Estate Tax–Life Insurance--Section 2035 As a Basis for Including Life Insurance Proceeds in the Gross Estate of an Insured Who Paid Premiums on a Policy Owned by Another Person

NOTES

ESTATE TAX—LIFE INSURANCE—Section 2035 As a Basis for Including Life Insurance Proceeds in the Gross Estate of an Insured Who Paid Premiums on a Policy Owned by Another Person

If a decedent possessed any of the incidents of ownership[1] of a life insurance policy, or if the policy proceeds were payable to his executor, the entire amount of the insurance proceeds is included in his estate for estate tax purposes under section 2042 of the Internal Revenue Code of 1954 (Code).[2] However, if the decedent had

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1. Among the incidents of ownership are included, generally, "the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc." Treas. Reg. § 20.2042-1(c)(2) (1968). *See* Farwell v. United States, 243 F.2d 373 (7th Cir. 1957) (right to change beneficiary); Liebmann v. Hassett, 148 F.2d 247 (1st Cir. 1945) (right to cash surrender value); Prichard v. United States, 255 F. Supp. 552 (N.D. Tex. 1966) (right to assign policy as security for a loan); Estate of Myron Selznick, 15 T.C. 716 (1950), *aff'd*, 195 F.2d 735 (9th Cir. 1952) (right to cancel policies and obtain income from the cash surrender value); *cf.* Rev. Rul. 68-334, 1968-1 CUM. BULL. 403. However, some interests in a policy, such as the right to dividends, are not considered "incidents of ownership." Old Point Nat'l Bank, 39 B.T.A. 343 (1939) (acq. 1939-2 CUM. BULL. 27); Blacksher v. Commissioner, 38 B.T.A. 998 (1938) (acq. 1939-2 CUM. BULL. 4).

While it is clear that "incidents of ownership" generally refers to the right of an individual to control the disposition of the policy proceeds, there remains some question as to the extent of control required. C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES 279-81 (2d ed. 1962). It was once supposed that there must be "real," rather than "nominal," possession of the incidents of ownership before the proceeds from a policy would be included in a decedent's estate. Rhode Island Hosp. Trust Co. v. United States, 241 F. Supp. 586 (D.R.I. 1965), *vacated*, 355 F.2d 7 (1st Cir. 1966). However, that theory was repudiated, and the district court's opinion thereafter vacated, when the Supreme Court decided, in Commissioner v. Noel, 380 U.S. 678 (1965), that the proceeds of an airline flight insurance policy taken out for one flight by the decedent shortly before a crash resulted in his death, were properly included in his estate under section 2042 of the Internal Revenue Code of 1954, even though, on the facts of the case, it would have been impossible for the decedent to exercise any of the incidents of ownership.

2. INT. REV. CODE OF 1954, § 2042. This section provides:

The value of the gross estate shall include the value of all property—

(1) Receivable by the executor.—To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

(2) Receivable by other beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For purposes of the preceding sentence, the term "incident of ownership" includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent. As used in this paragraph, the term "reversionary interest" includes a possibility that the policy, or the proceeds of the policy, may return to the de-

transferred ownership of the policy to another person in a transaction that both met the requirements of section 2042[3] and was not regarded as "in contemplation of death,"[4] but continued to pay the insurance premiums until his death, it is unclear whether any of the proceeds are includible in his estate under any other provision of the Code.[5]

Prior to 1954, proceeds from life insurance were generally[6] included in the gross estate of a decedent who had taken out the policy and paid premiums, even though ownership of the policy had been transferred to another person. From 1942 to 1954, a statute[7] provided that the part of the insurance proceeds which was attributable to the premiums paid by the decedent should be included.[8] In the 1954 Code, this premium-payment test was deleted

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cedent or his estate, or may be subject to a power of disposition by him. The value of a reversionary interest at any time shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Secretary or his delegate. In determining the value of a possibility that the policy or proceeds thereof may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such policy or proceeds may return to the decedent or his estate.

3. The proceeds must not be made receivable by his executor upon decedent's death and the decedent must not retain any of the incidents of ownership.

4. If a transfer is made more than three years prior to the date of death, it is conclusively presumed not to have been made in contemplation of death. INT. REV. CODE OF 1954, § 2035(b). If a transfer is made within three years of the date of death, it is presumed, rebuttably, to have been made in contemplation of death. INT. REV. CODE OF 1954, § 2035(b). The value of any property transferred "for adequate and full consideration in money or money's worth" will not be included in the estate under the provision for transfers in contemplation of death. INT. REV. CODE OF 1954, § 2035(a). As to various life motives which have been recognized with respect to the transfer of life insurance policies, *see* cases cited in note 64 *infra*.

5. In particular, this Note is concerned with the applicability of the section 2035 provision dealing with transfers in contemplation of death. The regulations pertaining to section 2042 specifically indicate that a sum which is not includible under that section may nonetheless be includible under section 2035. Treas. Reg. § 20.2042-1 (a)(2) (1958).

