

## A DECEDENT'S POWERS AS TRUSTEE OF A LIFE INSURANCE TRUST—TAXABLE “INCIDENTS OF OWNERSHIP”?

The estate tax treatment of insurance benefits paid on the life of an insured-decedent has been unsettled since the earliest enactment of the tax; continuing controversy has marred the interpretation of the statutory language. Congress has amended the estate tax statute governing life insurance several times, and the regulations and court rulings have been even more frequently altered. Currently, a direct conflict exists among the courts of the Second, Fifth, and Sixth Circuits over the proper interpretation of the statute and regulations imposing an estate tax on life insurance proceeds.

The current statute requires inclusion in the decedent-insured's gross estate of insurance proceeds payable to beneficiaries other than the decedent's estate only if the insured possessed any of the incidents of ownership in the policy at his death.<sup>1</sup> Both the regulations and the courts have attempted to define the phrase “incidents of ownership”; the statute itself is silent except for a provision that a reversionary interest

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1. I.R.C. § 2042 provides:

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

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

(2) Receivable by other beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For purposes of the preceding sentence, the term “incident of ownership” includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent. As used in this paragraph, the term “reversionary interest” includes a possibility that the policy, or the proceeds of the policy, may return to the 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 death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Secretary or his delegate. In determining the value of a possibility that the policy or proceeds thereof may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such policy or proceeds may return to the decedent or his estate.

The Tax Reform Act of 1976 did not change this section.

exceeding five per cent of the value of the policy immediately before the decedent's death is to be treated as an incident of ownership. Not surprisingly, interpretations of the Code in the absence of statutory guidelines have been confusing and conflicting.

The taxation of life insurance trusts is one important area of current conflict. The popularity of life insurance trusts as estate planning devices<sup>2</sup> heightens the need for fixed interpretation. Nevertheless, a conflict has arisen in the case of trusts which include in the corpus a life insurance policy on the decedent's life, and which appoint the decedent as trustee. The trustee's usual powers over the trust corpus, including the insurance policy, would normally result in inclusion of the insurance proceeds in the decedent's gross estate, because such powers constitute incidents of ownership. In the case of a life insurance trust, however, the decedent-trustee holds his powers over the insurance policy in a fiduciary capacity. The issue, therefore, is whether the fiduciary nature of the decedent's powers sufficiently restrains his ability to benefit himself through the exercise of those powers so that the powers do not, or should not, constitute taxable "incidents of ownership." This question has been raised with only slight factual variations before the Second, Fifth, and Sixth Circuit Courts of Appeals. The three circuits have reached contrary conclusions, each court relying on slightly different interpretations of the "incidents of ownership" concept.

This Note will review the history of the current statute, focusing especially on the "incidents of ownership" concept, and attempt to determine what that term should encompass. The impact of fiduciary restraints, as exemplified by the recent circuit court decisions, will then be examined. Finally, the proper resolution of the conflict in the circuit courts will be suggested.

## I. HISTORY OF ESTATE TAXATION OF LIFE INSURANCE

Congress has made three significant changes in the statutory language, in 1918, 1942, and 1954. This section will be divided into three

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2. See, e.g., Doyle, *Life Insurance in Estate Planning*, 22 OHIO ST. L.J. 258, 263-74 (1961); Gordon, *Life Insurance as a Planning Tool*, 1975 N.Y.U. 33D INST. FED. TAX. 793; Gordon, *Recent Developments in the Use of Life Insurance in Estate Planning*, 22 TUL. TAX. INST. 477 (1973); McKenny, *The Role of Variable Life Insurance in Estate Planning*, 112 TRUSTS & EST. 698 (1973); Simmons, *Tax Planning with Group Term Life Insurance*, 11 LAW OFF. ECON. & MANAGEMENT 483 (1971); Simmons, *Life Insurance Trusts*, 12 PRAC. LAW., Oct. 1966, at 63; Comment, *The Life Insurance Trust in Estate Planning*, 34 MISS. L.J. 81 (1962).

parts, corresponding to these three major changes. Each part will discuss the statutory language, legislative history, judicial decisions, and treasury regulations interpreting the three versions of the statute.

