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## Life Insurance, the Forbidden Fruit

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# LIFE INSURANCE, THE FORBIDDEN FRUIT

WILLIAM J. BOWE\*

Until recently life insurance has represented the most impenetrable stronghold of the professional tax avoider and his advisors. As a vehicle for the transmission of wealth to future generations with minimum tax levies, it stood unrivaled. During a policyholder's life the value of his policy for gift tax purposes was and is measured by replacement cost.<sup>1</sup> Under applicable regulations during the thirties, when insurance was transferred by way of inter vivos gift the tremendous increase in value of the policy that came with death escaped gift tax, income tax, and estate tax.<sup>2</sup> But since 1941 the situation has been reversed so that it may be fairly said from the standpoint of tax avoidance that life insurance is now in the doghouse.<sup>3</sup>

It is the object of this paper to trace the history of the impact of federal taxation on life insurance and the efforts of the Treasury "to keep apace with the fertility of invention" of taxpayers.<sup>4</sup> It might as appropriately have been entitled "A Study in the Consequence of Tax Avoidance." This is not to say that tax avoidance is in any sense improper. The legal right of a taxpayer to decrease the amount of what would otherwise be his taxes or altogether to

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1. *Guggenheim v. Rasquin*, 312 U. S. 254, 61 Sup. Ct. 507, 85 L. Ed. 813 (1941).

2. The cost of a single premium policy in the face amount of \$100,000 at age 40 is \$57,833. Thus an inter vivos gift of the policy resulted in the remaining \$42,177 passing free of gift, income, and estate taxes.

3. This may be shown by example. Thus a person who irrevocably transfers policies to a trust, together with securities producing sufficient income to meet the annual charges, incurs gift tax liability on the replacement value of the policies in addition to the value of the securities. *Commissioner v. Beck*, 129 F. 2d 243 (C. C. A. 2d 1942). The income used to pay the premiums will continue to be taxable to him though permanently beyond his control. INT. REV. CODE § 167(a)(3). On his death the proceeds of the contract will be included in his gross taxable estate. This conclusion is contra to the often cited case of *Helvering v. Reybne*, 83 F. 2d 215 (C. C. A. 2d 1936). But the 1942 amendments to INT. REV. CODE § 811(g) were clearly intended to remove any lingering hope taxpayers might have reposed in that decision. H. R. REP. No. 2333, 77th Cong., 2d Sess. 162 (1942); SEN. REP. No. 1631, 77th Cong., 2d Sess. 235 (1942): "A decedent similarly pays the premium or other consideration if payment is made by a corporation which is his alter ego or by a trust whose income is taxable to him, as, for example, a funded insurance trust." See PAUL, SUPPLEMENT TO FEDERAL ESTATE AND GIFT TAXATION 363 (1946). It is immaterial that the transfer was irrevocable, made many years before death and there is no contention that it was made in contemplation of death.

To cite another example, a husband assigns his insurance contract to his wife, and pays gift tax on its then value. Each time he pays a subsequent premium he pays a further gift tax or reduces the amount he otherwise could give her annually free of tax. Their son is named beneficiary. On death the proceeds of the policy will be taxed as part of his estate (with gift tax credit) and his wife will incur, simultaneously, gift tax liability measured by the full amount of the identical proceeds—estate tax, INT. REV. CODE § 811(g)(2); gift tax, *Goodman v. Commissioner*, 156 F. 2d 218 (C. C. A. 2d 1946). Nor will the permissive splitting of gift tax liability under INT. REV. CODE § 1000(f)(1)(A) ameliorate the double burden, since the completion of the gift does not precede the termination of the marital relationship.

4. *Burnet v. Wells*, 289 U. S. 670, 676, 53 Sup. Ct. 761, 77 L. Ed. 1439 (1933).

avoid them by means which the law permits, is hornbook law. He need not adopt the most expensive tax method of procedure. Rather than sell securities held for exactly six months and incur a tax on the whole profit, he may delay the sale for one additional day and suffer income tax on only half of his profits.<sup>5</sup> Rather than pay a debt with a \$20.00 check where a tax is imposed on all checks of \$20.00 or more, he may pay the same debt by drawing two checks each in the amount of \$10.00.<sup>6</sup> The difficulty with drawing a line, as Mr. Justice Holmes has pointed out, is that the taxpayer may come as close to the line as he will so long as he does not cross it.<sup>7</sup>

But those who draw the lines—legislators, courts and administrators—are free to re-draw them and when large numbers approach too closely to a given line it is almost certain to be moved. Since the placing of the line initially resulted from the exercise of discretionary power, difficulties rarely arise in enlarging the scope of a statute's coverage. Even constitutional limitations may be stretched where a vital need exists. To prevent evasion Congress may include within the sweep of a statute a status or an act not normally within its reach. It may adopt measures reasonably calculated to prevent avoidance of a tax. "A legislative declaration that a status of the taxpayer's creation shall in the application of the tax be deemed to be the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process."<sup>8</sup>

#### HISTORICAL EVOLUTION OF CURRENT LAW

##### (1) *The Statute*

The only specific references to life insurance in the 1913 and 1916 Revenue Acts were provisions which granted exemption from income taxes.<sup>9</sup> The 1916 Act required as a condition of estate taxability that the property of the decedent be subject to the payment of charges against his estate and the expenses of administration.<sup>10</sup> Thus only proceeds of insurance payable to the insured's executor or administrator were caught. Payments to beneficiaries

5. INT. REV. CODE § 117.

6. *United States v. Isham*, 17 Wall. 496, 21 L. Ed. 728 (U. S. 1873).

7. *Superior Oil Co. v. Mississippi*, 280 U. S. 390, 395, 50 Sup. Ct. 169, 74 L. Ed. 504 (1930).

8. *Helvering v. City Bank Farmers Trust Co.*, 296 U. S. 85, 90, 56 Sup. Ct. 70, 80 L. Ed. 62 (1935). Mr. Justice Holmes in his dissent in *Schlesinger v. Wisconsin*, 270 U. S. 230, 241, 46 Sup. Ct. 260, 70 L. Ed. 557 (1926) (a case involving the constitutionality of a statute creating a conclusive presumption that all gifts made within six years of the date of death were to be classed as made in contemplation of death), expressed the thought graphically: "Of course many gifts will be hit by the tax that were made with no contemplation of death. But the law allows a penumbra to be embraced that goes beyond the outline of its object in order that the object may be secured."

9. 1913 Act § II, subd. 2B, 38 STAT. 167; 1916 Act § 4, 39 STAT. 758.

10. 1916 Act § 202(a), 39 STAT. 777.

were not included as part of the taxable estate. The easy road to avoidance was too clear to pass unnoticed.

