[53] This is the logical corollary of the rule that the retention of the right of reverter in his own estate does not make the proceeds taxable. It is doubtful if any reserved rights other than the ones discussed would be of sufficient importance to render the insurance taxable at the death of the insured, even though they might give the insured some economic interest. Consider that the right, and in some cases the duty, of paying the premiums remains with the insured. This gives him a definite economic interest in the policy, but no one would say that was sufficient to make the proceeds taxable under a death duty.[54] If he ceases to pay the premiums, the beneficiary may pay them to protect his own interest. So it cannot be said that the right of the insured to cease paying premiums is of any importance.

3.

Heretofore we have discussed the problem of determining what policies are to be included in the gross estate under section 302(g) with only a slight reference to the question of the dates when these policies were taken out. On the basis of cold logic it is difficult to see how the date when the policy was taken out makes any difference. The act imposes an excise upon the transfer of property, or of some economic or legal incident of ownership therein, at the death of the transferor. We have just discussed what legal incidents of ownership are included. The act does not propose to tax the inter vivos part of the transfer. If it did, it would no doubt be unconstitutional as a denial of equal protection. Logically, therefore, there is no more question of retroactivity involved when the policy was taken out prior to the passage of the act, than when the policy was taken out subsequent thereto. In either case the transfer at death is exactly the same. This view has been expressed by the Court on occasion.[55] The only possible argument that could be made for a different treatment of policies taken out before the act must be based upon considerations of fairness and policy. There is some reason in the argument that many decedents would not

[53] Levy's Estate v. Commr. of Int. Rev., (C. C. A. 2d, 1933) 65 F. (2d) 412, reversing in part, 25 B. T. A. 1174 (1932).

[54] Oppenheimer, "Proceeds of Life Insurance Policies Under the Federal Estate Tax," 43 HARV. L. REV. 724 at 746 (1930).

[55] " 'A transfer made subject to a power of revocation in transferor, terminable at his death, is not complete until his death,' and hence the taxing act 'is not retroactive since his death follows the passage of the statute.' " Weiller v. Commr. of Int. Rev., 18 B. T. A. 1121 at 1123 (1930), relying on Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1928). See also, Cook v. Commr. of Int. Rev., (C. C. A. 3rd, 1933) 66 F. (2d) 995, cert. den. 291 U. S. 660, 54 S. Ct. 377 (1934).

have taken out so much insurance had they known the proceeds would be taxable to their estate. In the words of the Supreme Court, such a construction of the act would "impose an unexpected liability that if known might have induced those concerned to avoid it and use their money in other ways." [56] This is not likely to be a harsh result in view of the fact that the decedent must be presumed to have known Congress might decide to tax such transfers to prevent avoidance of the death duty. A possible situation of harshness could arise if the policy represented the great bulk of the decedent's estate, and the tax upon it has to be paid out of the share of the small estate left to the residuary legatee for whom the decedent had really meant to provide a comfortable living.[57]

But whatever may be the logic of the situation, the fact remains that cases have been won and lost on the court's answer to the question whether the act applied to insurance taken out before its passage. Section 302(h) was not included in the Revenue Act until 1924. Prior to that there was no express provision in the act stating that it was applicable retroactively. The Supreme Court in the famous case of *Lewellyn v. Frick*[58] held that the 1918 Act was not applicable to policies taken out prior to the passage of the act. As a matter of fact, in that case the Court affirmed a decision of the lower court imposing a tax upon the proceeds of several policies, in some of which the right to change the beneficiary was reserved and in others not. The Court hinted that if the act were to be considered as applying thus "retroactively," it would be unconstitutional. Subsequent cases have very definitely limited the application of the rule of the *Frick* case to policies in which no legal incidents of ownership are retained. Where legal incidents of ownership are retained, it is now settled that it is immaterial when the policies were taken out; the policies are taxable.[59] Where no legal incidents of ownership are retained, the *Frick* case, and those that follow and limit its application, are authority for the rule that the policies are not taxable if taken out before the taxing act was enacted. If no legal incidents of ownership are retained and the policy is taken out after the enactment of the taxing act, as we have before noted, we have no exact case in point for authority. However, from the

[56] Lewellyn v. Frick, 268 U. S. 238 at 252, 45 S. Ct. 487 (1924).

[57] Curley v. Tait, (D. C. Md. 1921) 276 F. 840.