6. Before 1942, the statute was vague and the Treasury Department fluctuated between using and not using the premium-payment test. *See* 1 R. PAUL, FEDERAL ESTATE AND GIFT TAXATION § 10.13 (1942).

7. Revenue Act of 1942, § 404, 56 Stat. 944 (1942), which became INT. REV. CODE OF 1939, § 811(g).

8. The premium-payment test, as used under the 1942 addition to the 1939 Code (*see* note 7 *supra*), provided for the inclusion of that part of the proceeds which bore the same proportion to the premiums paid by the decedent as the full amount of the proceeds bore to the total amount of premiums paid. If, for example, *A* insured his life for $100,000, paid $30,000 in premiums, irrevocably assigned the policy to *B* and then died after *B* had paid an additional $20,000 in premiums, the amount includible in *A*'s estate would be three-fifths of $100,000—or $60,000—since *A* had paid three-fifths of all the premiums. *See* C. LOWNDES & R. KRAMER, *supra* note 1, at 275.

The fact that an individual could not avoid having some part of the proceeds included in his estate if he had paid any premiums led to the rejection of this test when the 1954 Code was enacted: "No other property is subject to estate tax where the decedent initially purchased it and then long before his death gave away all rights to the property and to discriminate against life insurance in this regard is not from the section providing for the inclusion of life insurance proceeds.[9] However, the question has since arisen whether this test might be revived to include some portion of the proceeds in decedent's estate under section 2035,[10] the provision for transfers which are made in contemplation of death.[11]

The question has been examined by various commentators;[12] many have concluded that at least some of the proceeds should be included,[13] and all have recognized that such inclusion is a possibility. Generally, three theories have emerged.[14] Under the first, the full amount of the proceeds would be included on the grounds that the transfer was not complete until the last premium was paid. No case has accepted this theory, and the commentators have recognized that it is of limited significance at best.[15] Under the second

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justified." S. REP. No. 1622, 83d Cong., 2d Sess. 124 (1954). *See also* ALI, FEDERAL ESTATE AND GIFT TAX PROJECT STUDY xxii (Draft No. 1 1965).

9. *See* INT. REV. CODE OF 1954, § 2042. There has been some dissatisfaction with the current provision, since an individual may pass on unlimited amounts without paying any tax and, of course, the proceeds are not taxable to the beneficiary as income. INT. REV. CODE OF 1954, § 101. *See* C. LOWNDES & R. KRAMER, *supra* note 1, at 277. *See also* ALI, FEDERAL ESTATE AND GIFT TAX PROJECT 14 (1968). However, proposed changes in section 2042 have failed to obtain support. ALI, FEDERAL ESTATE AND GIFT TAX PROJECT 14 (1968).

10. INT. REV. CODE OF 1954, § 2035.

11. Under section 2035, only those payments made within three years of the date of the decedent's death could be considered. *See* note 4 *supra*. The premium-payment test, if used in conjunction with this section, would therefore provide for the inclusion of that part of the proceeds which bears the same proportion to the premiums paid by the decedent within three years of his death as the full amount of the proceeds bears to the total amount of premiums paid. Thus, in the example used in note 8 *supra*, if *A* had transferred the $100,000 policy three years and one day before he died (after paying $30,000 in premiums), had continued—in contemplation of death —to pay the premiums, and had paid $20,000 in premiums between the time of the transfer and his death, two-fifths of $100,000, or $40,000, would be included in his estate since he had paid two fifths of the premiums within three years of his death.

12. *See, e.g.*, A. CASNER, ESTATE PLANNING 324 (3d ed. 1962); Brown & Sherman, *Payment of Premiums as Transfers in Contemplation of Death*, 101 TRUSTS & ESTATES 790 (1962); MacKay, *Life Insurance in the Estate Plan*, 43 B.U. L. REV. 270, 273-75 (1963); Mannheimer, Wheeler, & Friedman, *Gifts of Life Insurance by the Insured*, 13 N.Y.U. INSTITUTE OF FEDERAL TAXATION 247, 260 (1955); Simmons, *District Court Invalidates IRS' Three-Year Premium Payment Rule*, 29 J. TAXATION 338 (1968); Yohlin & Bomze, *Some Unresolved Gift and Estate Tax Problems of the Unfunded Irrevocable Insurance Trust*, 41 TAXES 521, 535-37 (1963); sources cited in note 13 *infra*.

13. C. LOWNDES & R. KRAMER, *supra* note 1, at 287; W. WARREN & S. SURREY, FEDERAL ESTATE AND GIFT TAXATION 523 (1961 ed.); Goodson, *Are Life Insurance Proceeds Gifts in Contemplation of Death?*, 103 TRUSTS & ESTATES 25 (1964); Schwartz, *Life Insurance Estate Planning*, 35 S. CAL. L. REV. 1 (1961).