This led to prompt amendment. In the 1918 Act insurance was includible as part of the gross estate "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."<sup>11</sup> This provision continued without change until 1942.

The Ways and Means Committee Report in discussing reasons for the legislative amendment stated with what in the light of later events seems unbelievable naiveté: "It has been brought to the attention of the Committee that wealthy persons have and now anticipate resorting to this method of defeating the estate tax. Agents of insurance companies have openly urged persons of wealth to take out additional insurance . . . for the reason that insurance would not be included in the gross estate."<sup>12</sup>

The limitation, "taken out by the decedent," cried at birth for clarification. The need for administrative regulations and judicial construction was immediately apparent. To give these words their literal meaning—*i.e.*, applied for and first premium paid by the decedent—would fly in the face of the expressed Congressional policy of subjecting insurance proceeds to taxation with other property transmitted at death. A moment's reflection by the legislators would have satisfied them that the agents who openly urged the purchase of insurance to avoid estate taxes would be ingenious enough now to urge its purchase to accomplish the same objective by having some member of the insured's family apply for and pay the initial premium.

The phrase, "taken out," permits of three possible constructions: (1) purchased and owned by the decedent or, (2) owned by decedent (incidents-of-ownership test) or (3) purchased by him (premium-payment test). The first construction would appear to cover the normal situation. In the absence of tax considerations, only in exceptional circumstances would the premiums be paid by someone other than the owner. Also the insured would normally purchase and continue to own the contract. The second construction would rely upon ownership of a policy (without regard to the source of the premium payments) as the test of taxability. The policy with its loan and cash surrender values and power to designate and change beneficiaries, is property of substantial worth even prior to death. These rights are as capable of valuable economic use as stocks, bonds and bank deposits. The third construction would

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11. 1918 Act § 402(f), 40 STAT. 1098 (1919).

12. H. R. REP. No. 767, 65th Cong., 2d Sess. 22 (1918). Compare this language with the less restrained Committee Reports in 1942 (H. R. REP. No. 2333, 77th Cong., 2d Sess. 162; SEN. REP. No. 1631, 77th Cong., 2d Sess. 235); dealing with insurance amendments and referred to later in this article: "This provision is intended to prevent avoidance of the estate tax and should be construed in accordance with this objective."

fasten on the payment of premiums as the decisive factor. The argument that Congress intended to reach the fund built up over the years by periodic payments by an insured and transmitted at his death to the natural objects of his bounty would seem to be in accord with the general objective of any system of succession taxation. The presence of the technical indicia of ownership in an insured's donee in a case where the insurance contract has been assigned ought not to deprive this argument of force in view of the tax-avoiding opportunities a contrary rule would offer. Here the considerations justifying the taxation of the full value of jointly owned property to the one who had contributed the funds with which it was purchased would seem to have special relevance.<sup>13</sup> The absence of legal title in the decedent is of substantially less significance in the case of an insurance policy than in that of other assets, since the full utility of this type of property springs up with death. The values inherent in the contract prior to death as a practical matter are infrequently utilized and are generally considered as incidental to its primary function. "[D]eath, coupled with the payment of premiums, is the indispensable event giving rise to or enlarging the enjoyment of valuable property rights."<sup>14</sup>

The Treasury, as will appear presently, shifted from the premium-payment test to the ownership test and back again, with consequent bewilderment to the taxpayer. The courts contributed their share to the confusion. Congress stood mute until 1942, perhaps because no satisfactory solution was apparent until the Supreme Court should indicate the constitutional limitations on the taxation of the complex interests which tax-conscious citizens were creating in their policies in the hope of freeing them from a constantly increasing tax burden.

## (2) *Regulations and Decisions*

The 1918 regulations defined the words, "taken out by the decedent," as referring to cases where the decedent paid the premiums either directly or indirectly. Subsequent regulations throughout the twenties continue, with variations, this test.<sup>15</sup> In spite of decisional setbacks the Treasury, convinced

13. INT. REV. CODE § 811(e).

14. *Bailey v. U. S.*, 27 F. Supp. 617, 622 (Ct. Cl. 1939).

15. PAUL, *FEDERAL ESTATE AND GIFT TAXATION*, § 10.13, pp. 512-514 (1942): "Under the 1918 Act the regulations defined the words 'taken out by the decedent upon his own life' as referring to cases in which the decedent 'pays the premiums, either directly or indirectly, whether or not he makes the application.' Under the 1921 Act this interpretation was changed so that the only express exemption from tax was in the situation where the beneficiary paid the premiums; the regulations were mute as to premium payments by someone other than the insured and other than the beneficiary.

"The regulations issued under the 1924 Act first provided for an apportionment of the proceeds where the insured paid a portion of the premiums and the beneficiary paid the remainder. With minor changes this interpretation was carried over into Regulations 70 issued under the 1926 Act. Under a subsequent edition of Regulations 70 it was expressly stated (1) that all proceeds payable to third party beneficiaries were taxable if the insured retained control over the policy, and (2) that all proceeds were taxable regardless of control as to all decedents dying after the date of the 1924 Act, and also as

that payment of premiums should be the vital factor if large-scale avoidance was to be checked, stuck to its guns, until in 1929 the Supreme Court in *Chase National Bank v. United States*<sup>16</sup> gave what looked like convincing evidence of its preference for the incidents-of-ownership test.<sup>17</sup>

In the *Chase National Bank* case the decedent had both owned the policies and paid the premiums. The court emphasized ownership of the policies as justifying taxation of the proceeds.

"A power in the decedent to surrender and cancel the policies, to pledge them as security for loans and the power to dispose of them and their proceeds for his own benefit during his life which subjects them to the control of a bankruptcy court for the benefit of his creditors, . . . and which may under local law applicable to the parties here, subject them in part to the payment of his debts . . . is by no means the least substantial of the legal incidents of ownership, and its termination at his death so as to free the beneficiaries of the policy from the possibility of its exercise would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death."<sup>18</sup>

The Treasury surrendered in the following year (1930) to the notion that the insurance section covered only those policies in which the decedent retained an interest.<sup>19</sup>

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to all decedents dying between the 1918 and 1924 Acts where the policy was taken out, or the beneficiary named, after the enactment of the revenue act in force at the time of insured's death.