## A. 1918

The first specific inclusion of life insurance in the estate tax provisions of the Internal Revenue Code is found in the Revenue Act of 1918. Section 402 of that Act listed insurance proceeds among other kinds of property to be included in the decedent's gross estate:

To the extent of the amount receivable by the executor as insurance 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>3</sup>

The principle of splitting insurance taxation into two categories—insurance payable to the decedent-insured's estate or executor, and insurance payable to all other beneficiaries—has been carried forward from the 1918 Act to the current Code without change. Taxation of insurance proceeds paid to the decedent's estate or executor has not created interpretative difficulty, because the benefit to the decedent is not disputed.<sup>4</sup> This Note concerns only the second category of insurance taxation—the estate tax consequences of life insurance proceeds payable to beneficiaries other than the decedent's estate or executor.

### 1. *The \$40,000 Exemption and the Definition of "Life Insurance"*

Neither the current statute nor its predecessors explicitly define life insurance.<sup>5</sup> Under the 1918 Act, however, it was necessary to define the term to determine whether property constituted life insurance, thus qualifying for the \$40,000 exemption, or should be treated as another sort of property not qualifying for the exemption.<sup>6</sup> The first

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3. Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098 (current version at I.R.C. § 2042).

4. See C. LOWNDES, R. KRAMER, & J. MCCORD, *FEDERAL ESTATE & GIFT TAXES* § 13.2, at 322 (3d ed. 1974) [hereinafter cited as LOWNDES].

5. See *Helvering v. Le Gierse*, 312 U.S. 531, 537-38 (1941). I.R.C. § 2039(a) (estate taxation of annuities) specifically excludes life insurance without defining it. Nor does the income tax provision for life insurance define the term. I.R.C. § 101.

6. See, e.g., *Keller v. Commissioner*, 312 U.S. 543, 544-45 (1941); *Helvering v. Le Gierse*, 312 U.S. 531, 538 (1941); *Helvering v. Tyler*, 111 F.2d 422, 425-27 (8th Cir. 1940), *aff'd*, 312 U.S. 657 (1951). The \$40,000 exemption was re-enacted without

Treasury Regulations presented a perfunctory definition of insurance: "The term 'insurance' refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system."<sup>7</sup> This definition has never been changed by the Treasury Regulations and remains the same today.<sup>8</sup> The legislative history of the Revenue Act of 1918 is not helpful, either; it merely indicates that Congress included the provision taxing insurance benefits in excess of \$40,000 payable to beneficiaries other than the decedent's estate or executor to prevent tax evasion.<sup>9</sup>

Court decisions have amplified the definition of insurance, holding that the essence of insurance is an actual "insurance risk" at the time of the transaction.<sup>10</sup> In other words, there must be some element of risk-shifting from the insured to the insurer and possibly some element of risk-distribution. Thus, if the benefits payable on the insured's death cannot exceed the total premiums paid plus interest, there is no "insurance risk" because the insurer assumes no risk of financial loss.

Aside from the difficulty of defining insurance, courts have faced a separate problem in defining "life insurance." Courts have held that the term encompasses group insurance, accidental death benefits, stock exchange benefits, war risk insurance, and annuity and life insurance combinations.<sup>11</sup> In 1965, the Third Circuit accepted the taxpayer's argument that an accidental death policy was not life insurance because the likelihood of accidental death is extremely low, whereas a specified sum is certain to be paid on a life insurance policy.<sup>12</sup> The Supreme Court, however, in its most recent ruling on the estate taxation of life insurance, reversed the Third Circuit's decision. The

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change in 1921, 1924, 1926, and 1939. Revenue Act of 1921, ch. 136, § 402(f), 42 Stat. 279; Revenue Act of 1924, ch. 234, § 302(g), 43 Stat. 305; Revenue Act of 1926, ch. 20, § 1094(g), 44 Stat. 835; Int. Rev. Code of 1939, ch. 3, § 811(g), 53 Stat. 122. See generally 1 A. CASNER, ESTATE PLANNING 323 n.71 (3d ed. 1961).

7. Treas. Reg. 37, art. 32 (1921 revision), quoted in *Helvering v. Le Gierse*, 312 U.S. 531, 538 (1941).

8. Treas. Reg. § 20.2042-1(a)(1) (1974).

9. H.R. REP. NO. 767, 65th Cong., 2d Sess. 22 (1918); S. REP. NO. 617, 65th Cong., 2d Sess. 42 (1918).

10. *Helvering v. Le Gierse*, 312 U.S. 531, 539-40 (1941); see *Ritter v. Mutual Life Ins.*, 169 U.S. 139 (1898). For a general discussion of life insurance policies, see Berall, *Use of Life Insurance in Estate Planning—Recent Developments*, 1973 N.Y.U. 33D INST. FED. TAX. 721; Gordon, *Life Insurance as a Planning Tool*, supra note 2.