14. Schwartz, *supra* note 13, at 11.

15. The theory is based on the concept that the payment of the last premium was the effective cause of the payment of the proceeds to the beneficiary. It is probably applicable only to term policies, since it gives no effect to the payment of prior premiums. Yohlin & Bomze, *supra* note 12, at 536. This approach suggests that an appropriate test for inclusion of proceeds should be the payment of the last premium. However, this is not one of the tests used under section 2042 and never has been a

theory, a revival of the premium-payment test, that part of the proceeds which is attributable to the premiums paid by the decedent in contemplation of death would be included in the decedent's gross estate. Several commentators have anticipated that the Internal Revenue Service would take this position,[16] and by 1962 at least one district director of the Internal Revenue Service had adhered to it.[17] In 1967 the IRS issued Revenue Ruling 67-463,[18] officially adopting this position, and a recent federal district court case has accepted that ruling.[19] However, in another recent case, *Gorman v. United States*,[20] the District Court for the Eastern District of Michigan expressly rejected the ruling and accepted the third theory: that only the actual amount of the premiums paid in contemplation of death should be included.

Revenue Ruling 67-463 relied primarily[21] on the 1945 decision

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test under previous provisions. *See* C. LOWNDES & R. KRAMER, *supra* note 1, at 271-91. It should also be noted that this theory rests on the implicit assumption that if the decedent had not paid the last premium no one else would have, although the policy owner would certainly have had an interest in maintaining the vitality of the policy. For a recent rejection of the theory, by way of dictum, *see* Goodnow v. United States, 302 F.2d 516, 520 (Ct. Cl. 1962).

16. *See* authority cited note 13 *supra*.

17. In Los Angeles. Brown & Sherman, *supra* note 12, at 790. However, the practice apparently was not universal among district directors; a 1965 case in which the theory would have been relevant did not even consider its application. LaMade v. Brownell, 245 F. Supp. 691 (M.D. Pa. 1965). The decedent had paid premiums for two of the three years preceding his death on an insurance policy which he had long since transferred to his wife. Without discussing the payment of premiums, the court held that none of the proceeds of the policy were includible in his estate.

18. 1967-2 CUM. BULL. 327.

19. First Natl. Bank v. United States, 2 CCH FED. EST. & GIFT TAX REP. (69-1 U.S. Tax Cas.) ¶ 12,574 (W.D. Tex. Dec. 11, 1968). The position advanced by Revenue Ruling 67-463 was accepted without discussion.

20. 2 CCH FED. EST. & GIFT TAX REP. (68-2 U.S. Tax Cas.) ¶ 12,553 (E.D. Mich. July 25, 1968). The government has informally indicated its intention not to appeal this case. FED. ESTATE & GIFT TAX REP. 142 (Feb. 11, 1969).

21. The ruling also made reference to Lehman v. Commissioner, 109 F.2d 99 (2d Cir.), *cert. denied*, 310 U.S. 637 (1940); Scott v. Commissioner, 374 F.2d 154 (9th Cir. 1967), *reversing* 43 T.C. 920 (1965); and Chase Natl. Bank v. United States, 278 U.S. 327 (1929). However, the support which these cases provide for the ruling seems limited.

Lehman v. Commissioner was a reciprocal trust case quoted in the ruling for the proposition that " '[a] person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another . . . .' " 109 F.2d at 100, quoting 1 A. SCOTT, TRUSTS 785 (1939). Since the statement is quoted in the ruling without comment, the proposition for which it is supposed to stand may be open to question. It may be intended to indicate that if a decedent paid an insurance company to give the proceeds to the beneficiary he should be considered as having given those proceeds himself. This, however, is merely the basis for the use of the premium-payment test in the first instance. Since the test has been repudiated by Congress (*see* note 35 *infra* and accompanying text), there seems to be no reason to revive the test purely on the basis of this theory. Furthermore, the propriety of reasoning even this far from an isolated statement concerning reciprocal trusts is itself questionable. If the statement was intended to support the point that the result reached by the ruling would be the same if the decedent transferred the policy other than in contemplation of death or if the policy was originally owned by an-of the Court of Appeals for the First Circuit in *Liebmann v. Hassett*,[22] the case which has been universally recognized[23] as providing a rationale for the revival of the premium-payment test. *Liebmann* involved the taxation[24] of proceeds from life insurance policies which the decedent gave to his wife in contemplation of death. The First Circuit relied on Professor Randolph Paul's deductions from the existence of the premium-payment test under other sections of the applicable Code[25] and held that although the proceeds (rather than the cash value of the policies on the date of transfer) should be included in the gross estate, that portion of the proceeds attributable to the premiums paid by the wife should be excluded.

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other, its use was probably legitimate (Simmons, *supra* note 12, at 339), but unnecessary (*see* note 27 *infra*); and the case cannot then provide support for the basic position taken in the ruling.