"Up to 1930, therefore, incidents of ownership were not expressly required as a condition of taxability. Then, on August 6, 1930, the Treasury surrendered to the idea that the insurance section covered only policies over which the decedent retained an interest. In the first edition of Regulations 80, appearing in 1934, wiser heads developed Article 25 as follows: 'Insurance is considered to be taken out by the decedent in all cases, whether or not he makes the application, if he pays the premiums either directly or indirectly, or they are paid by a person other than the beneficiary, or decedent possesses any of the legal incidents of ownership. . . .' This was the first formal edition of the regulations which made legal incidents of ownership a test of whether policies are taken out by the decedent, although only as one of three alternative tests. The alternative word 'or' in the foregoing sentence from Regulations 80 naturally gave rise to the impression that policies were taxable to the decedent's estate if any of the alternative factors existed. This result would have been irreconcilable with Article 27 of the same regulations, which stated that insurance receivable by beneficiaries other than the estate should be taxed only where the insured decedent had reserved legal incidents of ownership. At this point there was complete bewilderment for anyone who attempted to decipher the mosaic, except that, one did at least know that the insurance meaning of the words 'taken out' did not supply even a portion of the pattern."

16. 278 U. S. 327, 49 Sup. Ct. 126, 72 L. Ed. 405 (1929).

17. Later events justified the soundness of the Treasury's views.

18. 278 U. S. 327, 335, 49 Sup. Ct. 126, 73 L. Ed. 405 (1929).

19. T. D. 4296, XI-2 Cum. Bull. 427 (1930). Where both husband and wife have substantial independent means, the effect of the statute and regulations under either test can be readily avoided by having the wife pay the premiums and own the policy on her husband's life. It is difficult, if not impossible, to bring this type of transaction within the premium-payment rule (which includes indirect payments) even in the case where the wife's expenditures for premiums lessened the portion of family expenses which she might otherwise have borne. This is not to argue that such insurance should be included but merely to suggest the discriminatory advantage. Where each pays the premiums on the other's insurance, the case for exemption under the indirect premium payment test is less clear. But in the overwhelming majority of cases family income or wealth is attributable to a single spouse. Thus the burden of the premiums necessarily falls on the spouse whom it is desirable to insure. To grant exemption, as the 1930 Treasury Decision did, to the husband and income producer, when he transfers ownership in his policy to his

(3) *Avoidance Devices*

Insurance began to enjoy a tremendous popularity, having no relation to the function it serves in our economy. During the thirties it represented the principal vehicle used by the wealthy for the removal of substantial portions of their assets beyond the reach of the tax-gatherer.<sup>20</sup> What follows is largely of historical interest; its present significance lies in the fact that it may explain why insurance, once the recipient of preferred treatment under the tax statutes, now finds itself subject to very real discrimination.<sup>21</sup>

With the upping of the estate tax rates in 1932 to a point then thought of as confiscatory, and the imposition of a tax on gifts to eliminate complete avoidance through inter vivos transfers, the investment aspects of insurance came to overshadow, in the minds of many, its primary purpose of protection against the risks of premature death.

The annual premium on \$100,000 worth of insurance purchased by a man aged 50, in 1932 was \$4,666. The immediate assignment of the policy, even to a trust, incurred no gift tax as its value—*i.e.*, its cost—was well within the then liberal exemption of \$50,000. Additional premiums after the tenth year might incur gift tax,<sup>22</sup> but the rates seemed nominal compared with the privilege of having his donee receive on his death \$100,000 free of estate tax. When contrasted with the cost of a gift of \$100,000 in securities, the advan-

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wife, even though he continues to pay all the premiums, is to concede tax consequences to events that have no significance economically within the family. It is equally hard in this type of transfer to imagine that a husband feels himself the poorer after the assignment or after any subsequent premium payment than does a grantor in a Clifford trust type of transfer.

20. A father may well hesitate to transfer income-producing securities to his children. Human nature being what it is, the acquisitive instinct that enabled him to gain his preferred economic position makes it difficult for him to part with control, even partial, over the family purse strings, as the cost of accomplishing substantial tax reduction. The *pater familias* satisfaction is peculiarly dear to the very type of mind to whom tax avoidance has an especially strong appeal. The resultant clash created emotional conflicts which made a multitude of tax avoiders easy prey to insurance agents armed with the 1930 Treasury Decision making incidents of ownership the decisive test. Transferring insurance has myriad attractions. The recipient son or daughter feels no immediate sense of enrichment, so long as papa lives, no new feeling of economic independence springs up, no shifting in family wealth or control is factually recognized or likely to upset well-ordered lives.

21. COMMITTEE ON POSTWAR TAX POLICY—TAX PROGRAM 1947, p. 148. "For purposes of inclusion in the gross estate, insurance is discriminated against because, even though the decedent retains no ownership of the insurance, it may be included in the estate because he paid the premiums on the insurance during his lifetime. There seems to be no sound reason why the estate tax should discriminate against property owned by the decedent in the form of life insurance. If one person wishes to make provision for his relatives or others in the form of life insurance and makes an outright gift of the policies during his lifetime, retaining no incidents of ownership, there is no reason why his estate should have to pay a higher tax than that of one who chose to make the same provisions with stocks, bonds, real estate, or other forms of property. This arbitrary treatment of life insurance discriminates against the salaried or professional man, and favors those who by reason of inherited wealth or successful business ventures own other forms of property." See also MONTGOMERY, FEDERAL TAXES ON ESTATES, TRUSTS AND GIFTS, 1945-46, p. 457.

22. Gifts of future interests were excepted from the annual exclusion. 1932 Act § 504(b), 47 STAT. 247 (1932).



tages were irresistible even to those who had no need for insurance protection. The variations to attain this and additional advantages were limited only by the ingenuity of insurance agents. Single-premium policies were purchased with bank loans, and the deductibility of the interest each March 15th, resulted in the Government's bearing a substantial part of the cost of carrying the insurance. Funded insurance trusts were used in the hope of freeing from heavy surtax the income used to pay premiums. Annuities enjoying tax-free income tax status were purchased to restore the lost income resulting from the funding of the trusts.<sup>23</sup>

Meanwhile Congress and the Treasury were busy with that most obvious method of escaping the estate tax, the transfer with a retained life estate. By 1931 this problem seemed to be well in hand,<sup>24</sup> but here again even for the uninsurable, "insurance" threatened to nullify the efforts of Congress. The companies began writing what were termed combination single premium life insurance-annuity contracts. For a lump sum of \$217,000, regardless of age and without any physical examination, a company would issue two contracts (each studiously avoiding reference to the other), one called a life insurance contract, in the principal sum of \$200,000 payable on death to a designated beneficiary, and the other an annuity contract, agreeing to pay the purchaser \$6,000 per year during his life.<sup>25</sup> Physical condition and age (except for inter-company allocation of the purchase price to the annuity and life insurance contracts) were immaterial factors, since the risks counterbalanced each other. Any loss which might result from premature death was exactly offset by the profits of premature termination of the annuity obligation. The insurance feature could be assigned to the insured's children or to a trustee and gift tax computed upon the replacement cost not of the entire contract but of the insurance feature since this alone was transferred.<sup>26</sup> Thus it was hoped that \$200,000 could come to his donee free of estate tax at his death. Meanwhile so

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23. Prior to the adoption of Sec. 22(b)(2), INT. REV. CODE, in 1934, it was the law that when an amount was paid for an annuity, no part of the amount received annually was taxable as income until the cost had been restored. See *Burnet v. Logan*, 283 U. S. 404, 414, 51 Sup. Ct. 550, 75 L. Ed. 1143 (1931).

