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TAXATION-FEDERAL GIFT TAX-LIFE INSURANCE POLICIES

John W. Riehm S.Ed.
University of Michigan Law School

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TAXATION—FEDERAL GIFT TAX—LIFE INSURANCE POLICIES—On December 19, 1930 the petitioner created two trusts, placing in the first five $100,000 life insurance policies on the life of her husband, and in the second, securities, the income from which was to pay premiums on the policies, excess if any to be paid to the petitioner; after the death of her husband the whole of the income from the securities was to be paid to her for life. On death of the husband the proceeds of the life insurance policies were to be used to provide life estates for four named beneficiaries followed by remainders over; and on the death of the petitioner the securities in the second trust were to be added to the proceeds of the policies, thus augmenting the trust estates. The petitioner reserves the exclusive right to revoke the trusts during the lifetime of her husband, and after his death the right to repossess herself of any amount up to 50 per cent of the corpus of the securities trust. The husband of the petitioner died March 10, 1939, but she reported no taxable gifts for that year. The commissioner assessed a deficiency on $503,314.15, the face value of the policies plus post mortem dividends. Petitioner appealed the assessment to the Tax Court.[1] In that court she first contended that she had made no gift in 1939, but the court overruled her on the basis of *Burnet v. Guggenheim*.[2] She then contended "that the value of the gift is the value of property which passes from the donor and not the value of the property receivable by the donee." The Tax Court, however, found the value of the gift to be $503,314.15. Petitioner appealed, disputing only the finding on the issue of valuation. *Held*, affirmed. *Goodman v. Commissioner of Internal Revenue*, (C.C.A. 2d, 1946) 156 F. (2d) 218.

There are four general bases used in valuing an insurance policy; the face value, the aggregate of premiums paid, terminal reserve value, and cash surrender value. Terminal reserve value may be measured by the replacement cost at any given time. It is equal to the aggregate of premiums paid less the costs of administration and contingencies; and it is greater than the cash surrender value by the amount of the charge made for terminating the policy. The petitioner's position throughout the proceeding was that the amount of the gift tax to be paid should be based on the sum of $122,042.02 which was the terminal reserve value of the five policies on the day preceding the death of her husband. To support her position she cited the provision found in the Gift Tax Regulations, first promulgated in 1936,[3] and the court decisions upholding its validity. Pursuant to this regulation and the supporting judicial decisions it has been held that the value of a gift of a single premium policy assigned on issuance is the cost of the policy;[4] that the value of any paid up policy assigned after it became paid up is the cost of duplication of that policy on a person the age of the insured

[1] Adele F. Goodman v. Commissioner of Internal Revenue, 4 T.C. 191 (1944).

[2] 288 U.S. 280, 53 S. Ct. 369 (1933). This case held that a gift became complete for tax purposes upon the relinquishment of a power of revocation held by the donor.

[3] Regulation 79, GIFT TAX REG., art 19 (9) (1936), presently Regulation 108, § 86.19(i), Valuation of property—Life insurance and annuity contracts.

[4] Guggenheim v. Rasquin, 312 U.S. 254, 61. S. Ct. 507 (1941); Pauline Wilkins Tideman, 1 T.C. 968 (1943).

at the time of the assignment.[5] Thus it can be seen, though it has not been expressly stated, that the valuation used in these cases is the terminal reserve or replacement value of the policies. This is in direct contrast to the position taken by the Treasury prior to 1936, which was that the value of an insurance policy for gift tax purposes was "the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift." [6] The regulation in that form was upheld by courts even after the 1936 change had been made,[7] despite the commissioner's attempt to apply the new standards, on the theory that the former regulation must have been the correct interpretation of the law because Congress had reenacted the law in its identical form in the face of the existing regulation. However, these decisions were overruled by the Supreme Court in *Guggenheim v. Rasquin*,[8] which affirmed the interpretation placed upon the law by the regulations as amended on February 26, 1936. But conceding the validity of the present regulation, petitioner's reliance upon it in the principal case was misplaced. The value of the policies in her hands at the time the gift became absolute was the face value, not the terminal reserve value. The fact which the petitioner failed to take into consideration was that the death of her husband had two simultaneous effects; it matured the policies, and it also cut off her right of revocation thus vesting the gift absolutely and making it complete for tax purposes. At the instant the gift was completed it was worth $500,000. Therefore, using her own argument that, "the value of the gift is the value of the property which passes from the donor and not the value of the property receivable by the donee," it was proper to tax her on the face value of the policies.

John W. Riehm, S. Ed.

[5] United States v. Ryerson, 312 U.S. 260, 61 S. Ct. 479 (1941); Margaret R. Phipps, 43 B.T.A. 790 (1941); Estate of James H. Lockhart, 46 B.T.A. 426 (1942).

[6] Regulation 79, GIFT TAX REG., art. 2 (5) (1932).

[7] United States v. Ryerson, (C.C.A. 7th, 1940) 114 F. (2d) 150; Commissioner of Internal Revenue v. Haines, (C.C.A. 3d, 1939) 104 F. (2d) 854; Helvering v. Cronin, (C.C.A. 8th, 1939) 106 F. (2d) 907.

[8] See note 4, supra.