Scott v. Commissioner was a community property case. In that part of the opinion relevant to Revenue Ruling 67-463, the Ninth Circuit used the amount of premiums paid from the decedent's separate funds to determine the extent of his ownership interest in the policy, the value of which was then included in his gross estate pursuant to section 2042. *See* Freedman v. United States, 382 F.2d 742 (5th Cir. 1967); Rev. Rul. 67-228, 1967-2 CUM. BULL. 331.

In *Chase Natl. Bank v. United States*, the Supreme Court was merely concerned with whether payment by an insurer could be considered a transfer by the decedent so that the tax could be considered a tax upon the transfer and, therefore, constitutional. The decedent was the owner of the policy and the proceeds were included under a provision relating to policies owned by a decedent, Revenue Act of 1921, § 402, 42 Stat. (pt. 1) 278 (1921). The Court did indicate that the includible amount was the value of that which was received by the beneficiary rather than the cost to the decedent, but it did not consider whether this would be the case if the decedent had no ownership interest in the policy.

22. 148 F.2d 247 (1st Cir. 1945).

23. *See* authorities cited in notes 12 and 13 *supra*.

24. Under the Revenue Act of 1926, § 302(c), 44 Stat. (pt. 2) 70 (1926), *as amended*, Revenue Act of 1934, § 404, 48 Stat. 754 (1934).

25. Professor Paul argued that the amount included in an estate under the provision for transfers in contemplation of death should not be greater than the amount which would be included if there had been no transfer. R. PAUL, *supra* note 6, at 551 n.9. If, under section 302(g) of the Revenue Act of 1926 (the statute relevant to the *Liebmann* case), there had been no transfer of the policy, the gross estate would include proceeds only from policies "taken out" by the decedent. This would not include any portion of the proceeds attributable to payments made by another person, since, under the relevant regulations at that time, the premium-payment test was in use. *See* R. PAUL, *supra* note 6, at 512-14.

Section 302(g) of the Revenue Act of 1926 provided for the inclusion in the gross estate of all property "[t]o 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." 44 Stat. (pt. 2) 71 (1926). A 1941 amendment to the 1937 regulations had interpreted "taken out":

> Where a portion of the premiums or other consideration was actually paid by another and the remaining portion by the decedent, either directly or indirectly, such insurance is considered to have been taken out by the latter in the proportion that the payments therefor made by him bear to the total amount paid for the insurance.

Treas. Reg. 80, art. 25, T.D. 5032, 1941-1 CUM. BULL. 427, 428.

Assuming that some part of the proceeds should be included in the gross estate, the *Liebmann* case supports the position taken in the ruling; *Liebmann* resulted in the inclusion of the part of the insurance proceeds attributable to premiums paid by the decedent-insured. But the question is whether there is—under the Code provisions *now* prevailing—a sound basis for extending the *Liebmann* principle to the situation presented in *Gorman*, as the revenue ruling has done.

In *Gorman* the district court held that the *Liebmann* principle should not be so extended. The decedent's wife had apparently[26] taken out the policy originally; thus, no transfer of the policy itself was involved. But, the revenue ruling explicitly states that this fact would not affect the conclusion which it advances.[27] All of the premiums were paid by the decedent, who died approximately one year after the policy had been issued. The Government asserted that since all the premium payments were made in contemplation of death, all of the policy proceeds should be included in the gross estate pursuant to section 2035.

The court rejected this contention, distinguishing *Liebmann* on the ground that in that case there was implicit support for using a premium-payment test, because such a test would have been used under the then applicable Code provisions[28] to determine the taxability of proceeds from policies transferred to another whether or not the transfer was in contemplation of death.[29] Since this test was deliberately eliminated from the income tax law in 1954, when section 2042 was enacted, the court stated that the premium-payment concept should not now be reintroduced under section 2035. Furthermore, the court suggested that if the theory relied on in *Liebmann*—that an amount should not be included in the gross estate under the contemplation-of-death provision unless it would be included if there had been no transfer[30]—was followed in *Gorman*, only the amount of the premiums paid should be included. Thus,

26. The court did not decide whether the decedent or his wife was the original owner of the policy. The matter is not easily determined, since the decedent made all the arrangements for the issuance of the policy, but it was issued listing his wife as the owner. Whether this constitutes a transfer by the decedent is apparently an open question. Simmons, *supra* note 12, at 339-40. For purposes of discussion, it is assumed that the wife was the original owner of the policy and that the *Gorman* case is in direct conflict with Revenue Ruling 67-463.

27. Rev. Rul. 67-463, 1967-2 CUM. BULL. 327, 328. Although it might be thought that *Gorman* could be distinguished from the ruling on this basis, the IRS position on this issue appears sound. If a policy has been transferred other than in contemplation of death it must, for estate tax purposes, be treated as though the decedent never owned it. Therefore, the same result must follow in the situation in which another person originally owned the policy.

28. *See* note 25 *supra*.

29. *See* C. LOWNDES & R. KRAMER, *supra* note 1, at 274-75.

