LEGISLATION

TAXABILITY OF LIFE INSURANCE PROCEEDS UNDER STATE AND FEDERAL STATUTES—Prior to 1918, no government, state or federal, had expressly imposed a tax on life insurance proceeds. Since that time, Congress [1] and the legislatures of twenty-one states [2] have seen fit, in a variety of ways, to advert to this type of property in their respective death tax statutes. Congress, the originator of the idea, has attempted to enlarge and buttress its own enactment during the past few years.[3] While from a legal standpoint this legislation is of comparatively recent origin, yet the prominent role which insurance plays in the scheme of modern wealth has given rise, in the few years of the operation of these enactments, to frequent opportunities for judicial interpretation. It is the scope of this note to record the breadth of this interpretation and to consider some of the more troublesome problems arising therefrom.

Where an express statute does not intervene, it is accepted doctrine that life insurance payable to the insured's estate is subject to the usual inheritance tax; [4] however, it is tax exempt where payable to a beneficiary named in the policy.[5] Where payable to the estate, the policies represent a claim or chose in action against the insurance company which, like any other of the decedent's claims against a solvent party, comprise assets of the estate. But, when third persons are the beneficiaries the courts reason that the generating source of the gift is not the death of the insured but a contract right under the policy, and so the inheritance tax act is not applicable. The doctrine of *strictissimi juris* is

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[1] 44 STAT. 71 (1926), 26 U. S. C. A. 1094g (1928). This provision has been carried through without change since 1918.

[2] ARK. DIG. STAT. (Crawford & Moses, Supp. 1927) § 10218 (4); CAL. GEN. LAWS (Deering, 1931) Act 8443, § 2; Colo. Laws 1933, c. 106, §§ 4, 5; CONN. GEN. STAT. (Supp. 1933) § 1363; Del. Laws 1931, c. 8; FLA. COMP. LAWS (Supp. 1932) § 1342 (3) (g); IND. ANN. STAT. (Burns, Supp. 1929) § 14389; KY. STAT. (Carroll, 1930) § 4281a-5; Me. Laws 1933, c. 148, § 2 (b); MISS. CODE ANN. (1930) § 5069 (e); MONT. REV. CODE (Choate, Supp. 1927) § 10377.1 (7); N. J. COMP. STAT. (Supp. 1930) § 208-537, p. 1829 (continued in N. J. Laws 1931, c. 303); N. C. CODE ANN. (Michie, 1931) § 7880 (11); N. D. Laws 1933, c. 251, § 2 (8); Okla. Laws 1933, c. 141, § 1 (3) (4); Ore. Laws 1933, c. 26, § 1; PA. STAT. ANN. (Purdon, 1930) tit. 72, § 2301 (d); TENN. ANN. CODE (Shannon, 1932) § 1261a (4); WASH. REV. STAT. (Remington, 1932) § 11201-1; WIS. STAT. (1931) c. 72.01 (7); WYO. COMP. STAT. ANN. (1931) c. 115, art. 1201.

In 1921, Iowa (Acts 1921, c. 38, § 17) enacted a provision taxing proceeds of life insurance policies payable to designated beneficiaries in excess of $40,000. But this provision was repealed at the same session of the legislature about one month after it became effective. (Acts 1921, c. 164, § 4.)

[3] By including in the Act of 1924, and continuing in successive acts up to the present time, a retroactive clause imposing a tax on insurance taken out before or after effective date of Act. 44 STAT. 71 (1926), 26 U. S. C. A. § 1094h (1928).

[4] Knoedler's Est., 140 N. Y. 377, 35 N. E. 601 (1893); Murphy's Est., 21 Pa. Super. 384 (1902); Stark's Est., 43 Lanc. 417 (Pa. 1933); *cf.* Myers' Est., 309 Pa. 581, 164 Atl. 611 (1933). See Hanna, *Some Legal Aspects of Life Insurance Trusts* (1931) 79 U. OF PA. L. REV. 346, 381; 2 COUCH, CYCLOPEDIA OF INSURANCE LAW (1929) § 349.

The Maine statute, *supra* note 2, taxes insurance payable to the insured's estate, except, if insured dies testate, "such part thereof as is bequeathed to a widow, or widower, or issue, or if intestate, such part thereof as descends under" provisions of intestate law regarding disposal of life insurance.

The North Dakota statute, *supra* note 2, provides that "all proceeds from life insurance policies not in excess of $20,000 shall be exempt from taxation".

[5] Tyler v. Treasurer, 226 Mass. 306, 115 N. E. 300 (1917); Vogel's Est., 1 Pa. C. C. 352 (1886); Succession of Hedden, 146 So. 732 (La. App. 1932), *rev'g* 140 So. 851 (La. App. 1931); Ryan, *Taxation of Donative Transfers Effective at Death* (1933) 19 VA. L. REV. 761, 790.

stretched to its fullest when the courts construe as impertinent the ordinary provision which subjects to tax a testamentary gift of personal property.[6] However, where the circumstances reflect a flagrant attempt to evade an otherwise taxable transfer, the courts are not hesitant to abandon the doctrine that a taxing statute must be strictly construed against the government.[7]

The beneficiary is generally treated as having only a contingent interest where the insured reserves in the policy the right, until death, to change the beneficiary.[8] Where such a right in the insured is wanting or has been expressly disclaimed, the beneficiary has a vested interest in the policy.[9] Yet, he is exempt from taxation in both cases. It is obvious that in the latter situation the beneficiary succeeds to no rights on the death of the insured, and the proceeds should not be subject to tax. But the case is much stronger for the government if the insured may at any moment before his death deprive the beneficiary of any chance to acquire the proceeds. The termination by death of a similar right has been the subject of tax by the states in other types of property.[10] Moreover, if an insurance policy payable to an insured's estate is an ordinary chose in action, its taxable status should not be altered where the recipient is a third party. But courts are impervious to this argument. It is for the legislature, they reason, explicitly to subject to a tax insurance payable to a designated third person.[11]