11. LOWNDES, supra note 4, at § 13.12.

12. *Estate of Noel v. Commissioner*, 332 F.2d 950, 952 (3d Cir.), rev'd, 380 U.S. 678 (1965).

Court rejected the evitable-inevitable risk distinction as not viable, because in either case the risk assumed by the insurer is the insured's death, and it is that risk upon which payment depends in both cases.<sup>13</sup>

The definition of life insurance has been further refined in cases disputing the value of the policy for gift tax purposes. In *Guggenheim v. Rasquin*,<sup>14</sup> for example, the Court faced the issue of the gift tax due on a single premium policy purchased for \$852,000, with a cash surrender value of \$717,000 and a face value of \$1,000,000. Although the taxpayer argued that the gift tax should be based upon the cash surrender value,<sup>15</sup> the Commissioner valued the policy at its cost to the taxpayer. The Court upheld the Commissioner's determination, stating:

[T]he owner of a fully paid life insurance policy has more than the mere right to surrender it; he has the right to retain it for its investment virtues and to receive the face amount of the policy upon the insured's death. That these latter rights are deemed by purchasers of insurance to have substantial value is clear from the difference between the cost of a single-premium policy and its immediate or early cash surrender value . . . .<sup>16</sup>

## 2. Criterion for Inclusion

The Revenue Act of 1918 did not specify the criterion to determine whether insurance proceeds payable to beneficiaries other than the decedent-insured's estate or executor should be included in the decedent's estate. The 1918 Act merely stated that such proceeds were includible if they were paid "as insurance under policies taken out by the decedent upon his own life."<sup>17</sup> This phrase caused more confusion than any other part of the statute.

The earliest Treasury Regulations attempted to explicate the phrase "taken out by the decedent upon his own life," stating that insurance was to be treated as taken out by the decedent

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13. *Commissioner v. Estate of Noel*, 380 U.S. 678 (1965).

14. 312 U.S. 254 (1941).

15. I.R.C. § 2512(a) provides that "if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift." Treas. Reg. § 25.2512-1 (1965) provides that "the value of the property is the price at which such property would change hands between a willing buyer and a willing seller . . . . The value is generally to be determined by ascertaining as a basis the fair market value at the time of the gift . . . ."

16. *Guggenheim v. Rasquin*, 312 U.S. 254, 257 (1941); *accord*, *United States v. Ryerson*, 312 U.S. 260 (1941); *Powers v. Commissioner*, 312 U.S. 259 (1941).

17. Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098 (current version at I.R.C. § 2042).

where he pays the premiums, either directly or indirectly, whether or not he makes the application. On the other hand, the insurance should not be included in the gross estate, even though the application is made by the decedent, where the premiums are actually paid by some other person or corporation, and not out of funds belonging to, or advanced by, the decedent.<sup>18</sup>

Thus, the first defined criterion for including insurance proceeds in the decedent's estate was whether or not he had paid, directly or indirectly, the premiums on the policy. The 1924 Treasury Regulations carried forward this definition with slight alterations<sup>19</sup> and the 1926 regulations re-adopted it without substantial change.<sup>20</sup> Many courts construing the 1918 Act also supported the view that insurance was "taken out" by the decedent, regardless of who made application, if he had paid the premiums.<sup>21</sup>

In 1929, however, the Supreme Court decided the landmark case *Chase National Bank v. United States*.<sup>22</sup> In that case the taxpayer had purchased three insurance policies on his life, naming his wife as beneficiary but reserving the right to change the beneficiary. The decedent's representatives argued that the estate tax statute imposed a direct, unapportioned tax on property in contravention of article 1, sections 2 and 9 of the Constitution.<sup>23</sup> The taxpayer asserted that the beneficiaries' interest had "vested" in them before the death of the insured, and that the proceeds were paid to the beneficiaries by the insurer, not the insured; therefore, no taxable transfer from the decedent-insured had occurred at the moment of the taxpayer's death. Rejecting the taxpayer's argument, the Court first discussed the concept of incidents of ownership. The Court stated that the taxpayer had

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18. Treas. Reg. 37, Art. 32 (1919), quoted in *Lang v. Commissioner*, 304 U.S. 264, 268-69 (1938) and Schlesinger, *Taxes and Insurance: A Suggested Solution to the Uncertain Cost of Dying*, 55 HARV. L. REV. 226, 230 (1941).