30. *See* note 25 *supra*.

dismissing the other cases relied on by the ruling more or less summarily,[31] the court concluded that the decedent's transfer in contemplation of death consisted only of the amount of the premiums which he had paid.[32]

It is submitted that the *Gorman* court's rejection of revenue ruling 67-463 was appropriate. In the first place, it is essential to realize that Congress did repudiate the premium-payment test as applied in the section specifically concerning inclusion of life insurance proceeds in the gross estate.[33] When this matter was under consideration prior to the enactment of the 1954 Code, a minority of the House Ways and Means Committee vigorously opposed the removal of the test.[34] Both the Senate and the House Reports discussed the question,[35] but when enacted, the Code did not provide for the use of the premium-payment test.[36] In 1957 an attempt was made to re-establish the test,[37] but it was defeated. This legislative history strongly suggests that the premium-payment test should not be applied under section 2035 to accomplish the result which Congress sought to avoid by eliminating that test from section 2042. As suggested above, congressional rejection of the premium-payment test indicates that the *Liebmann* case, which relied on the existence of the test[38] under the Revenue Act of 1926, should be disregarded under the present Code. Other differences between the present Code provisions and those relevant to *Liebmann* also lead to this conclusion; *Liebmann* would be decided differently under the present law. When the Revenue Act of 1942 was passed, the test applied in *Liebmann* was replaced by a provision calling for inclusion of proceeds if the decedent had paid premiums[39] or possessed any incidents

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31. Largely for the reasons indicated in note 21 *supra*.

32. Having distinguished *Liebmann*, the court based its decision on four major considerations. First, the right to pay premiums belongs to the owner of the policy, and since the decedent's wife was the owner, the disposition of the premium amounts was under her control. The policy proceeds could not, therefore, be properly identified with decedent's premium payments. *See* MacKay, *supra* note 12, at 275; *cf.* Walker v. United Order of The Golden Star, Inc., 212 Mass. 289, 98 N.E. 1039 (1912). Second, Congress has clearly indicated that the premium-payment test is not generally appropriate. *See* note 33 *infra* and accompanying text. Third, the donee benefited only by the amount of the premium paid. Of course, this conclusion depends completely on the assumption that if the decedent had not paid the premiums his wife would have. Finally, the court reasoned that it is the nature of the insurance contract itself which enhances the value of the premiums rather than any process analogous to the growth in value of a trust res. *See also* Goodnow v. United States, 302 F.2d 516, 519-20 (Ct. Cl. 1962).

33. C. LOWNDES & R. KRAMER, *supra* note 1, at 276.

34. H.R. REP. No. 1337, 83d Cong., 2d Sess. B14-15 (1954).

35. S. REP. No. 1622, 83d Cong., 2d Sess. 124 (1954); H.R. REP. No. 1337, 83d Cong., 2d Sess. A316-17 (1954).

36. *See* INT. REV. CODE OF 1954, § 2042.

37. H.R. 8381, 85th Cong., 1st Sess. § 56 (1957).

38. *See* note 25 *supra*, and accompanying text.

39. Revenue Act of 1942, § 404(a), 56 Stat. 944 (1942), which became INT. REV. CODE OF 1939, § 811(g)(2)(A).

of ownership.[40] Under this section it was consistently held that payment of premiums by another person was irrelevant—if the decedent had possessed any incidents of ownership of a policy or if he had transferred them to another person in contemplation of death (as in *Liebmann*), the full amount of the policy proceeds would be included in the gross estate.[41] Under the 1954 Code, the courts have continued to hold that if the decedent retained any incidents of ownership, no part of the policy proceeds may be excluded merely because some of the premiums were paid by another.[42] Since exclusion of part of the proceeds—permitted in *Liebmann*—can no longer be obtained, that case does not, under the present Code, provide logical support for the position taken in the revenue ruling.[43]

Since the *Liebmann* case fails to support the Government's position,[44] it is important to examine analogous cases in the area of transfers in contemplation of death. Specifically, it is submitted that among the various analogies which might be drawn, the payment of premiums by a decedent is most similar to a gift of cash from a decedent invested by his donee upon receipt—a case in which only the cash amount would be included in the estate.[45]

Although there are few cases concerning the valuation of gifts made in contemplation of death when one donee did not retain the original property,[46] some generalizations can be made. If a gift is

40. Revenue Act of 1942, § 404(a), 56 Stat. 944 (1942), which became INT. REV. CODE OF 1939, § 811(g)(2)(B).

41. *See, e.g.*, Hall v. Wheeler, 174 F. Supp. 418 (D. Me. 1959); Fried v. Granger, 105 F. Supp. 564 (W.D. Pa. 1952), *aff'd*, 202 F.2d 150 (3d Cir. 1953); Estate of Collino v. Commissioner, 25 T.C. 1026 (1956); Estate of Goldblatt v. Commissioner, 16 T.C. 204 (1951).