Among those states which have revised their statutes to make express reference to life insurance, eleven[12] have retained the judicial exemption of

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[6] See Tyler v. Treasurer, *supra* note 5, where statute taxed "all property . . . passing . . . by gift intended to take effect in possession or enjoyment after death". Insured had reserved the right to change the beneficiary. The court held that if the proceeds of the policy were a "gift", it took effect in possession or enjoyment at once. See also State Board of Tax Comm'rs v. Holliday, 150 Ind. 216, 49 N. E. 14 (1898), where the court held there could be no tax because the statute had not provided a regulation for evaluating insurance policies. But see the dissenting opinion.

[7] Matter of Einstein, 114 Misc. 452, 186 N. Y. Supp. 931 (1921) (Insured, 68 years old and under constant care of physician, assigned policies three days before his death. *Held*, that transfer was in contemplation of death and thus taxable). However, a mere change of beneficiary or assignment of a policy is not a transfer in contemplation of death. Matter of Voorhees, 200 App. Div. 259, 193 N. Y. Supp. 168 (1922).

[8] Richards, Law of Insurance (4th ed. 1932) § 333; Vance, *The Beneficiary's Interest in a Life Insurance Policy* (1922) 31 Yale L. J. 343, 358. Some courts, however, hold such interest to be vested. Indiana National Life Ins. Co. v. McGinnis, 180 Ind. 9, 101 N. E. 289 (1913); Neary v. Metropolitan Life Ins. Co., 92 Conn. 488, 103 Atl. 661 (1918); Tyler v. Treasurer, *supra* note 5.

[9] Richards, *op. cit. supra* note 8, § 328; Vance, *supra* note 8.

[10] Where the donee of a power of appointment fails to appoint, and by the terms of the power a designated beneficiary is to take in default of appointment, such failure to appoint is taxable on the donee's death. Minot v. Treasurer, 207 Mass. 588, 93 N. E. 973 (1911); Manning v. Board of Tax Com'rs, 46 R. I. 400, 127 Atl. 865 (1925). *Contra:* Matter of Slosson, 216 N. Y. 79, 110 N. E. 166 (1915). See Note (1933) 82 U. of Pa. L. Rev. 39, 44-45.

[11] In Haedrich's Est., 134 Misc. 741, 236 N. Y. Supp. 395 (1928), *aff'd*, 230 App. Div. 763, 243 N. Y. Supp. 896 (1930), *aff'd*, 256 N. Y. 608, 177 N. E. 160 (1931), the court held that life insurance is not a chose in action, but is rather *sui generis*. See (1929) 43 Harv. L. Rev. 322.

[12] California (includes accident policies), Connecticut (includes accident policies), Delaware, Indiana, Kentucky, Maine, New Jersey, Oregon (but the exemptions "shall not include any investment policy issued by a life insurance company which does not include in the policy the element of life insurance"), Pennsylvania, Washington (the exemption is allowed "so long as the state collects for the general fund, a tax on the premiums paid for such life insurance"), and Wyoming. See citations, *supra* note 2.

The statutes of Delaware, Indiana, New Jersey, Oregon, Pennsylvania, and Wyoming also exempt life insurance proceeds when payable to beneficiaries through trustees. The New Jersey statute was passed because of the rule enunciated in Fagan v. Bugbee, 105 N. J.

proceeds payable to a beneficiary named in the policy. The other states,[13] except Wisconsin,[14] tax proceeds in excess of specified amounts. However, several[15] of these states condition the tax on the retention by the insured of the right to change the beneficiary.

In the states which expressly exempt insurance payable to a designated third party, a tax is imposed under the ordinary provision of the inheritance tax statute, where the policy fails to name a beneficiary and the insured supplies one in his will.[16] Also, an irrevocable assignment of the policy by the insured to another party, which ordinarily is not taxable in any state, will be subject to a tax if the assignment was made in contemplation of death.[17] Where a revocable assignment is made, not in contemplation of death, it is taxable in those states which tax a policy reserving the right to change the beneficiary.[18] A designation in the policy that the proceeds are payable to the insured's estate if the beneficiary predeceases the insured will not give rise to a tax.[19]

The use of the trust device to distribute the proceeds will not render taxable what is otherwise exempt.[20] Nor will the fact that the policy provides for an

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L. 85, 143 Atl. 807 (1928), where the court held there was a "transfer", on which a tax could be imposed, when the trustee distributed the proceeds to the beneficiaries.

The Kentucky statute makes no reference to proceeds payable to beneficiaries through trustees, but the Attorney General of the state has ruled that they are exempt. OP. ATT'Y GEN. no. 42-1 (1928).

The Arkansas statute is peculiar. It taxes proceeds of life insurance policies on death of the insured which "by the terms thereof, by operation of law, or by the will of the insured, inure to the benefit of any person or persons other than the direct descendants or ascendants, or the widow of the insured, in the nature of a gift, bequest or devise, not based upon the valuable consideration passing from said beneficiaries to the insured".