19. Treas. Reg. 68, Art. 25, 28 (1924), quoted in *Lang v. Commissioner*, 304 U.S. 264, 269 (1938).

20. The 1926 regulations were the same as the 1924 regulations. *Lang v. Commissioner*, 304 U.S. 264, 270 (1938).

21. E.g., cases cited Annot., 85 L.Ed. 1001, 1014 (1941).

22. 278 U.S. 327 (1929).

23. U.S. CONST. art. I, § 2 provides that "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers . . . ."

U.S. CONST. art. I, § 9 provides that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken."

retained an incident of ownership—the power to change the beneficiaries and thus dispose of the proceeds—until the moment of his death, and the termination of this power at death could be treated as a taxable transfer.<sup>24</sup> The Court stated:

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 no less a transfer within the reach of the taxing power than a transfer effected in other ways through death.<sup>25</sup>

. . . .

. . . Termination of the power of control at the time of death inures to the benefit of him who owns the property subject to the power and thus brings about, at death, the completion of that shifting of the economic benefits of property which is the real subject of the tax, just as effectively as would its exercise, which later may be subjected to a privilege tax . . . .<sup>26</sup>

The Court also rejected the narrow interpretation of “transfer” that permits taxation only of transfers directly from the decedent: “[the definition of a taxable transfer] must . . . at least include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another.”<sup>27</sup>

Subsequent to the *Chase* decision, lower courts and the Treasury Department altered their interpretations of the test for inclusion of life insurance proceeds with disconcerting frequency,<sup>28</sup> apparently construing *Chase* to mean not only that estate tax could be levied on the basis of incidents of ownership, but also that incidents of ownership was a prerequisite to taxation. In a ruling issued in 1930, the Treasury Department amended the determining test to include a requirement of

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24. *Chase Nat'l Bank v. United States*, 278 U.S. 327, 336-37 (1929).

25. *Id.* at 335.

26. *Id.* at 338.

27. *Id.* at 337.

28. See generally LOWNDES, *supra* note 4, at ch. 13; Schlesinger, *supra* note 18, at 227-37.

possession of incidents of ownership.<sup>29</sup> In 1932, the Treasury Regulations were again amended to make the test a two-prong one: proceeds of life insurance were includible in the gross estate only if the decedent had paid the premiums *and* possessed incidents of ownership at his death.<sup>30</sup> In 1934, however, new Regulations made the test for inclusion alternative: either possession of incidents of ownership at death *or* payment of premiums by the insured justified including the proceeds in his gross estate.<sup>31</sup> In the 1937 Regulations, however, the Treasury once again reversed itself, apparently making possession of incidents of ownership the sole test for taxation.<sup>32</sup> Finally, in 1941, the Treasury reversed itself again, stating that "taken out by the decedent" turned solely upon whether or not he had paid the policy premiums.<sup>33</sup>

#### B. *Revenue Act of 1942*

Congress attempted to introduce some harmony into this confusing state of affairs by amending the statute in 1942. The Revenue Bill of 1942 made major changes in the prior statute's language. It totally eliminated the \$40,000 exemption.<sup>34</sup> It also eliminated the phrase "policies taken out by the decedent" because that language had "produced confusion and unnecessary litigation";<sup>35</sup> the amended statute specifically enumerated the criterion governing inclusion in the decedent's estate of life insurance proceeds payable to beneficiaries other than the decedent's estate. The test for inclusion adopted by the 1942 bill was the either-or test previously used to define "taken out by the decedent": inclusion was justified either if the decedent had paid the policy premiums or if at death he possessed any incidents of ownership in the policy.<sup>36</sup> If the decedent possessed any incident of ownership, the entire policy amount was includible in his estate; if he had only paid the premiums, an amount proportionate to the ratio of the premiums paid

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29. I.T. 2553, IX-2 C.B. 101 (1930), *quoted in* Schlesinger, *supra* note 18, at 232 n.17.