42. *See, e.g.*, Commissioner v. Estate of Noel, 380 U.S. 678 (1965); Estate of Piggott v. Commissioner, 340 F.2d 829 (6th Cir. 1965).

43. It has also been suggested that even if the *Liebmann* result were possible under the present Code, application of the *Liebmann* principle to the *Gorman* facts is inappropriate since there is an essential difference between the payment of a premium by a donee (as in *Liebmann*) and the payment by a donor (as in *Gorman*). Yohlin & Bomze, *supra* note 12, at 535-36. While this may be true, it is difficult to determine why this difference should, of itself, lead to a different tax result.

44. Prior to the enactment of the 1954 Code there was explicit provision for the use of the premium-payment test in the section concerning life insurance (*see* notes 6 and 7 *supra*), so litigation over the use of the test did not often arise. Under the 1954 Code, *Gorman* and First Natl. Bank v. United States, 2 CCH FED. EST. & GIFT TAX REP. (69-1 U.S. Tax Cas.) ¶ 12,574 (W.D. Tex. Dec. 11, 1968) are the only relevant cases, and both were decided after the issuance of the Ruling.

45. In *Gorman*, the Government was willing to concede that an outright gift in the amount of the premium would be includible only at the cash value. Simmons, *supra* note 12, at 339.

46. C. LOWNDES & R. KRAMER, *supra* note 1, at 435. It should be noted that the Code provides for the inclusion of "all property . . . of which the decedent has made a transfer in contemplation of death" at "the value at the time of his death." INT. REV. CODE OF 1954, § 2035. This seems to imply that the sale and reinvestment by the donee of property transferred to him in contemplation of death are irrelevant, and that the value of the property, whoever owns it, should be the includible amount. If a transfer is revocable, this result does not follow, since the transfer in such a case

irrevocable and consists of a specific asset, the value of that asset on the date of the decedent's death[47] should be included in his gross estate, even if the donee no longer owns the asset.[48] When the gift is of cash, the cash amount will be included in the estate without regard to any reinvestment by the donee.[49] If a gift is in trust, the amount included in the estate will be the value of the trust res[50] on the date of the decedent's death, whether or not the assets in the trust are identical to those which were originally transferred to it.[51]

The characterization of a life insurance premium payment within this context is difficult. It is similar to a gift of a specific asset in that the value of the gift to the donee is an increase in the value of the life insurance policy. It can also be viewed as similar to a gift of cash in that the donor parts with money and has no ultimate control over the eventual disposition of the transfer.[52] Finally, such payment may be likened to a gift in trust since the value of the gift is enhanced without action by the donor or the donee and the amount is held by a third party for eventual distribution to the beneficiary.[53]

The purpose of section 2035 suggests that the analogy to a gift of cash is the most appropriate.[54] That section is intended to pre-

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is not complete until the decedent's death. *See* Howard v. United States, 125 F.2d 986, 989-90 (5th Cir. 1942). Apart from the logic of this conclusion, a revocable transfer will be included pursuant to INT. REV. CODE OF 1954, § 2038. *See also* INT. REV. CODE OF 1954, § 2036(a)(2).

47. The Code also provides for an alternative valuation date, generally one year after the decedent's death. In this Note, as in the Code, "date of death" should be read to mean date of death or alternative valuation date. INT. REV. CODE OF 1954, § 2032(b).

48. Humphrey's Estate v. Commissioner, 162 F.2d 1 (5th Cir.), *cert. denied*, 332 U.S. 817 (1947); Treas. Reg. § 20.2035-1(e) (1958); Lowndes & Stephens, *Identification of Property Subject to the Federal Estate Tax*, 65 MICH. L. REV. 105, 140 (1966). There is, however, dictum in Estate of Kroger, 12 P-H TAX CT. MEM. ¶ 43,392 (1943), *aff'd*, 145 F.2d 901 (6th Cir. 1944), *cert. denied*, 324 U.S. 866 (1945), indicating that the includible amount is the value of the assets actually held by the donee at the date of the decedent's death. If the gift is revocable, this will certainly be the value included in the decedent's estate. INT. REV. CODE OF 1954, § 2038; Howard v. United States, 125 F.2d 986 (5th Cir. 1942); Whited v. United States, 219 F. Supp. 947 (W.D. La. 1963); C. LOWNDES & R. KRAMER, *supra* note 1, at 437.

49. Humphrey's Estate v. Commissioner, 162 F.2d 1 (5th Cir.), *cert. denied*, 332 U.S. 817 (1947). *See* note 45 *supra*.

50. Income accumulated by the trust will not usually be considered a part of the res. *See* note 54 *infra*.

51. Igleheart v. Commissioner, 77 F.2d 704 (5th Cir. 1935); Estate of Kroger, 12 P-H TAX CT. MEM. ¶ 43,392 (1943), *aff'd*, 145 F.2d 901 (6th Cir. 1944), *cert. denied*, 324 U.S. 866 (1945); C. LOWNDES & R. KRAMER, *supra* note 1, at 435.