24. By a series of per curiam decisions decided March 2, 1931, following *May v. Heiner*, 281 U. S. 238, 50 Sup. Ct. 286, 74 L. Ed. 826 (1930), the Supreme Court held that property transferred in trust to pay the settlor the income for his life, with remainders over, need not be included in the gross estate. *Burnet v. Northern Trust Co.*, 283 U. S. 783, 51 Sup. Ct. 343, 75 L. Ed. 1412 (1931), *Morsman v. Burnet*, 283 U. S. 783, 51 Sup. Ct. 343, 75 L. Ed. 1412 (1931), *McCormick v. Burnet*, 283 U. S. 784, 51 Sup. Ct. 343, 75 L. Ed. 1413 (1931). "The sequel was dramatic. Less than two days were left until the adjournment of Congress on March 4; but March 3 sufficed for the drafting, introduction, passage, and approval of an amendment to section 302 making it clear that the transfer with reserved life estate was taxable. Joint Resolution of March 3, 1931, c. 454, 46 Stat. 1516." Quoted from GRISWOLD, *CASES AND MATERIALS ON FEDERAL TAXATION* 168 (2d ed. 1946).

25. One agent known to the writer sold \$7,500,000 of these contracts to six individuals in 1935.

26. To a donor age 40, the replacement cost of the insurance would be approximately \$110,000.

long as he lived he enjoyed the same income from the annuity that he would have enjoyed from the principal fund, had it been invested in securities.<sup>27</sup>

#### (4) *Governmental Reaction to Wholesale Avoidance*

Congress came to the aid of the Treasury with amendments to the income tax sections of the Code. Income from annuities to the extent of 3% of the purchase price was treated as taxable income in the year received, beginning with 1934, even though a portion of the principal had still to be recouped.<sup>28</sup> In the same year income from an irrevocable trust was made taxable to the grantor to the extent that it was used to pay premiums on insurance on his life,<sup>29</sup> and finally in 1942 income tax deductions were denied for interest paid on indebtedness incurred or continued to purchase single premium life insurance contracts.<sup>30</sup> But the major problem of dealing with estate tax avoidance was left to the Treasury and the courts.

Throughout the thirties the lower courts (heeding the language of the *Chase Bank* case) continued to base liability on the possession at death of one or more incidents of ownership.<sup>31</sup> It was not until 1938 in *Lang v. Commissioner*<sup>32</sup> that the Supreme Court again had occasion to deal with the insurance provisions of the estate tax law and the regulations issued thereunder. This case involved contracts most of which had been purchased with community property funds. While the decedent-insured had the power to change the beneficiary the state court had determined that under state rules the contracts were community property whose character the insured could not defeat through change of beneficiary. As to the portion of the proceeds attributable to the premiums paid with community property funds, only half was held by the Supreme Court to be subject to tax. The Court cited the regulations, treated the section of the Code as peculiarly subject to administrative interpretation and as the pertinent regulation (1929) made liability depend on the payment of premiums assessed the tax only on that portion of the proceeds equal to the decedent's interest in funds used to pay the premiums. This decision together with the first opinion in the famous *Bailey* case,<sup>33</sup> gave the

27. It was not until 1941 that the Supreme Court in *Helvering v. Le Gierse*, 312 U. S. 531, 61 Sup. Ct. 646, 85 L. Ed. 996, held that the payment of the death benefits under the combination insurance-annuity contracts did not constitute insurance proceeds within the \$40,000 exemption of 811(g), because no insurance risk was involved in the transaction. The corollary from this was obvious. Gifts of the insurance contract, with retention of the annuity, would fall within 811(c), as transfers with retained life estates.

28. INT. REV. CODE § 22(b)(2).

29. INT. REV. CODE § 167(a)(3). The constitutionality of this provision was sustained in *Burnet v. Wells*, 289 U. S. 670, 53 Sup. Ct. 761, 77 L. Ed. 1439 (1933).

30. INT. REV. CODE § 24(a)(6).

31. *Robinson v. United States*, 12 F. Supp. 550 (W. D. N. Y. 1935).

32. 304 U. S. 264, 58 Sup. Ct. 880, 82 L. Ed. 1331 (1938).

33. In *Bailey v. United States*, 27 F. Supp. 617, 621 (Ct. Cl. 1939), the court dealing with a situation where the insured had irrevocably assigned the policies but paid all the premiums, said: "But, in the circumstances here present, we find nothing arbitrary or

Treasury new hope and on January 10, 1941, Treasury Decision 5032 announced that for the future ownership of incidents would no longer be determinative. Payment of premiums was once again fixed upon as the vital element.

#### 1942 AMENDMENTS

Congress finally revised the statutory provisions in 1942. These revisions with minor changes<sup>34</sup> continue as the current law. The \$40,000 exemption was abolished.<sup>35</sup> Insurance proceeds payable to an insured's executor were included as heretofore. With respect to proceeds payable to named beneficiaries, two alternative tests of taxability were established: (1) payment of premiums directly or indirectly by the insured, or (2) the possession of incidents of ownership at his death. An apportionment formula was provided in the event that a portion only of the premiums had been paid by the insured. To avoid any charge of changing the rules in the middle of the game, premium payments made prior to January 10, 1941<sup>36</sup> were not treated as having been paid by the decedent, regardless of the facts, unless he owned incidents in the policy after that date.

Section 811(g)(2), as formerly, applies to cases where the proceeds are receivable by other beneficiaries. The statute, as noted above, adopted in the alternative both tests of taxability—ownership of incidents or payment of premiums. There has never been any serious doubt as to the constitutionality of requiring the inclusion in the taxable estate of policies in which the decedent retained an interest at death. Indeed the *Chase Bank* case gave rise to the common, if unfounded, belief that anything less than such an interest

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capricious in the statutory requirement that the proceeds of life-insurance policies be included in the decedent's gross estate, nor do we think it can properly be said that the requirement that such proceeds be included in the gross estate deprives the beneficiary of property without due process of law. Life insurance is inherently testamentary in character. The payment of premiums and the insured's death are the necessary events giving rise to the full and complete possession and enjoyment of the face amount of the policies by the beneficiary. The acquisition of life-insurance policies on one's own life is a substitute for testamentary disposition of property, and to allow an insured to avoid the estate tax upon his estate by making an assignment of policies taken out by him, and upon which he had paid the premiums at a time when the statute required the inclusion of the proceeds of such policies in his gross estate, would be contrary to the clear language of the statute."