30. Schlesinger, *supra* note 18, at 233.

31. Treas. Reg. 80, Art. 25 (1934), *quoted in* Schlesinger, *supra* note 18, at 234.

32. Schlesinger, *supra* note 18, at 234.

33. Treas. Reg. 80, art. 25, T.D. 5032, 1941-1 C.B. 427-28.

34. Revenue Act of 1942, ch. 619, § 404(g)(2), 56 Stat. 944.

35. H.R. REP. NO. 2333, 77th Cong., 2d Sess. 162 (1942).

36. Revenue Act of 1942, ch. 619, § 404(g)(2), 56 Stat. 944.

by the decedent to the total premiums was included in the decedent's estate.<sup>37</sup>

Although the 1942 statute eliminated the troublesome "policies taken out by the decedent" phrase and substituted specific grounds for inclusion, it did little to clarify those grounds. The statute did not explain what constituted payment of premiums nor what was considered an incident of ownership. Congress did not explain why it adopted the either-or test; aside from a straightforward statement that the payment-of-premiums test was designed to prevent tax avoidance, the legislative history of the section specified no further reason.<sup>38</sup> Nor did the amendment add to pre-existing understanding of the term "payment of premiums." Although the legislative history did not explain why the test was adopted, the committee reports did provide a detailed list of examples of incidents of ownership that became quite significant. Portions of the current regulations, for example, are taken directly from these committee reports.<sup>39</sup> The legislative history also does not explain why Congress adopted the provision including policy proceeds in the estate when the decedent possessed an incident of ownership "exercisable either alone or in conjunction with any other person."

Without specific congressional indication of the reason for the either-or test, courts have struggled to explain why taxation is or is not justified in a particular instance. Recently courts have relied on the general theory of the estate tax in cases involving a decedent-insured who acquired an insurance policy within three years of his death, retained no incidents of ownership, but continued to pay premiums on the policy until his death.<sup>40</sup> The taxpayers argued that only the value of the

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37. *Id.*

38. H.R. REP. NO. 2333, 77th Cong., 2d Sess. 162-63 (1942) provides:

Payments of premiums or other consideration by the decedent include payments made by him directly or indirectly. This provision is intended to prevent avoidance of the estate tax and should be construed in accordance with this objective. For example, if the decedent transfers funds to his wife so that she may purchase insurance on his life, and she purchases such insurance, the payments are considered to have been made by the decedent even though they are not directly traceable to the precise funds transferred by the decedent. 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. Payment is also made by the decedent if the decedent's employer makes payment as compensation for services. These examples merely illustrate the concrete application of the provision.

39. Treas. Reg. § 20.2042-1(c)(2) (1974).

40. *See, e.g., Detroit Bank & Trust Co. v. United States*, 467 F.2d 964 (6th Cir.

premiums paid should be included in the gross estate because only that amount had been diverted from the decedent's gross estate. Most courts rejected this argument, however, adopting the more accurate position that the estate and gift taxes are event taxes which focus not on the depletion of the decedent's gross estate but on the occurrence of a taxable event. That taxable event has always been tied to the term "transfer," but the Supreme Court in *Chase* defined "transfer" very broadly.<sup>41</sup>

By adopting the either-or test in 1942, Congress attempted to exercise its taxing power to the fullest by using a two-fold criterion to define a taxable transfer or event. Though the statute by its terms did not require either a taxable event or a transfer, it did require one of two potentially taxable events: the payment of premiums by the decedent or the lapse of an incident of ownership at his death. The Treasury Regulations prior to 1942 had taxed policy proceeds only if the decedent paid the premiums; Congress' adoption of the either-or test recognized that a taxable event can occur even if the decedent does not pay the premiums. Thus, to exercise its taxing power to the fullest, Congress adopted the alternative tests for taxation.

