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language.<sup>60</sup> *Foster*, on the other hand, has rendered section 103 a mere redundancy.

THOMAS C. WETTACH

### Taxation—Gross Estate—Accident Insurance as Life Insurance

For federal estate tax purposes, a decedent's gross estate includes the proceeds of insurance on the decedent's life, regardless of the identity of the beneficiary, if the decedent at his death possessed any of the incidents of ownership in the policy.<sup>1</sup> In *Commissioner v. Estate of Noel*,<sup>2</sup> decedent, just prior to a fatal plane crash, acquired two flight insurance policies which were paid for by his wife. The terms of the policies provided that the beneficiary could be changed and the policies assigned by written endorsement of the insured. However, having designated his wife as beneficiary, decedent merely handed her the policies. His executor subsequently excluded the flight insurance proceeds from the gross estate. The Commissioner determined a deficiency under section 2042(2) and was sustained in this by the Tax Court.<sup>3</sup> The Court of Appeals for the Third Circuit reversed,<sup>4</sup> distinguishing flight insurance as accident insurance against a risk rather than insurance against an inevitable event which is within the purview of this section.<sup>5</sup> Rejecting the appellate court's rationale, the Supreme Court held that

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<sup>60</sup> See *United States v. Menasche*, 348 U.S. 528 (1955). In a proceeding on petition for naturalization, the court said:

The Government's contention that § 405(a) does not apply to any phase in the processing of naturalization petitions would defeat and destroy the plain meaning of that section. "*The cardinal principle of statutory construction is to save and not to destroy.*" . . . *It is our duty "to give effect, if possible, to every clause and word of a statute,"* *Montclair Tp. v. Ramsdell*, 107 U.S. 147, 152, *rather than to emasculate an entire section* . . . .

*Id.* at 538-39. (Emphasis added.)

<sup>1</sup> INT. REV. CODE OF 1954, § 2042 provides in part:

§ 2042. PROCEEDS OF LIFE INSURANCE. The value of the gross estate shall include the value of all property—

. . . .  
(2) RECEIVABLE BY OTHER BENEFICIARIES. To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. . . .

<sup>2</sup> 380 U.S. 678 (1965).

<sup>3</sup> *Estate of Marshall L. Noel*, 39 T.C. 466 (1962).

<sup>4</sup> *In re Noel's Estate*, 332 F.2d 950 (3d Cir. 1964).

<sup>5</sup> *Id.* at 952.

section 2042(2) applies to any type of accidental death insurance on the life of the decedent<sup>6</sup> and includes such proceeds if the decedent at his death possessed any of the incidents of ownership in the policy notwithstanding the factual impossibility of his exercising these rights.<sup>7</sup> Thus, the *Noel* case represents an encompassing application of section 2042(2) to all types of insurance policies on the decedent's life even though such proceeds might be included under some other section of the Code.<sup>8</sup>

Entitled "Life Insurance," section 2042(2) applies to "policies on the life of the decedent"<sup>9</sup> which "are designed to shift to a group of individuals the risk of premature death."<sup>10</sup> The distinction between death proceeds from life insurance and accident insurance has been purely academic for estate tax purposes<sup>11</sup> since a 1929 Board of Tax Appeals interpretation:

It is well recognized that there is a distinction between life insurance and accident insurance, the former insuring . . . against death in any event and the latter against death under certain contingencies, but we fail to see why one is not taken out upon the life of the policy holder as much as the other. In each case the risk assumed by the insurer is the loss of the insured's life, and the payment of the insurance money is contingent upon the loss of life. . . . The provisions of Section [2042(2)] are broad enough to include both classes of insurance . . .<sup>12</sup>

Thus, relying on congressional, administrative, and judicial acquiescence in this general construction,<sup>13</sup> the Court applied section 2042(2). They intimated that the type of insurance policy is immaterial so long as it is "on the life of the decedent."<sup>14</sup> But, should not the type of policy make a difference?

<sup>6</sup> 380 U.S. at 682.

<sup>7</sup> *Id.* at 684.