[13] Arkansas, *supra* note 12, Colorado (taxable in excess of $75,000 if paid directly or through trustees), Florida (taxable in excess of $40,000), Mississippi (taxable in excess of $20,000), Montana (taxable in excess of $50,000), North Carolina (taxable in excess of $40,000, but such exemption applies only to certain beneficiaries specified in the act [a recent amendment reduced the exemption to $20,000. See PRENTICE-HALL, Executive Sheet, 2012]), North Dakota ("all proceeds from life insurance policies not in excess of $20,000 shall be exempt from taxation"), Oklahoma (taxable in excess of $20,000 if payable directly or through trustee), Tennessee (exemption of $40,000 to enumerated beneficiaries; this section includes proceeds of policies known as "paid up" or "investment" or "annuity" contracts or "similar types or forms of policies, the surrender value of which was subject to control of decedent prior to death"). For citations, see *supra* note 2.

[14] The Wisconsin statute (*supra* note 2) is the most exacting of all. It taxes life insurance proceeds payable to estate or to designated beneficiary. "Such insurance, except that returnable for income taxation, shall be taxable irrespective of the fact that insurance premiums on any policy may have been paid by some person other than the insured, if the payment of such premiums was made out of funds or property contributed by the insured for such payment, or out of the income accruing from a principal provided by the insured for such payment, whether such principal was donated in trust or otherwise."

[15] Colorado (also the right to receive the cash surrender value), Oklahoma ("directly or indirectly"). See citations, *supra* note 2.

[16] Myers' Est., *supra* note 4.

[17] Matter of Einstein, *supra* note 7; *cf.* Parson's Est., 117 App. Div. 321, 102 N. Y. Supp. 168 (1907), where policies were payable to insured's estate but had been assigned to his wife. However, the policies remained in the possession of the insured. The court held that the policies were absolutely assigned (and so not taxable), but it intimated that the holding might be otherwise if someone had disputed the wife's right to the proceeds.

[18] See State v. Cain, 162 Tenn. 213, 215, 36 S. W. (2d) 82, 83 (1931), where the court said that the tax is based on the right to "acquire", and if the beneficiary has not a vested right to the proceeds, a tax may be imposed; see also Will of Allis, 174 Wis. 527, 184 N. W. 381 (1921), (1921) 1 WIS. L. REV. 313.

[19] Parson's Est., *supra* note 17; see Pierson, *Inheritance Tax Laws and Insurance* (1925) 11 A. B. A. J. 722.

[20] Haedrich's Est., *supra* note 11 (court said public policy favors insurance trusts to prevent waste and extravagance); Marshall's Est., 179 Minn. 233, 228 N. W. 920 (1930).

annuity alter its taxable status.[21] However, where an annuity is employed chiefly to avoid testamentary disposition, courts will apply the rule commonly applied to tentative trusts and will subject the proceeds to the normal inheritance tax.[22] Accident insurance payable to the insured's estate [23] and insurance to pay the decedent's taxes [24] are subject to tax.

Many problems in this field are common to both the federal and the state statutes, and inasmuch as the greater amount of case law, not to mention the Treasury Regulations, has been built up through interpretation of the Federal Act, the remainder of this note will be devoted to a consideration of that statute.

The applicable provision enacted by Congress reads:

> ". . . 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——
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> "(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." [25]

Subsection (h), immediately following, taxes all transfers whether made prior or subsequent to the effective date of the Act.

The first question which the provision gives rise to is, did Congress intend that the taxing provisions applicable to life insurance proceeds be embodied solely in this subsection, to the exclusion of the remaining subsections of the Act? From settled theories of statutory construction the answer appears obvious; that by express reference to life insurance in subsection (g), and by a total want of such reference in the remainder of the Act, Congress intended that the one subsection be alone applicable. But questions have been raised. *Dictum* in one case,[26] an inference gleaned from language used in another case,[27] and the arguments of a commentator,[28] add some substance to the doubt. It

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[21] Wilson's Est., 143 Misc. 742, 257 N. Y. Supp. 230 (1931) (Joint annuity taken out by *H* and *W*, in 1928, in which both contributed to payment of the single premium. The insurance company agreed to pay an annuity jointly, and on death of one, to the survivor. *H* died in 1929. State contended that proceeds should be taxed under a provision taxing transfers of jointly-owned property to the survivor. *Held,* not taxable. The contract was absolute when made. Also, it was not a transfer in contemplation of death).

[22] State *ex rel.* Thornton v. Probate Court, 186 Minn. 351, 243 N. W. 389 (1932) (For a lump sum paid to insurance company, latter guaranteed fixed income and agreed to refund upon notice the lump sum paid in, and to pay to appointed beneficiaries said sum upon annuitant's death. *Held,* that it was taxable. Such contracts are virtually bank deposits. "The law will look behind the name of contracts and ascertain their scope and purposes to determine whether or not they come within the operation of the succession tax"); *cf.* Wilson's Est., *supra* note 21.

[23] Stark's Est., *supra* note 4.

[24] N. Y. Transfer Tax Reg. (1925 ed.) art. 62; Ill. Inher. Tax Reg. (1925 ed.) art. 21. *Contra:* Ohio (OP. ATT'Y GEN. 564, 1921) (Attorney General saying such proceeds do not become part of insured's estate); the Tax Commissioner of Massachusetts has also ruled that such proceeds are not taxable. See Handy, *Subjection of Life Insurance to Death Taxation* (1926) 25 ILL. L. REV. 777, 779.

[25] 44 STAT. 71 (1926), 26 U. S. C. A. § 1094 (1928).