The Supreme Court held the premium payment test of the 1942 law constitutional,<sup>42</sup> rejecting a challenge that it created an unapportioned direct tax.<sup>43</sup> Assuming that the decedent retained no incident of ownership until his death, the Court relied on *Chase* for the proposition that whether the decedent had transferred an interest directly to the benefi-

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1972); *Bel v. United States*, 452 F.2d 683 (5th Cir. 1971); *First Nat'l Bank v. United States*, 423 F.2d 1286 (5th Cir. 1970); Rev. Rul. 71-497, 1971-2 C.B. 330. Many recent articles have considered the relationship of §§ 2035 and 2042. See, e.g., Coale, *The Ghost of the Premium Payment Test Lives On*, 59 A.B.A.J. 1327 (1973); Eliasberg, *Contemplation of Death and Estate Taxation of Life Insurance*, 111 TRUSTS & EST. 690 (1972); Grant, *Premium Payment Tests: Dead or Alive?*, 11 CAL. W.L. REV. 60 (1974); Graves & Finley, *Irrevocable Term Life Insurance Trusts and Gifts in Contemplation of Death Under Section 2035*, 32 WASH. & LEE L. REV. 855 (1975) & 1976 INS. L.J. 127-46; Hopwood, *An Outline of the Federal Estate Taxation of Life Insurance*, 11 Hous. L. REV. 42, 55-64 (1973); Rhodes, *Contemplation of Death—the Problem of Life Insurance Premiums*, 24 TAX. LAW. 589 (1971); Rosenberg, *Section 2035—Premium Payments Made in Contemplation of Death*, 51 TAXES 468-76 (1973); 38 Mo. L. REV. 710 (1973); 5 N.C. CENT. L.J. 268 (1974); 44 U. COLO. L. REV. 633 (1973); 34 U. PITT. L. REV. 604 (1973).

41. *Chase Nat'l Bank v. United States*, 278 U.S. 327, 337 (1929).

42. *United States v. Manufacturers Nat'l Bank*, 363 U.S. 194 (1960).

43. See note 23 *supra* and accompanying text.

ciaries was irrelevant.<sup>44</sup> The Court held that the decedent's death was a taxable "transfer" even though he had only paid the premiums, because his death provided "the 'generating source' of the full value of the proceeds."<sup>45</sup>

### C. *Internal Revenue Code of 1954*

Congress amended the statute again in 1954 and has not altered it since.<sup>46</sup> A minor 1954 alteration included a reversionary interest worth more than five percent of the policy value immediately before the decedent's death as an incident of ownership. The major alteration contained in the 1954 Code eliminated the premium payment test for inclusion and made possession of an incident of ownership at death the sole criterion for inclusion. Congress did not believe it lacked the power to use the premium payment test; it merely felt that equitable considerations argued against the exercise of such power:

No other property is subject to estate tax where the decedent initially purchased it and then long before his death gave away all rights to the property.

. . . To place life-insurance policies in an analogous position to other property, however, it is necessary to make the 5-percent reversionary interest rule, applicable to other property, also applicable to life insurance.<sup>47</sup>

A minority of the House Ways and Means Committee attacked the elimination of the premium payment test:

It is sought to justify the change as merely putting life insurance on a par with other property which may be given away free from estate tax if the gift is not made "in contemplation of death." But life insurance is not like other property. It is inherently testamentary in nature. It is designed, in effect, to serve as a will, regardless of its investment features.<sup>48</sup>

The minority view is clearly wrong. Many cases have directly held that life insurance is not inherently testamentary. The definitions of life insurance discussed above clearly establish that life insurance constitutes

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44. *United States v. Manufacturers Nat'l Bank*, 363 U.S. 194, 199 (1960).

45. *Id.* at 198.

46. I.R.C. § 2042, *quoted in note 1 supra*.

47. H.R. REP. NO. 1337, 83d Cong., 2d Sess. 91, *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4025, 4118.

48. H.R. REP. NO. 1337, 83d Cong., 2d Sess. B14, *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4025, 4608.

more than the mere right to proceeds on the death of the insured, and that its significant investment features justify treating life insurance the same as other property for estate tax purposes.<sup>49</sup>

In contrast to the 1942 situation, Congress' purpose for altering the test for inclusion in 1954 was clear. Congress had the constitutional power to tax life insurance proceeds on the basis of premiums paid, but chose to restrict its use of that power so that life insurance proceeds would be included only when the decedent possessed an incident of ownership. Other than providing that a five percent reversionary interest qualified as an incident of ownership, however, Congress did not define the interests to be treated as incidents of ownership, again leaving that task to the courts and Treasury Regulations.