<sup>8</sup> See LOWNDES & KRAMER, *FEDERAL ESTATE AND GIFT TAXES* 286-87 (2d ed. 1962); 2 MERTENS, *LAW OF FEDERAL ESTATE AND GIFT TAXATION* 42-55 (1959).

<sup>9</sup> See note 1 *supra*.

<sup>10</sup> *Helvering v. Le Gierse*, 312 U.S. 531, 540 (1941).

<sup>11</sup> The technical distinction is that under an accident insurance policy the insured contingency is an accident resulting in death to the insured, whereas under a life insurance policy it is death by whatever cause. For discussion of the inadequacy of this distinction under the estate tax, see Johnston, *Flight Insurance and Federal Taxation: A Critical Examination of The Noel Case*, 1965 DUKE L.J. 32.

<sup>12</sup> Leopold Ackerman, 15 B.T.A. 635, 637-38 (1929).

<sup>13</sup> 380 U.S. at 681-82. See Johnston, *supra* note 11.

<sup>14</sup> The Treasury Regulations provide that "the term 'insurance' refers to life insurance of every description, including death benefits paid by fra-

Enacted to prevent estate tax avoidance in transmitting property at death,<sup>15</sup> section 2042(2) should apply to those types of insurance policies which would be purchased for that purpose, namely, the carefully selected life insurance policies and accident insurance policies with death benefits which protect the insured and his family during most of his life. However, trip-by-trip insurance policies with death benefits, hastily purchased from any seller, do not accomplish this long-range scheme of protection.<sup>16</sup> Rather they appear to be a one-shot gamble. But this type of policy does supplement the over-all plan of insurance protection to pass on at death a wealth to a recipient of the insured's selection and thereby falls squarely within the ambit of section 2042(2) if the decedent insured possessed at death any of the incidents of ownership in the policy.

Where he possesses at death the right (1) to change the beneficiary,<sup>17</sup> (2) to assign the policy, or to revoke an assignment,<sup>18</sup> (3) to surrender the policy and receive the cash value,<sup>19</sup> (4) to borrow on the policy,<sup>20</sup> (5) to cancel the policy,<sup>21</sup> or (6) to receive distribution in case of disability,<sup>22</sup> or where the decedent possesses at death (7) a possibility of reverter in the policy exceeding five per cent in value,<sup>23</sup> or (8) other economic benefits in the pol-

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ternal beneficial societies operating under the lodge system." Treas. Reg. § 20.2042-1(a)(1) (1958). For examples of "life insurance," see generally LOWNDES & KRAMER, *op. cit. supra* note 8, at 288-91; 2 MERTENS, *op. cit. supra* note 8, at 334-40.

<sup>15</sup> See H.R. REP. No. 767, 65th Cong., 2d Sess. 22 (1918); S. REP. No. 617, 65th Cong., 3d Sess. 42 (1918).

<sup>16</sup> However, those who travel extensively often purchase travel insurance to cover a specified period.

<sup>17</sup> Chase Nat'l Bank v. United States, 278 U.S. 327 (1929).

<sup>18</sup> Caldwell v. Jordan, 119 F. Supp. 66 (N.D. Ala. 1953).

<sup>19</sup> Liebmann v. Hassett, 148 F.2d 247 (1st Cir. 1945).

<sup>20</sup> *Ibid.*

<sup>21</sup> Estate of Myron Selznick, 15 T.C. 716 (1950), *aff'd sub nom.*, Selznick's Estate v. Commissioner, 195 F.2d 735 (9th Cir. 1952).

<sup>22</sup> Old Point Nat'l Bank, 39 B.T.A. 343 (1939).