[58] 268 U. S. 238, 45 S. Ct. 487 (1924).

[59] Heiner v. Grandin, (C. C. A. 3rd, 1930) 44 F. (2d) 141, cert. den. 286 U. S. 561, 52 S. Ct. 643 (1932), second appeal (C. C. A. 3rd, 1932) 56 F. (2d) 1082, relying upon the two trusts of the Reinecke case; Gillespie v. Heiner, (D. C. Pa. 1928) 27 F. (2d) 455; Liebes v. Commr. of Int. Rev., 20 B. T. A. 731 (1930), affd. (C. C. A. 9th, 1933) 63 F. (2d) 870; Mimnaugh v. United States, 66 Ct. Cls. 411 (1928).

test laid down in the *Chase National Bank* case,[60] which involved policies taken out after the enactment of the act, and from the Supreme Court's refusal to challenge the reasoning of the lower court in the case of *Pennsylvania Company for Insurances v. Commissioner*,[61] to which it denied certiorari, we are probably justified in stating that such policies are not taxable, though we must admit we cannot be absolutely certain here until the Supreme Court gives us its final answer. Hence under section 302(g), the question of retroactivity is not at all important. The sole test seems to be that of the retention of legal incidents of ownership.

Then in 1924, section 302(h) was added to the taxing act. The lower courts were pretty badly divided upon the question how much effect should be given this section. The first case in which the matter seems to have been seriously considered was that of *Wyeth v. Crooks*,[62] decided in 1928 by a federal district court in Missouri. Section 302(h), it is remembered, provides that subsections (b) through (g) of the act shall apply to all the transfers, trusts, estates, rights, powers, and relinquishment of powers, described therein, "whether made, created, arising, existing, exercised, or relinquished before or after the enactment of the act." The court took the view that this subdivision applied only to insurance payable to the estate. None of the terms therein used applied to insurance payable to named beneficiaries, said the court. Other federal courts, on the other hand, averred that section 302(h) should be given full effect.[63] However, in every such case, there were involved policies in which legal incidents of ownership had been retained. These as we have seen were taxable before subdivision (h) was added.[64] The Supreme Court has recently given us its answer to the question,[65] and has adopted the view of the *Wyeth* case citing that case with approval. It said that whether any of the terms used in subdivision (h) applied to an insurance policy payable to a named beneficiary was fairly disputable, but that if any of them did, grave constitutional doubts would arise. In this statement with regard to constitutionality the Court must be understood as speaking only of insurance in which no legal incidents of ownership were retained, for it was such policies only that were involved in the dispute. The Court

[60] 278 U. S. 327, 49 S. Ct. 126 (1928).

[61] (C. C. A. 3rd, 1935) 79 F. (2d) 295, cert. den. 296 U. S. 651, 56 S. Ct. 310 (1935). See supra, note 21.

[62] (D. C. Mo. 1928) 33 F. (2d) 1018. This case was approved in Anthracite Trust Co. v. Phillips, (D. C. Pa. 1931) 49 F. (2d) 910.

[63] Sampson v. United States, (D. C. Mass. 1932) 1 F. Supp. 95; Ballard v. Helburn, (D. C. Ky. 1933) 9 F. Supp. 812.

[64] Supra, note 58.

[65] Industrial Trust Co. v. United States, 296 U. S. 220, 56 S. Ct. 182 (1935).

does not presume to change the rule for policies in which legal incidents of ownership are retained.

Hence it would seem that section 302 (h) enlarges not at all the right to tax the proceeds of insurance policies. Before its adoption all insurance payable to the decedent's estate was taxable regardless of when it was taken out.[66] Also before its adoption the proceeds of policies payable to named beneficiaries in which legal incidents of ownership were retained by the insured were taxable regardless of when the policies were issued. Since the adoption of subdivision (h) the law is exactly the same.

In conclusion it must appear that the Court has worked out a fairly definite test for the taxability of the proceeds of insurance policies on the death of the insured. All insurance receivable by the executor as part of the general estate is included in the gross estate. All insurance payable to named beneficiaries other than the executors, on which the beneficiary paid no part of the premiums and in which the insured retained certain legal incidents of ownership to the moment of his death, is likewise to be included in the gross estate. What are sufficient legal incidents of ownership we have discussed. When the policies were taken out seems to make no difference.

J. S. W.

[66] Supra, note 4.