## II. DEFINING AN "INCIDENT OF OWNERSHIP" GENERALLY

As noted earlier,<sup>50</sup> section 2042 of the current Code<sup>51</sup> requires that the proceeds of life insurance policies payable to other beneficiaries<sup>52</sup> be included in the insured's gross estate if at his death he possessed, alone or in conjunction with another person, any of the incidents of ownership of the policy.<sup>53</sup> Although the statute has never defined "incident of ownership," both the Senate and House Reports of 1942 shed some light on Congress' intent:

There is no specific enumeration of incidents of ownership, the possession of which at death forms the basis for inclusion of insurance proceeds in the gross estate, as it is impossible to include an exhaustive list. Examples of such incidents are the right of the insured or his estate to the economic benefits of the insurance, the power to change the beneficiary, the power to surrender or cancel the policy, the power to assign it, the power to revoke an assignment, the power to pledge the policy for a loan, or the power to obtain from the insurer a loan against the surrender value of the policy. Incidents of ownership are not confined to those possessed by the decedent in a technical legal sense. For example, a power to change the beneficiary reserved to a

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49. See Annot., 85 L.Ed. 1001, 1004 (1941); Swihart, *Federal Taxation of Life Insurance Wealth*, 37 IND. L.J. 167 (1962).

50. See note 1 *supra* and accompanying text.

51. I.R.C. § 2042, quoted in note 1 *supra*.

52. See note 4 *supra* and accompanying text.

53. I.R.C. § 2042. Section 2042 does not, nor was it intended to, affect inclusion under other sections of the Code. S. REP. NO. 1631, 77th Cong., 2d Sess. 236 (1942); H.R. REP. NO. 2333, 77th Cong., 2d Sess. 163 (1942). See generally 54 MARQ. L. REV. 370 (1971); 52 N.C. L. REV. 671 (1974).

corporation of which the decedent is sole stockholder is an incident of ownership in the decedent . . . .<sup>54</sup>

The Treasury incorporated this language into Regulation 20.2042-1(c)(2) in 1954, but with significant alterations:

[T]he 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 or his estate to the economic benefits of the policy. Thus it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc.<sup>55</sup>

Both the legislative history and Regulation 20.2042-1(c)(2) state that legal ownership is not required for possession of an "incident of ownership." While the legislative history lists the right to economic benefits as only one of a number of considerations, the Regulation implies that the right to economic benefit is the basic criterion of an incident of ownership and that the other factors were intended only to serve as examples of incidents that may be of economic benefit. This slight alteration in language has caused courts considerable difficulty; for example, one taxpayer relied on the language of the Regulation requiring economic benefit, coupled with the statement that "incident of ownership" is not limited to technical legal ownership, to argue that the taxpayer must have real control, not just ownership, over economic benefits before inclusion is proper.<sup>56</sup>

Although courts have been forced to wrestle with the problem of defining "incidents of ownership" without statutory guidance, some basic principles governing the defining process are well established. One such principle is that whether the insured retained any incident of ownership at his death is a determination of fact, not law<sup>57</sup> and the

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54. H.R. REP. NO. 2333, 77th Cong., 2d Sess. 162 (1942); S. REP. NO. 1631, 77th Cong., 2d Sess. 235 (1942).

55. Treas. Reg. § 20.2042-1(c)(2) (1954).

56. *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 11 (1st Cir. 1966).

57. *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 9-10 (1st Cir. 1966); *Estate of Piggott v. Commissioner*, 340 F.2d 829 (6th Cir. 1965); *Hall v. Wheeler*, 174 F. Supp. 418 (D. Me. 1959); *Fried v. Granger*, 105 F. Supp. 564 (W.D. Pa. 1952), *aff'd*, 202 F.2d 150 (3d Cir. 1953); *Estate of Michael Collino*, 25 T.C. 1026 (1956).

burden rests on the taxpayer to show non-possession of all incidents.<sup>58</sup> Furthermore, factual questions, including the insured's rights under the policy, are controlled by state or other applicable law; federal law determines only whether the rights recognized under state law are sufficient to justify federal estate taxation.<sup>59</sup> Two types of facts arise in life insurance cases: "policy facts" revealed by the policy terms; and outside-the-policy, or "intent," facts revealed by the conduct and intent of the parties, either subjectively or objectively determined.<sup>60</sup> Courts have generally held that only policy facts are relevant to the determination of whether the decedent retained any incidents of ownership.<sup>61</sup> These general principles, however, are of little real aid in defining an "incident of ownership."