34. Problems dealing with the marital deduction under the 1948 Act are treated at length in other articles in this symposium.

35. The exemption of \$40,000 was exceedingly liberal and its continued presence from 1918 until 1942 somewhat puzzling. Congress over the years was less apathetic in plugging income tax loopholes. The monetary value of the exemption increased proportionately during the years with the enormous increase in tax rates. Yet policy considerations justifying its long retention are difficult to find and are of doubtful validity. The thought that people protect their dependents through insurance and that a tax-free fund should be available to the family when the contributions of the breadwinner cease loses force when it is remembered that Congress has always provided a liberal specific exemption. This insurance exemption in fact discriminated in favor of those who were insurable and also gave preferential treatment to the economically higher income class who could afford to lay aside large sums to pay premiums. These were the very persons who, being in the higher brackets, saved a larger percentage by virtue of the exemption.

36. Date of Treasury Decision 5032.

might meet constitutional obstacles. Incidents of ownership include, among others, the right to change the beneficiary, the power to borrow against or pledge the policy for a loan, the power to cancel it and receive the cash surrender value. The problem under this test was and will continue to be one of determining ownership—a problem no different from that encountered with other types of property where nominees are sometimes used in the hope of defeating the tax.

Prior to 1942 the cases and regulations referred to “legal” incidents. Congress purposely omitted this term from the present subsection. The Committee report explained: “Incidents of ownership are not confined to those possessed by decedent in a technical legal sense. For example, a power to change the beneficiary reserved to a corporation of which decedent is sole stockholder is an incident of ownership.”<sup>37</sup>

But a more comprehensive extension of the compass of the test is the statute’s expansion to cover “incidents owned in conjunction with any other person.”<sup>38</sup> In so far as this was intended to apply retroactively Congress appears to have thought of *Helvering v. Helmholz*<sup>39</sup> as dead. In that case the Supreme Court refused to sanction an estate tax where the decedent-settlor retained power to revest the corpus in herself with the consent of a person having a substantial adverse interest because the trust had been created before the first enactment of the Act imposing the tax. But the trend of the later decisions, particularly *United States v. Jacobs*,<sup>40</sup> would suggest that the constitutional argument against retroactivity will receive short shrift from the court. The enlarged coverage of the statute to prevent avoidance where control is subtly retained; particularly in view of the difficulties the Treasury faces in proving indirect payments in many cases, would seem wise Congressional caution. It must not be forgotten that the taxpayer sets the stage, plans each step in the proceedings, often years before the controversy arises, and more often than not with studied intent to clothe the transaction in the garments of non-taxability.

The statutory payment-of-premium test applies to indirect as well as direct payments by the insured. Where only a portion of the cost is borne by the insured only such portion of the proceeds as is attributable to his expenditure falls within the ambit of the tax. Thus if the insured paid four \$1,000

37. H. R. REP. NO. 2333, 77th Cong., 2d Sess. 163 (1942); SEN. REP. NO. 1631, 77th Cong., 2d Sess. 235 (1942). Would the Committee have the Commissioner include the proceeds, where payable to the corporation, in the decedent’s estate and also have him in valuing decedent’s stock interest take into consideration its enhanced value due to the receipt of the identical asset? This would obviously tax the same values twice. Additional pitfalls are present if the corporation designates one other than itself as beneficiary. *Golden v. Commissioner*, 113 F. 2d 590 (C. C. A. 3d 1940).

38. Under the earlier statute incidents exercisable with the consent of the beneficiary were held not to constitute the requisite control. *Walker v. United States*, 83 F. 2d 103 (C. C. A. 8th 1936).

39. 296 U. S. 93, 56 Sup. Ct. 68, 80 L. Ed. 76 (1935).

40. 306 U. S. 363, 59 Sup. Ct. 551, 83 L. Ed. 763 (1939).

premiums and the beneficiary paid eight \$1,000 premiums, only one-third of the proceeds would be included in the insured's estate.<sup>41</sup> It is of course assumed that the insured owned no incidents at his death.

How far the courts will go in finding payments to have been indirectly made by the decedent is still a matter of speculation. Paul speaks of the phrase as an "exhortation to those who judge that they judge with penetrating awareness of economic realities and the intangibles of the familial relationship."<sup>42</sup> It obviously extends beyond payments through spouse or child as agent of the insured. Even when the transfer of funds is made without any obligation that it be expended on insurance, if it is in fact so used it will be treated as an indirect payment by the donor-insured. The fact that he paid gift tax on the transfer will have as little persuasive effect, standing by itself, as does the self-serving declaration in a will of a decedent's domicile. Similarity in the amount of the gift and the premium payment, coincidence in time, may well be determinative without more. Conversely, the length of time between the two transactions and the differences in amount between the gift and the payment will tend to measure the chance of a finding either way. The varying applications of the test may be expected to be in direct proportion to the ingenuity of the taxpayers' efforts to get beyond the pale.<sup>43</sup>

Payments by controlled corporations or trusts, by employers or by those who in the natural course of events may confidently expect that their payments will not go unrewarded will all receive the closest scrutiny.

Section 811(g) (1) provides for the inclusion in the decedent's estate of the amount receivable by the executor as insurance under policies on the life of the decedent. The Committee Report and the Regulations state that this insurance shall be included whether the decedent or another person paid the premiums or other consideration. No reference is made to the situation where the decedent neither owned the policy nor paid any of the premiums, but the

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41. The apportionment principle operates differently where the insured exchanges his policy for a monetary consideration. If the assignment has none of the elements of a gift, as where the insured transfers his policy to a creditor in satisfaction of an obligation equalling its cash surrender value, the statute [see 811(g) (3)] specifically precludes the possibility of any tax should the creditor keep the policy alive. When an insured after paying \$4,000 of the premiums transfers the contract for \$4,000 to another except in an arm's-length business transaction and the latter thereafter pays \$8,000 in premiums, he would seem, within the rules, to have paid all the premiums, *i.e.* \$12,000. But in this situation the statute requires consideration of the value of the policy at the time of the transfer. Its value being its replacement cost is always in excess of the premium paid because of the decedent's greater age at the date of transfer. Only by receiving in exchange the full replacement value can the decedent free the proceeds entirely from tax. To the extent that he sells it for less he is making a gift of a fraction of the policy. This rule is closer to economic realities than the general rule of apportionment which disregards the dates of the respective payments. But the mathematical difficulties in its application to each separate premium payment may justify the rough approximation to the respective contributions of each when the exchange does not involve a payment to the decedent.