[26] Heiner v. Grandin, 44 F. (2d) 141 (C. C. A. 3d, 1930), *aff'd,* 56 F. (2d) 1082 (C. C. A. 3d, 1932), *certiorari* denied, 286 U. S. 561, 52 Sup. Ct. 643 (1932) (Court said Congress did not intend to make a distinction between trusts and policies of insurance where in both there is reserved the right to change the beneficiary; that the same section of the Act taxes both).

[27] Wilson v. Crooks, 52 F. (2d) 692 (W. D. Mo. 1931).

[28] Oppenheimer, *Proceeds of Life Insurance Policies Under the Federal Estate Tax* (1930) 43 HARV. L. REV. 724, 736-737.

might be added that insurance has already been taxed as a transfer in contemplation of death;[29] but this has been only where the proximity of the insured's death to his transfer is so pronounced as to give a distinct testamentary color to the gift. Moreover, it is clearly settled that the mere designation of a beneficiary in a policy is not *per se* a transfer in contemplation of death.[30]

A glance at Congressional proceedings will attest the exclusiveness of the subsection.[31] In accord are the rulings of the Treasury Department.[32] Moreover, reason supports this conclusion.[33] It might well be asked why subsection (g) was inserted as late as 1918 if the other subsections applied. If there is a genuine doubt it should be settled either by the courts or by Congress without delay. Otherwise, a taxpayer may be deprived of the $40,000 exemption allowed by subsection (g), as well as any total exemption which might result from its construction, if another subsection is applicable. In addition, taxpayers should be apprised of the provisions of the law which are applicable to them in given situations.

Under the Federal Act, the proceeds of all policies on the insured's life payable to his estate are taxable.[34] This includes policies taken out by the insured prior to the effective date of the statute without the application of the retroactive clause, subsection (h).[35] It also includes insurance payable to a third person to be applied indirectly to the use of the insured's estate.[36] Accident and health insurance are not exempt;[37] nor are the proceeds of policies taken out for the express purpose of defraying charges and taxes on the insured's estate.[38] However, an exception is made in the case of a pension fund, arising from compulsory contributions by the deceased, in which no vested right has accrued.[39]

The Supreme Court in *Lewellyn v. Frick*[40] held that subsection (g) did not subject to taxation policies payable to a beneficiary if taken out prior to the effective date of the Act, even where the insured had reserved the right to change the beneficiary. But this case was overruled,[41] in terms but not in words,

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[29] Iglehart v. Commissioner, 28 B. T. A. no. 139 (1933) (decedent was 74 years old and had been suffering from a stroke for eleven years, when he took out a single premium policy); see Gaither v. Miles, 268 Fed. 692 (D. Md. 1920).

[30] Matter of Voorhees, *supra* note 7; Parson's Est., *supra* note 17; Tyler v. Treasurer, *supra* note 5; see Oppenheimer, *supra* note 28, at 738-9.

[31] Committee on Ways and Means (Report 767, p. 22).

[32] V-1 CUM. BULL. 315; MONTGOMERY, FEDERAL TAX HANDBOOK (1932) 758; UNITED STATES TAX GUIDE (1933) § 385a.

[33] The Revenue Act, 44 STAT. 79 (1926), 26 U. S. C. A. § 1114 (1928), expressly provides that the executor of the insured's estate may recover from the beneficiaries of the proceeds the amount of the tax paid thereon. Inasmuch as this provision applies only to insurance, it might well be argued that Congress intended the insurance clause to be separate and distinct from the rest of the Revenue Act.

[34] U. S. Treas. Reg. 70, Art. 26; Mimnaugh v. United States, 66 Ct. Cl. 411 (1928); see Jones v. Commissioner, 20 B. T. A. 441, 443 (1930), *aff'd*, 62 F. (2d) 496 (C. C. A. 6th, 1932); Appeal of Lucky, 2 B. T. A. 1268 (1925).

[35] Mimnaugh v. United States, *supra* note 34.

[36] Morton v. Commissioner, 23 B. T. A. 236 (1931); see Surrey and Aronson, *Inter Vivos Transfers and the Federal Estate Tax* (1932) 32 COL. L. REV. 1332, 1362.

[37] Ackerman v. Commissioner, 15 B. T. A. 635 (1929) (accident insurance); Gray's Est. v. Commissioner, 29 B. T. A. no. 41 (1933) (health insurance).

[38] U. S. Treas. Reg. 70, Art. 26.

[39] Hulbert's Est. v. Commissioner, 12 B. T. A. 818 (1928).

[40] 268 U. S. 238, 45 Sup. Ct. 487 (1925).

[41] In Chase National Bank v. United States, 278 U. S. 327, 333, 49 Sup. Ct. 126, 127 (1929), Mr. Justice Stone, in the opinion for the Court, said the question was only "mooted" in Lewellyn v. Frick. In Liebes v. Commissioner, 63 F. (2d) 870, 873 (C. C. A. 9th, 1933), the court intimated that the Chase case overruled Lewellyn v. Frick. Buffington, J., dissenting in Heiner v. Grandin, *supra* note 26, refused to follow Reinecke v. Northern Trust Co.,

a few years later in *Chase National Bank v. United States*.[42] Although in the latter case the policies had been taken out subsequent to the effective date of the *Revenue Act*, the Court expressly held that the termination by death of a legal interest in the insured which could affect the disposition of the proceeds could be made the subject of a transfer tax. The right to change the beneficiary is such a legal interest. The *Chase* case is the most recent case on estate taxation of life insurance to come from the Supreme Court, and its principle has found ready application by the inferior federal courts.[43]