<sup>23</sup> Hock v. Commissioner, 152 F.2d 574 (8th Cir. 1945). The INT. REV. CODE OF 1954, § 2042(2) provides:

[T]he term "incident of ownership" includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent. As used in this paragraph, the term "reversionary interest" includes a possibility that the policy, or the proceeds of the policy, may return to the decedent or his estate, or may be subject to a power of disposition by him. The value of a reversionary interest at any time shall be determined (without regard to the fact of the decedent's

icy,<sup>24</sup> the decedent insured has sufficient incidents of ownership in the policy to include the proceeds under section 2042(2).<sup>25</sup> The Court interpreted the Code as not imposing a dual requirement of possession plus exercisability<sup>26</sup> and held that the decedent had met this requirement, even though as a practical matter he could not have changed the beneficiary or assigned the policy en route. If the view were taken that inability to exercise these rights negates possession of an incident of ownership, very few insurance proceeds would be included in a decedent's gross estate, since this situation almost always prevails moments before death.<sup>27</sup> Thus, mere legal possession at death of any of these incidents of ownership is enough for inclusion under the insurance section. Moreover, such possession by a decedent could warrant including the proceeds or some part thereof under some other section or sections of the Code, notwithstanding the application of section 2042(2).

The value of the incident of ownership possessed at death by the decedent insured could be included under section 2033.<sup>28</sup> While

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death) by usual methods of valuation, including the use of tables of mortality and actuarial principles . . . .

<sup>24</sup> The Treasury Regulations state that "the term 'incidents of ownership' is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured . . . to the economic benefits of the policy." Treas. Reg. § 20.2042-1(c)(2) (1958).

<sup>25</sup> For illustrations of nonincidents of ownership, see generally 2 MERTENS, *op. cit. supra* note 8, at 368-70.

<sup>26</sup> Even though the Code refers to incidents of ownership possessed by the decedent, "exercisable either alone or in conjunction with another person," the courts have held this clause not to require more than legal exercisability. See Estate of John J. Round, 40 T.C. 970 (1963).

<sup>27</sup> Most insurance policies require an endorsement of the policy to exercise the incidents of ownership. Unless the decedent insured carried the policy in his pocket, he could not exercise his rights at death regardless of his whereabouts. But, could it be argued that this factual question is one which should be submitted to a jury? Cf. *Empire Trust Co. v. United States*, 226 F. Supp. 623 (1963) (whether a woman is capable of having children is now a question for the jury). If such were allowed, the federal district courts would be swamped with cases involving this one question since the Tax Court does not have a jury. Moreover, the jury might be prejudiced against the government when, *e.g.*, a little old lady was too feeble to understand that complicated insurance policy. Thus, the key to inclusion is possession alone.

<sup>28</sup> INT. REV. CODE OF 1954, § 2033 provides that "the value of the gross estate shall include the value of all property . . . to the extent of the interest therein of the decedent at the time of his death." Only the value of the decedent's interest is included. Thus, where the only incident of ownership possessed by the decedent was a reversionary interest exceeding five per cent in value of the policy, the amount included in his gross estate is the value of such reversionary interest and not the entire proceeds.

the Treasury Regulations and the legislative history of section 2033 express such a possibility,<sup>29</sup> the courts have refused to apply this generic section to insurance on the life of the decedent by reasoning that the more specific provision, section 2042(2), preempts inclusion under section 2033.<sup>30</sup> However, they have freely utilized other specific sections to include such proceeds.<sup>31</sup>

Applying to inter vivos transfers where a grantor retains the power to affect beneficial interests, sections 2036(a)(2)<sup>32</sup> and 2038<sup>33</sup> would include the proceeds where a decedent transferred an insurance policy but retained and possessed at death such rights as the power to change the beneficiary, the power to assign the policy, or other incidents of ownership.<sup>34</sup> Furthermore, section 2037<sup>35</sup> applies to insurance proceeds where there was an inter vivos transfer by a decedent insured if beneficial enjoyment of the policy were solely dependent upon surviving the decedent who possessed at death a reversionary interest exceeding five per cent in value of the

<sup>29</sup> Treas. Reg. § 20.2042-1(a)(2) (1958); S. Rep. No. 1631, 77th Cong., 2d Sess. 236 (1942).

<sup>30</sup> See *Singer v. Shaughnessy*, 198 F.2d 178 (2d Cir. 1952); *Proutt's Estate v. Commissioner*, 125 F.2d 591 (6th Cir. 1942).