42. PAUL, SUPPLEMENT TO FEDERAL ESTATE AND GIFT TAXATION 359 (1946).

43. The Committee Reports state: "This provision is intended to prevent avoidance of the estate tax and should be construed in accordance with this objective." H. R. REP. No. 2333, 77th Cong., 2d Sess. 162; SEN. REP. 1631, 77th Cong., 2d Sess. 235 (1942).

clear language of the section would seem to require inclusion of the proceeds if payable to the executor.<sup>44</sup> Certain constitutional questions may be raised by such a construction.

Where a wife owns and pays all the premiums on a contract on her husband's life and names his estate beneficiary, the proceeds on his death can only pass to his creditors or his legatees. On the assumption that his wife reserved the right to change the beneficiary, it seems reasonably clear that she will be held to have made a taxable gift on his death in the face amount of the policy. If the husband is insolvent and the proceeds are used to pay his creditors, it may be argued that his wife has no donative intent toward them, but she does have a donative intent toward his estate, *i.e.*, her satisfaction in having her deceased husband's bills paid. Does this differ from the case where a living payor voluntarily discharges obligations of other members of his immediate family? She can hardly hope to avoid the gift tax by siphoning the fund through the husband's executor and the cases make it clear that had a legatee been directly named beneficiary a gift tax would be incurred.<sup>45</sup>

The husband by hypothesis does not buy, own or control the contract. The only connection his death bears to the transmission of the fund is the wife's choice of that contingency as the event which should give finality to her gift. Yet the statute would tax the proceeds as part of the husband's estate.

The regulations enlarge the scope of the section by providing that insurance receivable by the executor shall include all insurance which is in fact receivable by, or for the benefit of, the estate. It includes "insurance effected to provide funds to meet the estate tax and any other taxes, debts or charges which are enforceable against the estate."<sup>46</sup>

Assume that a father purchases a policy on the life of his thriftless son, and desiring that the son's creditors shall not go unpaid, creates a revocable trust consisting of the insurance contract. The trustee is directed upon receipt of the proceeds following the son's death to discharge his obligations and pay the balance, if any, to his widow. In this case it may well be questioned whether the proceeds to the extent necessary to pay his creditors may be taxed as part of the son's estate.<sup>47</sup>

In the first example it is difficult to justify the constitutionality of the

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44. It will be rare, perhaps only through inadvertence, that such a designation will be made.

45. *Goodman v. Commissioner*, 4 T. C. 191 (1944), *aff'd.*, 156 F. 2d 218 (C. C. A. 2d 1946).

46. This statement is a continuation of the prior regulations but the problem under discussion could not have arisen prior to 1942 as the former section and regulations used the phrase "taken out by the decedent," which meant, depending on the year involved, either paid for or owned.

47. This of course assumes a net taxable estate after all deductions and credits, including the debts discharged by the trustee. *Cf. Hooper v. Commissioner*, 41 B. T. A. 114 (1940).

imposition of the tax but it is equally difficult to construe the code provisions as not applicable. To hold 811(g)(1) does not apply except when the decedent owned or purchased the insurance, is to rob the subdivision of all purpose, as 811(g)(2) covers cases where either of these contingencies is present. But to include the fund in a decedent's estate, as the statute does in the first case and the regulations do in the second, is to tax property which the decedent during his life did not pay for, never owned or controlled and toward which he had no relationship beyond a post mortem expectancy. This would seem to be measuring A's tax by B's property.<sup>48</sup>

While the odds are all against the taxpayer whose sole arrow to his bow is unconstitutionality, it is submitted that the courts may well strike down the commissioner's regulation extending the phrase "receivable by the executor" to cases where the funds do not actually pass through his hands.<sup>49</sup>

#### CURRENT PROBLEMS

##### (1) *Contemplation of Death*<sup>50</sup>

Inclusion of insurance proceeds in the gross taxable estate does not depend solely on 811(g). Gifts of insurance policies are peculiarly susceptible to the contemplation-of-death provision of the code. This provision was designed to reach substitutes for testamentary dispositions and thus to prevent evasion of the estate tax.<sup>51</sup> Insurance has been repeatedly recognized as inherently testamentary in character.<sup>52</sup> Because the transferor's motive is the vital factor in contemplation-of-death disputes,<sup>53</sup> only gifts prompted by desires associated with continued life escape the tax.

"It is difficult to give living reasons for the gift of a life insurance policy, in that it is not always possible to say that the insured made the gift to create a separate estate for his wife (this is particularly true during the early years of the policy). Neither is it possible to say that the transfer was made to save income taxes, or that it was made to supply the wife with income, in that, as a practical matter, there is the obligation to continue the premiums and further, in many states we find that the insured could not say that he made the transfer to get the cash values free from the claims of his creditors for the reason that many states provide by their codes that in the instance of a life insurance policy payable to a wife and children, the cash values are not subject to claims of creditors.

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48. *Hoeper v. Tax Commission*, 284 U. S. 206, 52 Sup. Ct. 120, 76 L. Ed. 248 (1931).

49. Even here the courts will be faced with a difficult problem of construction. From 1919 [see Reg. 37 (1919 ed.) Art. 33], the regulation included insurance effected to provide funds to meet the estate tax, etc. and Congress used the language of the former statute except for the phrase "taken out" presumably intending to give it the meaning 23 years of history had attributed to it.

50. See generally, Cohn, *Gifts of Life Insurance in Contemplation of Death*, 26 TAXES 156 (1948); Polisher, *Transfers in Contemplation of Death*, 2 VAND. L. REV., 195 (1948).

51. *United States v. Wells*, 283 U. S. 102, 51 Sup. Ct. 446, 75 L. Ed. 867 (1931).

52. *Bailey v. United States*, 27 F. Supp. 617 (Ct. Cl. 1939); *Chase Nat. Bank v. United States*, 116 F. 2d 625 (C. C. A. 2d 1940).

53. *United States v. Wells*, 283 U. S. 102, 51 Sup. Ct. 446, 75 L. Ed. 867 (1931).

As stated above, it is difficult to give motives primarily associated with life, as the primary reasons for the transfer of insurance."<sup>54</sup>

The case law on this problem has been less prolific than might be expected because the indirect-payment test has relieved the Treasury in large measure from the need of calling to its aid the contemplation-of-death provision.