Occasionally, the question arises whether the insured in fact had reserved the right to change the beneficiary. It is the prevailing view that, where the policy is silent as to the right to change the beneficiary, the insured has no such right and the beneficiary's interest in the policy is vested.[44] However, the Board of Tax Appeals at times has overlooked this settled rule and has imposed a tax where the absence of the right to change the beneficiary (and other rights hereafter to be considered) would defeat the tax.[45] In a more recent case, the same court respected the common law rule, expressly holding that the right to change the beneficiary must be reserved formally before such right can be subject to tax.[46]

There are other rights which the insured may reserve. The most common are the right to borrow on the policy and pledge it as security for the loan, and the right to surrender the policy and obtain its cash value, both without the consent of the beneficiary. Both of these rights are usually incidental to the right to change the beneficiary,[47] but either may be reserved in the insured even where the right to change the beneficiary has been waived.[48] Under the doctrine of the *Chase* case the reservation of either of these rights, enduring until the insured's death, would subject the policy to a tax as a part of the decedent's gross estate.[49] While neither one gives the same degree of control over the entire proceeds as does the right to change the beneficiary, yet, by borrowing, the insured may materially reduce the amount payable to the beneficiary, or, by obtaining the cash surrender value, he may entirely defeat the provisions of the policy. In case of the insured's bankruptcy, the reservation of either of these rights constitutes assets in the hands of the trustee.[50] The fact that by the insured's death the beneficiary acquires only the difference between the cash surrender or loan value and the face amount of the policy will not reduce the

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278 U. S. 339, 49 Sup. Ct. 123 (1929) which involved revocable trusts, but on which the Court in the Chase case relied heavily, until the Court expressly overruled Lewellyn v. Frick.

[42] *Supra* note 41.

[43] Iglehart v. Commissioner, *supra* note 29; Ballard v. Helburn, 333 CCH § 9338 (W D. Ky. 1933); Cook v. Commissioner, 66 F. (2d) 995 (C. C. A. 3d, 1933); Willis' Est. v. Commissioner, 28 B. T. A. no. 29 (1933). See Newman v. Commissioner, 29 B. T. A. no. 14 (1933), for a complete citation of cases in which the principle enunciated in the Chase case has been followed.

[44] Brown v. Powell, 130 Miss. 496, 94 So. 457 (1923); 4 COOLEY, BRIEFS ON INSURANCE (2d ed. 1927) 3775; RICHARDS, *op. cit. supra* note 8, § 328; see Ballard v. Helburn, *supra* note 43; *cf.* Vance, *supra* note 8, at 355.

[45] Dann v. Commissioner, 20 B. T. A. 42 (1930); Latty v. Commissioner, 23 B. T. A. 1250 (1931) (did not appear whether insured could have changed the beneficiary); *cf.* Wyeth v. Crooks, 33 F. (2d) 1018 (W. D. Mo. 1928).

[46] Reed v. Commissioner, 24 B. T. A. 166 (1931).

[47] RICHARDS, *op. cit. supra* note 8, § 328.

[48] If the insured so provides in his contract of insurance.

[49] Sampson v. United States, 1 F. Supp. 95 (D. Mass. 1932); Ballard v. Helburn, *supra* note 43; Ballinger v. Commissioner, 23 B. T. A. 1312 (1931); *cf.* Levy's Est. v. Commissioner, 65 F. (2d) 412 (C. C. A. 2d, 1933).

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

amount (excluding the allowance for the $40,000 exemption) [51] to be included in the gross estate. Moreover, it is not subject to the constitutional arguments that a tax in such a case is direct and so invalid because it is not apportioned, or that there is a deprivation of property without due process within the meaning of the Fifth Amendment.[52]

A situation may possibly arise in which there is an absence of any of these rights, the policy being payable to a designated beneficiary, but the right reserved in the insured to receive the periodic dividends on the policy without the consent of the beneficiary. While the insured has no power of control over the proceeds of the policy, yet he has a right to the income which only death will terminate. Until the insured's death there is no "completion of the shifting of the economic benefits" in the proceeds, which is the fundamental basis of the tax. Moreover, the amount which the beneficiary would receive at the insured's death would be increased if the latter were without the right to claim the dividends. While the burden on the beneficiary would be heavier in a case of this sort than it would be in the situations discussed above, yet, under the language of the *Chase* case it appears rather certain that no distinction could be made, and the amount of the policy in excess of $40,000 would be included in the gross estate of the decedent.[53]

Where a policy expressly provides that the proceeds are payable to the insured's estate on the contingency that one or more beneficiaries predecease the insured, the proceeds will not be taxed where in the absence of this provision they would be exempt.[54] It is said that the interest of the insured is too remote on which to base a tax. An additional reason might be that the operation of the contingency does not depend on the will of the insured and to this extent at least the provision is substantially different from the other rights which an insured may reserve in the policy.

A legal relationship with which the Act does not specifically deal is that of assignments of insurance policies. It is a common occurrence in insurance transactions for the insured to assign his policies either to strangers or relatives, for or without consideration. One court has expressly held that "assignees" are not included among "all other beneficiaries" within the meaning of that phrase as used in the statute.[55] While it is admitted that there are accepted differences between an assignment of a policy and the designation of a beneficiary by the insured,[56] yet the recognition of such distinctions ought not to be sufficient to make the proceeds exempt in one case and taxable in the other, if in both instances substantially identical legal incidents result. If, in an assignment, the insured has retained the privilege of recalling the transfer, and such privilege remains with him until death, the amount realizable on the insured's death should not be excluded from taxation. And this is the prevailing judicial opinion,[57] despite doubts raised in various quarters.[58] Since the right to revoke

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[51] Sampson v. United States, *supra* note 49.