52. Both because the insured can pay the premiums only with the owner's consent, MacKay, *supra* note 12, at 275; *cf.* Walker v. United Order of The Golden Star, Inc., 212 Mass. 289, 98 N.E. 1039 (1912); and because the owner may at any time terminate the insurance policy and obtain the cash surrender value.

53. The analogy to a trust is the most unsatisfactory. *See* note 54 *infra*. Since the owner of an insurance policy may surrender it and obtain the cash surrender value, the analogous trust would be one that is terminable at will by the beneficiary.

54. The Government apparently disagrees: "A premium payment . . . is analogous

vent avoidance of the estate tax by returning to the estate that which would have been in it absent transfers in contemplation of death.[55] Thus, the characteristics of premium payments which should be relevant are those which relate to the transferor and the effect of the transfer on his estate. The value of the gift to the donee should be irrelevant, as should any external similarities to a trust. The central consideration should be that if the insured had not paid the premiums his estate would have been larger by only the premium amount. More important, if he had not paid the premiums, no part of the policy proceeds would have been in his estate. Returning his estate to what it would have been without the transfer simply requires treating the premium payments as gifts of cash and including only the premium amount in the estate. On the specific facts of *Gorman*, this conclusion is even more compelling. Where the policy owner has been someone other than the decedent from the beginning and the insured's only active connection with the policy has been the payment of premiums, the argument that he

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to a gift of specific property. . . . Unlike the unrestricted gift of money, a premium payment is a gift of insurance protection, a transfer of an interest in the policy which is transmuted at death into the proceeds of the policy." Rev. Rul. 67-463, 1967-2 CUM. BULL. 327, 328. However, it may be questioned whether a premium payment can legitimately be called a transfer of an interest in the policy. The decedent could have transferred an interest in the policy only if he had such an interest to transfer. Estate of Karagheusian, 23 T.C. 806, 814 (1955), *rev'd on other grounds*, 233 F.2d 197 (2d Cir. 1956) (acq. as to another issue, 1955-2 CUM. BULL. 7). If, however, the decedent did have such an interest, section 2042(b) would apply to make the proceeds includible, and the Government's reliance on section 2035 would be unnecessary. Indeed, this reliance on section 2035 may be taken as an admission that the decedent had *no* interest in the policy; thus, the Government's argument is self-defeating. *See* Brown & Sherman, *supra* note 12, at 790.

It is also important to note that income from a trust is not included in the estate [INT. REV. CODE OF 1954, § 2035, Treas. Reg. 20.2035-1(e) (1958); McGehee v. Commissioner, 260 F.2d 818 (5th Cir. 1958); Commissioner v. Gidwitz' Estate, 196 F.2d 813 (7th Cir. 1952) (acq. 1966-1 CUM. BULL. 2); Burns v. Commissioner, 177 F.2d 739 (5th Cir. 1949) (acq. 1966-1 CUM. BULL. 2)], although accumulated income may be included if the decedent has retained the power to determine the distribution of income [INT. REV. CODE OF 1954, §§ 2036, 2038; United States v. O'Malley, 383 U.S. 627 (1966); Commissioner v. Hager's Estate, 173 F.2d 613 (6th Cir. 1949)]. This fact provides additional support for including only the cash value of the premium payments in the estate, for it indicates that an increase in the value of the transfer not attributable to an increase in the market value of the transferred asset itself should not be included. The maturation of a life insurance contract is certainly not attributable to an increase in the value of the money given by the donor; therefore, the proceeds should not be included.

55. Iglcheart v. Commissioner, 77 F.2d 704, 709 (5th Cir. 1935); C. LOWNDES & R. KRAMER, *supra* note 1, at 60. With this in mind, it may be questioned whether the disparate treatment of gifts in trust and outright gifts is proper, for the effect on the donor's estate is identical in both cases. *See* Pavenstedt, *Taxation of Transfers in Contemplation of Death: A Proposal for Abolition*, 54 YALE L.J. 70, 88-90 (1944). The special treatment of trusts has, however, been characterized as "sensible." C. LOWNDES & R. KRAMER, *supra* note 1, at 435. *See also* Lowndes & Stephens, *supra* note 48, at 139.

paid the premiums in order to avoid having the policy proceeds in his estate is not persuasive.

The result reached in *Gorman* is also desirable because it is consistent with other tax provisions. Under section 2036, which deals with transfers with a retained life estate, it has been held that premiums cannot be identified with policy proceeds for the purpose of equating the payment of premiums with a transfer of the policy and, hence, of the proceeds.[56] Indeed, it has even been held that the payment of premiums coupled with a failure to alter a provision that income from proceeds of a policy on the life of decedent's husband would go to the decedent for life and then to others did not constitute a transfer of those proceeds by the decedent.[57] Certainly these cases tend to refute the argument that a decedent, by paying premiums, transfers an interest in the policy. Similarly, the gift tax regulations[58] indicate that the payment of a premium is a gift in the amount of the premium rather than a gift of any interest in the policy itself.[59] Finally, in *Hyde v. Commissioner*,[60] a 1962 income tax case, the Second Circuit held that payment of premiums by someone other than the taxpayer must be reported as income and that the appropriate amount to report is the premium amount rather than the increase in the cash value of the policy. The fact that the *Gorman* approach is consistent with other tax provisions is an important consideration in assessing the validity of Revenue Ruling 67-463.