The Revenue Revision Bill of 1948 was passed by the House of Representatives at the first session of the 80th Congress but was not acted upon by the Senate at either the first or the second sessions. This bill contained provisions limiting estate taxation to proceeds of insurance policies in which decedents owned one or more incidents at death. If passed, such provision would have eliminated the premium-payment test. However, should it, or similar legislation, be passed at some future session it is submitted that inter vivos transfers of insurance policies will not thereby automatically free the proceeds from estate tax. The Treasury will simply shift its attack to the contemplation-of-death field, heretofore largely neglected in the insurance cases only because unneeded.

## (2) *Indirect Premium Payments*<sup>55</sup>

The uncertainty in the application of the indirect payment test to particular cases has resulted in a serious limitation in the use of life insurance to accomplish what may be regarded as socially desirable objectives. The family of the typical American small businessman will illustrate one of the un-

54. From an address by Paul F. Millett, Esq., of the Illinois Bar before the University of Washington School of Law, Institute on Estate Planning and the Revenue Act of 1948, September 6-8, 1948. See also Learned Hand, J., in *Vanderlip v. Commissioner*, 155 F. 2d 152, 154 (C. C. A. 2d 1946). "All gifts necessarily differ from bequests in that they deprive the donor of future control over the property, and for that reason they can never be perfect substitutes; but if the effect of the gift is substantially the same as the gift of a remainder: that is, if the donor reserves the income to himself during his life, it is as nearly a substitute for a bequest as it can be and still remain a gift at all. . . . When the property produces no income, living the donor, . . . it may be open to question whether any motive can exclude it from his estate. . . . Situations may be put in which it might be plausibly argued that motive would be relevant: for example, the donor may wish to protect the property against the hazards of his business, or against a possible change in his feelings towards the donee, or he may contemplate getting married and losing power of disposal over all his property. Whether these would affect the result, we leave open because here the donor only desired to avoid estate taxes, and we cannot see how that can be classed among those motives which will on any theory take a gift out of the section. A gift differs from a bequest,—apart from the inevitable loss of control over the property—only in so far as it secures enjoyment to the donee during the donor's life; and the donor's motives are relevant to exclude the property only so far as they touch upon his enjoyment in that period. The motive to avoid taxes does not touch that at all; a donor, interested in saving taxes, is not concerned with the donee's enjoyment while he himself lives; he is interested in relieving his legatees from taxes after he dies, and, not only may his legatees not be the donees, but when they are, their relief will not concern their enjoyment of the property while he lives. Such a motive is necessarily testamentary, and not donative."

55. See generally, Foosner, *Indirect Life Insurance Premiums—When Paid?*, 25 TAXES 726 (1947); Hilgedag, *Life Insurance Planning for Estate and Gift Taxes*, in 5TH ANN. INST. ON FED. TAXATION 25 (N. Y. U. 1947); Kennedy, *Indirect Payment of Life Insurance Premiums*, 21 TAXES 475 (1943).



happy consequences of this rule. The successful merchant or manufacturer in the average American community has the great bulk of his wealth tied up in the business he has developed over the years. The problem of providing liquid assets to meet his death cost is always a perplexing one, both to him and to his family. There is rarely a ready market for the sale of shares in his company, or a partial interest in his proprietorship. The vague and uncertain criteria for fixing the value of a going concern make estimate of the taxes to be met at his death extremely difficult and always vague. A spread of 25% in the valuation figures of competent and impartial experts is neither surprising nor unusual. A multitude of factors enters into any study of industrial or mercantile valuation and the relevance and weight to be accorded each factor in the over-all appraisal is always a matter of judgment, with consequent wide variations of opinion. Thus the final judgment as to value will be affected by the countless sub-judgments as to the values of individual assets. Goodwill and going concern values are at best educated guesses. Whether the interest of a decedent is such an enterprise will be found by the commissioner or the courts to be worth \$400,000 or \$600,000 or some figure within that range is literally unpredictable.<sup>56</sup> Yet the son or son-in-law who has devoted his best years to the company and whose career centers around it, is faced with the prospect on father's death of parting with at least a partial interest in the business to meet estate taxes—what portion he cannot estimate—and this uncertainty plus the knowledge that such sales are generally at sacrifice prices may well cause him to pause. Life insurance should answer his problem. Its essential function in our economy is to spread risks and thus avoid disastrous loss to the unlucky few. Yet any competent advisor would feel a disturbing sense of insecurity in recommending such a solution.

Of course the opportunity for evasion of the estate tax is present in these

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56. Estate of Henry T. Sloane, P-H 1944 TC MEM. DEC. SERV. ¶ 44,206 (1944). There was involved an asserted deficiency in estate tax in the approximate amount of \$3,007,000, a large portion of which was attributable to adjustments made by the Commissioner with respect to the values of the stocks of four corporations. The variations between the Commissioner's determinations and the Tax Court's findings of values were as follows:

Summary description of stock involved	Approximate Values Per Share	
	As Determined by Commissioner	As Established by the Tax Court
Corp. A., common .....	\$ 35.00	\$ 16.00
Corp. A., pfd. ....	65.00	37.50
Corp. B., common .....	51.00	1.30
Corp. B., pfd. ....	100.00	5.00
Corp. B., pr. pfd. ....	100.00	30.00
Corp. C., capital .....	60.00	28.00
Corp. D., capital .....	6,232.00	2,600.00

The above chart was taken from *A Valuation Case*, in 4TH ANN. INST. ON FED. TAXATION 381 (N. Y. U. 1946).

cases. The father may want the insurance and to avoid the consequences of purchasing it himself may request the son to apply for it and pay the premiums, making appropriate adjustment in his compensation to offset the annual cost. But the son's personal welfare will be primarily served by an investment in insurance. Yet he may hesitate to use this medium—so peculiarly fitted to his needs—to accumulate the funds necessary to save the business when death comes. The risks of a reduction of 40% or 50% in the realized proceeds through their inclusion in his father's estate are substantial unless other economic benefits, reasonably to be expected, are foreborne. To lessen the chance of an adverse finding on the indirect-payment issue he will be wise to forego salary increases or family gifts for some considerable period. Here no fixed pattern or standard is available in determining the hidden motives which in individual cases lie behind such acts of apparent recognition of merit or generosity. Small businesses (and the small businessmen) are too individualized to warrant drawing conclusions from similar conduct in what on the surface appear to be comparable cases. There are always too many illusive variants.

The hesitancy to protect with insurance does not operate solely to the detriment of the legatee. The Treasury has a stake in the availability of assets to meet the tax. Enough has been said about the uncertainty of valuation and the opportunities for wide divergence of opinion to indicate that problems of this sort are peculiarly susceptible of compromise. Generally after negotiation and a good deal of give and take, a reasonable adjustment on the valuation issue will be made. An always important and not infrequently controlling factor in such negotiations is ability to pay. When the evidence shows that a \$600,000 valuation presents insuperable obstacles to raising the necessary cash to meet the increased tax, but possibility exists of a bank loan or a purchaser of a partial interest at an acceptable figure which would furnish cash to meet the tax measured on a \$500,000 valuation, counsel will be armed with an argument having a stronger appeal to Treasury officials who are accustomed to dealing with hard practical facts and who have other cases to turn to, than all the theoretical formulae for the ascertainment of values that economists can devise.