[52] See Surrey and Aronson, *supra* note 36, at 1363; Oppenheimer, *supra* note 28, at 744.

[53] No case has arisen in which this right alone was involved. In Matter of Voorhees, *supra* note 7, the insured named a trustee as beneficiary, reserved the right to change the beneficiary and receive the dividends. The court said such dividends were not "dividends" in the sense of a return on property or an investment.

[54] Levy's Est. v. Commissioner, *supra* note 49; Phelps v. Commissioner, 6 B. T. A. 648 (1927); Ballard v. Helburn, *supra* note 43.

[55] Guettel v. United States, 67 Ct. Cl. 613 (1929).

[56] See Oppenheimer, *supra* note 28, at 741 *et seq.;* Mutual Benefit Life Ins. Co. v. Swett, 222 Fed. 200, 205 (C. C. A. 6th, 1915); 7 COOLEY, *op. cit. supra* note 44, at 6443.

[57] Ballinger v. Commissioner, *supra* note 49; Anthracite Trust Co. v. Phillips, 49 F. (2d) 910 (M. D. Pa. 1931); see Chase National Bank v. United States, *supra* note 41; *cf.* Levy's Est. v. Commissioner, *supra* note 49.

[58] See Oppenheimer, *supra* note 28, at 744-5.

is similar to the right to change the beneficiary, the proceeds of such revocably assigned policies are included in the gross estate of the insured, less the $40,000 exemption, for tax assessment.[59] Where, however, the policy is irrevocably assigned the relationship created is comparable to that arising where the insured has reserved no right to change the beneficiary (or any of the other "operative" rights). By the assignment the insured is divested of all right and beneficial interest in the policy, and therefore no tax is assessed.[60] Consistently with this, it has been held recently that the proceeds are not taxable even where the insured continues to pay the premiums subsequent to the irrevocable assignment.[61] Other provisions of the *Revenue Act*[62] deal adequately with the case where the insured receives consideration from the assignee.

It has been assumed thus far that, where the insured has reserved none of the above-mentioned operative rights in the policy, the proceeds thereof will not be included in his gross estate for taxing purposes. In other words, where the beneficiary has a vested interest in the policy prior to the insured's death the proceeds are not taxable. A considerable number of decisions support this conclusion.[63] But the language of subsection (g) does not warrant it. In terms, all insurance "taken out" by a person is taxable at his death, excepting, of course, the $40,000 exemption. But grave constitutional doubts arise where an attempt is made to give the fullest effect to the language used. Inasmuch as the beneficiary has a vested right in such a policy, and since he must eventually pay the tax which would vary with the size of the insured's estate, he may invoke both the due process clause and the constitutional prohibition of a direct tax which is unapportioned.[64] It has been suggested that both of these arguments might be overcome.[65] However, there remains another more formidable obstacle which stands in the way of an imposition of the tax in this situation. There is, in fact, no transfer by the insured at his death of any property interest in the policy. No interest has terminated at death which has redounded to the benefit of another. In the language of the *Chase* case, this is the basis of the federal estate tax. That the courts and the Treasury Department have not been unmindful of these difficulties is attested by their reluctance to apply subsection (g) literally.[66]

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[59] See cases cited *supra* note 57. In the Chase case, *supra* note 41, at 338, 49 Sup. Ct. at 128, Mr. Justice Stone said, ". . . the power to tax the privilege of transfer at death cannot be controlled by the mere choice of the formalities which may attend the donor's bestowal of benefits on another at death, or of the particular methods by which his purpose is effected, so long as he retains control over those benefits with power to direct their future enjoyment until his death."

[60] Blood's Est. v. Commissioner, 22 B. T. A. 1000 (1931); Guettel v. United States, *supra* note 55; Fidelity & Columbia Trust Co. v. Lucas, 7 F. (2d) 146 (W. D. Ky. 1925); Levy's Est. v. Commissioner, *supra* note 49; Liebes v. Commissioner, *supra* note 41.

[61] Levy's Est. v. Commissioner, *supra* note 49.

[62] The income tax provisions of the Revenue Act would apply in this situation. UNITED STATES TAX GUIDE (1933) § 126; Note (1927) 1 CIN. L. REV. 467.

[63] Liebes v. Commissioner, *supra* note 41; Gaither v. Miles, *supra* note 29; Reed v. Commissioner, *supra* note 46; Anthracite Trust Co. v. Phillips, *supra* note 57; Ballard v. Helburn, *supra* note 43; Blood's Est. v. Commissioner, *supra* note 60; Levy's Est. v. Commissioner, *supra* note 49; Jones v. Commissioner, *supra* note 34; Union Trust Co. v. McCaughn, 24 F. (2d) 459 (E. D. Pa. 1927).

[64] Surrey and Aronson, *supra* note 36, at 1363, 1364.

[65] *Ibid.;* Oppenheimer, *supra* note 28, at 741-3.

[66] See cases cited *supra* note 63. Originally the Treasury provided for the taxation of all insurance irrespective of the retention of "legal incidents of ownership". U. S. Treas. Reg. 70, Art. 27. But by T. D. 4296 (issued August 6, 1930) this was amended to provide that only where "legal incidents of ownership" were reserved by insured could the government tax life insurance payable to designated beneficiary. See 332 C. C. H. 3634; Morton, *Taxability of Life Insurance* (1931) 9 TAX MAGAZINE 205, 207; MONTGOMERY, *op. cit. supra* note 32, at 757.