Thus, the better-reasoned view appears to be that when a decedent has transferred a life insurance policy to another person,[61] other than in contemplation of death, but has continued to pay the premiums, only the actual amount of the premiums paid should be included in his gross estate. This is also the preferable result in the somewhat different factual context assumed to exist in *Gorman*,[62] where the policy was never transferred but was owned originally by the decedent's wife.

However, it is not entirely clear that this was the actual situation in *Gorman*. The court stated that it made no difference whether the wife owned the policy originally or the decedent took it out and

56. Goodnow v. United States, 302 F.2d 516 (Ct. Cl. 1962).

57. National City Bank v. United States, 371 F.2d 13 (6th Cir. 1966).

58. Treas. Reg. § 25.2511-1(h)(8) (1958).

59. The Government itself contends that the federal estate tax and the federal gift tax are to be construed *in pari materia*. Goodnow v. United States, 302 F.2d 516, 520 (Ct. Cl. 1962).

60. 301 F.2d 279 (2d Cir. 1962). This case is another indication that the payment of premiums should not be identified with the increased value of the policy.

61. Provided, of course, that the proceeds are not payable to the estate and that the decedent had not retained any of the incidents of ownership, since either of these factors would trigger the operation of section 2042.

62. *See* note 26 *supra*.

transferred it to her later.[63] That statement is clearly wrong, for two reasons. First, if the decedent did transfer the policy to his wife, that transfer was probably in contemplation of death since he died within one year of the alleged transfer and the court did determine that he had paid the premiums in contemplation of death. Such a transfer would have been covered by section 2035, and the entire amount of the proceeds would have been includible in the gross estate. Second, even if the policy was not actually transferred in contemplation of death,[64] that very question would certainly require the court's consideration if a transfer of the policy was involved in the case. Whether the decedent or his wife was the original owner of the policy would therefore make *some* difference, at least in terms of the analysis of the case.

Because of this factual uncertainty, it is impossible to draw final conclusions about the propriety of the *Gorman* decision. It is necessary to know whether the decedent transferred the policy to his wife or whether she owned it from the outset; if there was a transfer, we should also determine whether or not it was accomplished in contemplation of death. If the wife was the original owner of the policy, or if the transfer to her was not in contemplation of death, it is submitted that *Gorman* was correct in rejecting Revenue Ruling 67-463 and including only the amount of the premiums paid in the decedent's gross estate.

63. "[U]nder either the plaintiff's theory that decedent had no interest in the policy other than payment of the premium, or under the government's theory that the plaintiff [sic] had interest [sic] in the policy and did transfer the policy, we are still limited to an amount equal to the premium." 2 CCH FED. EST. & GIFT TAX REP. (68-2 U.S. Tax Cas.) ¶ 12,553, at 8799 (E.D. Mich. July 25, 1968). It appears that the question of whether a policy has been transferred when one individual makes all the arrangements for issuance of the policy but it is issued with another person named as the owner is still open. Simmons, *supra* note 12, at 339-40.

64. While the transfer of a life insurance policy might seem to be naturally associated with contemplation of death [Garrett's Estate v. Commissioner, 180 F.2d 955, 956-57 (2d Cir. 1950); *cf.* Diamond's Estate v. Commissioner, 159 F.2d 672 (7th Cir. 1947); Davidson's Estate v. Commissioner, 158 F.2d 239 (10th Cir. 1946)], such is not necessarily the case. Various other motives for such a transfer have been recognized; *see, e.g.*, Estate of Hull v. Commissioner, 325 F. 2d 367 (3d Cir. 1963) (acq. 1964-2 CUM. BULL. 6); Flick's Estate v. Commissioner, 166 F.2d 733 (5th Cir. 1948); Cronin's Estate v. Comissioner, 164 F.2d 561 (6th Cir. 1947); Bruns v. United States, 62-2 U.S. Tax Cas. ¶ 12,112 (N.D. Cal. 1962); Estate of Hunt v. Commissioner, 14 T.C. 1182 (1950).

The payment of premiums would seem even less necessarily associated with contemplation of death than the transfer of a policy. *See* Brown & Sherman, *supra* note 12, at 791; *cf.* Allen v. Trust Co., 326 U.S. 630 (1946); Estate of Hull v. Commissioner, 325 F.2d 367 (3d Cir. 1963) (acq. 1964-2 CUM. BULL. 6). Where there is no transfer of the policy involved, the question of includibility of proceeds does not even arise unless it is first determined that the premiums were paid in contemplation of death.