#### CONCLUSION

Certain only is the uncertainty developing in the operation of the tests of ownership and payment of premiums. But uncertainty is not always a vice. It may indeed be desirable where certainty in the rules would offer opportunities for avoidance through transactions that do not effect substantially distinguishable factual results. To tax one approach to an objective and to leave untaxed another road to the identical objective ignores substance for form.

Theoretically ownership of incidents as the sole test is more in accord with our basic constitutional philosophy of taxation at death. The estate tax is a transfer tax. Shifting of interests by death has long been the traditional justification for its imposition. Let us take an example: *A* purchases Blackacre subject to a \$40,000 mortgage and thereafter deeds it by gift to *B*. The mortgage calls for principal payments of \$2,000 per year and *A*, even after the gift, meets the annual charges and amortization payments until his death 15 years later. No one would argue that Blackacre should be included as part of *A*'s estate in the absence of evidence that the original transfer was a sham and that *B* held the title merely as nominee or that the transfer or annual payments were made in contemplation of death. Yet the inclusion of insurance proceeds as part of a donor's gross taxable estate under identical circumstances is the accepted rule. An insurance investment is thus subject to a discrimination.

Does the fact that death is the generating source of new values distinguish insurance from other property, and thus justify the difference in treatment? This argument would have equal validity whether the insured or another paid for and owned the contract. Yet no one has suggested its inclusion in the latter case.<sup>57</sup> Further, while insurance is the most common example of such enlargement of value by death this is not a characteristic peculiar to insurance. A father owns lots No. 2 and 4, Main Street. By deed of gift he transfers No. 2 to his son, and on his death he devises No. 4 to same son. The death of the father results in an enlargement of the value of lot 2 because of the additional worth attributable to the plottage of which it is a part. Similarly where a minority stockholder inherits another minority interest if the combined holding gives him control, the value of the total shares as a unit will be greater than the sum of the individual values of each share. Thus the death of *A* may generate new values in the property of *B*, even where property other than life insurance is involved. The payment of gift tax will free other property from estate tax so long as the donor relinquishes his full interest, but giving away insurance, paid for by the decedent, has no such advantageous effect.

An analysis of the nature of an insurance contract may explain the

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57. "The theory of the Inheritance Tax law is that where one transmits property to another by will, under the interstate statutes, or in contemplation of death, a tax is imposed upon the privilege of succeeding to the ownership of the property. Where no property or interest therein is transferred necessarily there is no tax. The insurance companies contracted with the Bag Company, and the other beneficiaries, that upon the payment of certain annual premiums they would pay them certain sums upon the death of Morris Werthan, which they did. Werthan was not a party to these contracts, had not expended so much as a dollar for this insurance, and had no interest in the policies or their proceeds. Hence, there was no transfer from the estate of Werthan to these beneficiaries. If *A* purchases from *B* a tract of land upon agreement that possession is to be withheld until the death of *C*, certainly *A* acquires no interest in the land from *C* upon his death. Or if *X* agrees to pay *Y* a certain sum upon the death of *Z*, upon the happening of that event *Y* succeeds to no part of the estate of *Z*. That, in principle, is this case. It is not unusual for parties to contract for the doing of an act or the payment of a sum of money upon the happening of some contingency, such as birth, marriage or death." *Werthan v. McCabe*, 164 Tenn. 611, 613-14, 51 S. W. 2d 840, 840-41 (1932).

reason for the different result. A gift of real estate, securities or chattels involves more than the execution and delivery of documents. These transfers create rights and obligations that call for continuous series of acts. Real estate needs management and management calls for decisions. There are taxes and mortgage interest to be paid, rents to be collected, repairs to be made, leases to be negotiated. The dominating influence (either of donor or donee) in these transactions will show itself in many ways and thus the bona fides of the transfer will disclose itself in the pattern of conduct of the donee toward the property. The same is also true of chattels. Problems come with ownership of securities and there is income to spend or reinvest. Thus the need for extending the tax to cover other property transferred prior to death has generally been less urgent than in the case of insurance because evidence pro and con to establish ownership rather than paper title has been available.

But with life insurance the only certain continuing relationship to the policy is the payment of premiums. Changes of beneficiary and loans against or pledges of the policy may occur. While such action in particular cases may furnish telling evidence, by and large it is noncommittal in character. Within the family group changes of beneficiary will rarely be indicative of where the control lies; and as insurance loans are largely used only in emergency situations, the purpose of the loan may not be convincing evidence of control in view of the normal availability of assets of individual family members for the temporary urgent needs of other members. Thus the difficulty of distinguishing between the real and the sham transfer and the need to prevent avoidance may well justify the different treatment. Had the philosophy of *Helvering v. Clifford*<sup>58</sup> and the doctrine of substantial ownership appeared 15 to 20 years earlier, the need for the premium-payment test and the bewildering shifts of position in the regulations might never have arisen.

Continued payment of premiums is strong evidence of ownership. Much of the law of resulting trusts is bottomed on the concept that he who pays normally owns. In the absence of compelling evidence to the contrary the continued payment of premiums should have been sufficient, here, as elsewhere in the law, to establish ownership; but the early cases looked to the paper title and Congress finally made the *reason* the rule. But this should not require arbitrary taxation or make insurance a forbidden investment. An underlying principle stabilizing the vagueness of the indirect payment test and the uncertainty created by the Congressional deletion of "legal" from the incidents-of-ownership test, may yet be evolved if courts remember that the rule was originally only the reason for the result. In finding indirect payment or possession of incidents without technical legal title, the fundamental question to be answered is to what extent the donor really continued to dominate the property

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58. 309 U. S. 331, 60 Sup. Ct. 554, 84 L. Ed. 788 (1940).

and its uses; whether some substantial relationship connected with it disappeared with his death. The lines tracing payments back to the donor-insured will often be shadowy. In determining the issue of indirect payment, as the shadow grows fainter the greater should be the weight accorded acts of the donee tending to establish a real inter vivos shift, along with the paper title, of dominion over the policy. The courts should be mindful that in imposing taxes on insurance proceeds as part of an insured's estate, when he retained no incidents of ownership, Congress has included something not normally within its reach. This permissible penumbra of constitutional power should be strictly limited by the necessity justifying it and not thought of as a further grant of power to be liberally construed.