It has been suggested [67] that the recent case of *Burnet v. Wells*,[68] involving income tax, is applicable to the problem here involved. In that case an assured created a funded irrevocable life insurance trust, the income of which was to pay the premiums on insurance policies payable to the trustee for the use of designated beneficiaries. The insured had retained none of the operative rights in the policies. The Supreme Court held that such part of the income of the trust as was used in the payment of premiums was to be included in the gross income of the insured for taxing purposes. The Court rested its decision on the fact that, by safeguarding the rights of the objects of his bounty by means of the trust, the insured had a benefit in the income which was so substantial that a tax could be imposed. It was found to be immaterial that the insured had no legal rights to the income of the trust. While the opinion embodies language broader than the Court heretofore has been willing to adopt, and while it indicates a definite trend toward a more flexible application of taxing statutes, yet it is difficult to perceive how in the assessment of estate taxes it can overcome the want of a transfer at the insured's death. Having no operative right in the policies, the insured at no time could have diverted the proceeds to someone other than the named beneficiary. To tax such proceeds on the basis of a testamentary transfer will require the use of more subtle distinctions than the Court has yet been willing to employ.

An acute problem which subsection (g) raises is the interpretation to be given the phrase "under policies taken out by the decedent upon his own life". The words "taken out" have an accepted meaning in insurance terminology, *viz.*, where the insured applies for the policy and pays the first premium on it.[69] Accordingly, the Treasury Department has ruled that the policies are subject to tax where the insured, directly or indirectly, has paid the premiums, but that the policies are exempt where all the premiums have been paid by the beneficiary.[70] But it is immaterial if the insured has not applied for the insurance.[71] The Treasury also has ruled that where the premiums are paid partly by the beneficiary and partly by the insured, the policy is taxable to the extent of the proceeds realizable from the payments by the insured.[72] However, where a corporation paid the premiums on a policy insuring the life of a majority shareholder, a federal court held that there was no proportionate payment of premiums by the insured to the extent of his interest in the corporation, and no tax was imposed.[73] The court reasoned that in such a case the corporate entity could not be disregarded. But where a corporation took out a policy on a shareholder, paid the premiums for a number of years, then for an adequate consideration transferred it to the insured who paid the subsequent premiums, the Board of Tax Appeals upheld the assessment of a tax.[74]

It will be noted that the Treasury's ruling excludes entirely the situation where someone other than the insured or the beneficiary pays the premiums on the policy. While, ordinarily, cases of this nature would not be common, yet their existence may not be entirely precluded, especially if they provide havens for tax avoidance. A husband might well insure his wife, pay the premiums, have an object of his bounty designated a beneficiary, with operative rights

[67] Lowndes, *The Constitutionality of the Federal Estate Tax* (1933) 20 VA. L. REV. 141, 168-169.

[68] 289 U. S. 670, 53 Sup. Ct. 761 (1933); Note (1933) 20 VA. L. REV. 104. Accord: Cummins v. United States, 3 F. Supp. 728 (Ct. Cl. 1933); Thacher v. United States, 4 F. Supp. 108 (Ct. Cl. 1933); Pillsbury v. Burnet, 67 F. (2d) 151 (Ct. App. D. C. 1933); see DuPont v. Commissioner, 289 U. S. 685, 688, 53 Sup. Ct. 766, 767 (1933).

[69] Morton, *supra* note 66, at 238.

[70] U. S. Treas. Reg. 70, Art. 25; UNITED STATES TAX GUIDE, *supra* note 32.

[71] *Ibid.*

[72] *Ibid.*

[73] Wilson v. Crooks, *supra* note 27 (policies not "taken out" by insured).

[74] Iglehart v. Commissioner, *supra* note 29 (policies "taken out" by insured).

reserved in the insured.[75] Or, he might create an irrevocable trust to pay the premiums on policies on his own life with operative rights in the policy reserved to himself.[76] Certainly, a logical construction of the statute, as interpreted by the Treasury, impels the conclusion that the proceeds of such arrangements cannot be made a part of the insured's gross estate for tax assessment. Did the Treasury intend this result? It might be said that when the Treasury mentioned only premiums paid by "beneficiaries" as giving rise to exemption, that it intended subsection (g) to apply to the case where a third party paid the premiums. But if this be the proper conclusion, why was it not specifically so declared?

It is obvious that Congress did not contemplate such escapes from the application of subsection (g). Looking to the broad language of the Supreme Court in the *Chase* case, the gap might well be filled without doing any substantial violence to the language employed by Congress to express its will. The *Chase* case has ruled that a transfer tax may be imposed legitimately where death results in a shifting of economic benefits in property from an insured to a beneficiary. It should not be material that a third party has paid the premiums.[77] The decisive factor should be whether on the insured's death the beneficiary has acquired some additional property right which he might not have acquired had the insured continued to live. It is the beneficiary who ultimately must pay the tax.[78] Moreover, it should not be difficult to reconcile this approach with the common acceptation of "taking out". The payment of premiums by the third party might be construed as a gift to the insured, and the payments considered as in fact made by the insured. In the irrevocable trust illustration, *Burnet v. Wells* should serve as a conclusive precedent for holding that the insured in fact paid the premiums. Moreover, courts are not restricted to inflexible definitions of words when interpreting a taxing statute.[79] Pertinent *dicta* of adjudicated cases point to the position here taken as a possible solution of the problem.[80]

One of the perplexing problems involved in the taxability of ordinary transfers under the *Revenue Act* is the effect to be given subsection (h), which purports to impose a tax on transfers made prior or subsequent to the effective date of the Act. Courts [81] and commentators [82] have expressed divergent views on the applicability of this subsection to life insurance proceeds, the constitutionality of the clause being the common point at issue. On analysis, however, it would seem that this mooted question need not even be raised. Under the present status of the law, subsection (h) cannot be applied to a policy payable to the insured's estate which has been taken out prior to the effective date of

[75] In Bromley v. Commissioner, 16 B. T. A. 1322, 1326 (1929), the relationship created was somewhat similar. However, there the insurance was payable to the insured's estate although there was the right reserved in the insured to change the beneficiary. The Court said that the policies "were taken out by the decedent upon her own life and the proceeds" were to be included in her gross estate.