<sup>31</sup> See, e.g., *Estate of Ruth Brainard Cutler*, 13 T.C. 138 (1949) (transfer taking effect at death).

<sup>32</sup> (a) GENERAL RULE.—The value of the gross estate shall include the value of all property . . . to the extent of any interest therein of which the decedent has at any time made a transfer . . . by trust or otherwise, under which he has retained for life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

INT. REV. CODE OF 1954, § 2036(a).

<sup>33</sup> INT. REV. CODE OF 1954, § 2038 provides in part:

The value of the gross estate shall include the value of all property . . . to the extent of any interest therein of which the decedent has at any time made a transfer . . . by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power . . . by the decedent alone or by the decedent in conjunction with any other person . . . to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death. . . .

<sup>34</sup> *Estate of Mabel E. Morton*, 12 T.C. 380 (1949). However, once the court has found § 2042 applicable, they deem it unnecessary to consider §§ 2036(a)(2) and 2038. See *Estate of Myron Selznick*, 15 T.C. 716 (1950), *aff'd sub nom.*, *Selznick's Estate v. Commissioner*, 195 F.2d 735 (9th Cir. 1952).

<sup>35</sup> INT. REV. CODE OF 1954, § 2037.

policy.<sup>36</sup> Usage of these inter vivos transfer sections would be decisive for the government if the application of section 2042(2) were dubious.<sup>37</sup> However, the *Noel* case enlarges the scope of this section to include the insurance proceeds of any type of policy "on the life of the decedent" if he possesses at death incidents of ownership. Thus, the possession at death of these incidents of ownership is required for inclusion under both the insurance section and the inter vivos transfer sections.

To avoid the inclusion of proceeds from insurance on his life, an insured must irrevocably designate a beneficiary other than his estate and completely divest himself of all other incidents of ownership in the policy. Moreover, unless actuated by "living motives,"<sup>38</sup> this divestiture must occur more than three years before the decedent's death to escape inclusion under section 2035<sup>39</sup> as a transfer in contemplation of death.<sup>40</sup> With this three-year limitation, however, a decedent insured can still avoid the inclusion of trip insurance proceeds by having the transferee pay the premiums on the policy.<sup>41</sup> Thus, the key to exclusion is prudent planning.

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<sup>36</sup> Estate of Ruth Brainard Cutler, 13 T.C. 138 (1949). For evaluation of the reversionary interest, see Treas. Reg. 20.2037-1(c)(3) (1958).

<sup>37</sup> See, e.g., *Goldstone v. United States*, 325 U.S. 687 (1945); *Commissioner v. Clise*, 122 F.2d 998 (9th Cir. 1941).

<sup>38</sup> See, e.g., *Des Portes v. United States*, 171 F. Supp. 598 (E.D.S.C. 1959) (transfer to his wife to make her more financially independent); *Estate of Verne C. Hunt*, 14 T.C. 1182 (1950) (transfer to wife to avoid judgment creditors).

<sup>39</sup> INT. REV. CODE OF 1954, § 2035 states that "if the decedent within a period of 3 years ending with his death . . . transferred an interest in property . . . such transfer . . . unless shown to the contrary," shall be included in the decedent's gross estate.

<sup>40</sup> *Garrett's Estate v. Commissioner*, 180 F.2d 955 (2d Cir. 1950). Even after complete divestiture, where a decedent insured continued to pay the premiums on the policy, that part of the insurance proceeds proportionate to the premiums paid within this three-year period will be included in his gross estate. See *Liebmann v. Hassett*, 148 F.2d 247 (1st Cir. 1945). However, this situation can be avoided by creating a funded insurance trust more than 3 years before his death. See *LOWNDES & KRAMER, op. cit. supra* note 8, at 147-48.

<sup>41</sup> See *Liebmann v. Hassett*, 148 F.2d 247 (1st Cir. 1945), where the court held that the proportionate part of the insurance policy purchased by the transferee should be excluded from the decedent's gross estate.