[76] This is substantially the set-up in Burnet v. Wells, *supra* note 68, except that here the insured has operative rights (legal incidents of ownership) in the policies.

[77] See *supra* note 62. Where the beneficiary pays the premium, the transfer to him has been made for a consideration and no problem is involved.

[78] 44 STAT. 79 (1926), 26 U. S. C. A. § 1114 (1928).

[79] See *supra* note 59.

[80] See Bromley v. Commissioner, *supra* note 75; Ballard v. Helburn, *supra* note 43. In Sampson v. United States, *supra* note 49, the Court said at 99, "If the death terminated some right, power, or interest of the deceased in the property", that is sufficient on which to base a tax; *cf.* Morton, *supra* note 66.

[81] Anthracite Trust Co. v. Phillips, *supra* note 57 (the Court said Congress did not intend by subsection (h) to make subsection (g) retroactive); Wyeth v. Crooks, *supra* note 45; *cf.* Feuerbacher's Est. v. Commissioner, 22 B. T. A. 734 (1931); Heiner v. Grandin, *supra* note 26; Will of Allis, *supra* note 18.

[82] See Oppenheimer, *supra* note 28, at 733-4; MONTGOMERY, *op. cit. supra* note 32, at 757.

the Act, inasmuch as such proceeds are taxable under subsection (g) itself. Moreover, it can bear no reference to a policy payable to a beneficiary in which the insured has retained until his death an operative right, for in this situation, under the doctrine of the *Chase* case, subsection (g) imposes a tax irrespective of the date when the policy was taken out. Finally, it can have no application to the situation where, in a policy having a named beneficiary, the insured possesses at his death no operative right in the policy, inasmuch as the proceeds thereof are not taxable under subsection (g) even where the policies have been taken out subsequent to the effective date of the *Revenue Act*. It is an *a fortiori* case where the policy has been taken out, and the beneficiary's right to the proceeds has vested, prior to the effective date of the Act. Inasmuch as revocable and irrevocable assignments are comparable, respectively, to the latter two situations, no other relation involving different legal incidents can arise. It is apparent, therefore, that the construction given by the courts and the Treasury Department to subsection (g) has completely sterilized the operation of the retroactive clause, subsection (h), and further discussion of it in the light of life insurance can have at the most only academic interest.

A problem recurrent in the interpretation of all federal taxing acts is the effect of the state law on collateral issues which determine the applicability of the taxing statute.[83] This is an especially bothersome problem in the field of life insurance due, in the main, to the existence of state statutes which fix personal rights in the proceeds, in a manner peculiar to each jurisdiction. Inasmuch as it is a rule that the law of the state fixes property rights,[84] this, naturally, serves as a serious impediment to the uniformity of application which a federal act requires.[85] Thus, it is found that if insurance is payable to the insured's estate it is not taxable under the Federal Act if by the state law the proceeds do not pass to the executor.[86] But, one court has refused to abide by the state rule that a beneficiary named in a policy has a vested right therein, even though the insured has reserved the right to change the beneficiary.[87] However, where under the law of the state the insured could not obtain the cash surrender value of the policies without the consent of the beneficiary, even though he had reserved such a right, a federal court acquiesced and refused to impose a tax.[88] But where the taxpayer has not sustained the burden of proving that proceeds of insurance were community property, and only half was payable to the insured's estate, courts will require the inclusion of the full amount in the gross estate of the decedent for taxing purposes.[89]

It is obvious that the peculiarities of state law offer a serious deterrent to a uniform application of a national tax statute. This has always been a problem. Perhaps *Burnet v. Harmel*,[90] which asserted that a state law may affect the operation of a federal taxing act only when Congress expressly or by implication so provides, will help to serve as a solution of the problem. At any rate, it signifies a bolder attitude on the part of the Supreme Court in attacking the question.

H. T.

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[83] See Note (1933) 82 U. of Pa. L. Rev. 39, 47.

[84] Lederer v. Pearce, 266 Fed. 497 (C. C. A. 3d, 1920); Lederer v. Northern Trust Co., 262 Fed. 52 (C. C. A. 3d, 1920).

[85] Fidelity Trust Co. v. McCaughn, 1 F. (2d) 987 (E. D. Pa. 1924).

[86] Jones v. Commissioner; Appeal of Lucky, both *supra* note 34; *cf.* Merrill Trust Co. v. Commissioner, 21 B. T. A. 970 (1930) (solvent estate not exempt where statute of Maine provides that insurance could not be payable to insolvent estate).

[87] Sampson v. United States, *supra* note 49 (involving the Massachusetts rule enunciated by Tyler v. Treasurer, *supra* note 5).

[88] Levy's Est. v. Commissioner, *supra* note 49 (abiding by the law of New York).

[89] Sanchez v. Bowers, 57 F. (2d) 324 (S. D. N. Y. 1932); Newman v. Commissioner, *supra* note 43 (community property in Louisiana). Accord: Carroll's Est. v. Commissioner, 29 B. T. A. no. 3 (1933).

[90] 287 U. S. 103, 53 Sup. Ct. 74 (1932).