Ownership in this context is clearly not restricted to legal title.<sup>62</sup> Unlike other sections of the Code, which require property to be included only to the extent of the decedent's interest in the property held,<sup>63</sup> section 2042 provides that the entire insurance proceeds are included in the insured's estate whenever his interest is sufficient to amount to an "incident of ownership."<sup>64</sup> Section 2042 imposes the tax whether the insured holds the incident of ownership alone or in conjunction with another person,<sup>65</sup> this too suggests that the insured's ownership need not

58. See, e.g., note 57 *supra*.

59. See, e.g., *Parson v. United States*, 460 F.2d 228 (5th Cir. 1972); *Landorf v. United States*, 408 F.2d 461, 466 (Ct. Cl. 1969) (citing *Morgan v. Commissioner*, 309 U.S. 78, 80 (1940); and *Burnet v. Harmel*, 287 U.S. 103, 110 (1932)); *Wissbrun, Bosch and Its Aftermath: The Effect of State Court Decisions on Federal Tax Questions*, 114 TRUSTS & EST. 8 (1975).

60. See, e.g., *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7 (1st Cir. 1966); *Cockrill v. O'Hara*, 302 F. Supp. 1365 (M.D. Tenn. 1969); *Eliasberg, The Estate Taxation of Life Insurance: A Survey of Recent Developments*, 26 U.S. CAL. 1974 TAX INSTR. 1. But see *Doing v. Commissioner*, 58 T.C. 115 (1972).

61. Compare, e.g., materials cited note 60 *supra*, with *Morton v. United States*, 322 F. Supp. 1139 (S.D. W. Va. 1971), *aff'd*, 457 F.2d 750 (4th Cir. 1972) (decedent's intent considered).

62. See notes 54 & 55 *supra* and accompanying text.

63. See, e.g., I.R.C. § 2033.

64. I.R.C. § 2042 provides in pertinent part:

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 [from policies] . . . with respect to which the decedent possessed at his death any of the incidents of ownership . . . . (emphases added).

65. I.R.C. § 2042(2). See, e.g., *Commissioner v. Estate of Karagheusian*, 233 F.2d 197 (2d Cir. 1956); *Godfrey v. Smyth*, 180 F.2d 220 (9th Cir. 1950); *Hall v. Wheeler*, 174 F. Supp. 418 (D. Me. 1959).

be full legal ownership, and that the term "incident" includes partial or fractional interests.

Although the term "incident" itself suggests that the interest being taxed is only fractional and incomplete, and although ownership may be incomplete in a technical legal sense but still justify taxation, neither of these rationales offers any real help in deciding what interests should qualify as incidents of ownership. In general, courts have interpreted the rule that less than full legal ownership may qualify as an "incident of ownership" to mean that control or power over the insurance policy is a sufficient indication of an incident even though that power does not amount to ownership. This definition appears to coincide with the examples in the House and Senate Reports; for instance, power to designate the beneficiaries of the policy may be equivalent to substantial control over the policy although it does not amount to full ownership of the policy in a technical sense. Merely recognizing that power is what is contemplated by the term "incident of ownership," however, does not provide a useful guideline to apply to specific factual situations.

The "power" must probably be a legal right, although the ownership need not be legal ownership; mere naked power to control a policy does not require inclusion.<sup>66</sup> On the other hand, the insured-decedent need not have physical possession of the policy in order to possess an "incident of ownership." In *Commissioner v. Estate of Noel*,<sup>67</sup> the Supreme Court's most recent decision regarding incidents of ownership, the taxpayer's wife purchased flight insurance policies on his life shortly before he died in a plane crash. Though his wife applied and paid for the policies, the policy terms reserved to the insured the right to change the beneficiary. Arguing that the proceeds should be excluded from the decedent's estate, the executors contended that even if the right to change beneficiaries is ordinarily an incident of ownership, Noel's power should not be so considered since it was physically impossible for him to exercise the power to change beneficiaries while he was in flight and the policy was on the ground. The Supreme Court rejected this argument: "We hold that estate tax liability for policies 'with respect to which the decedent possessed at his death any of the incidents of ownership' de-

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66. *Estate of Bartlett v. Commissioner*, 54 T.C. 1590 (1970), *Estate of Bert L. Fuchs*, 47 T.C. 199 (1966). *But see United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7 (1st Cir. 1966).

67. 380 U.S. 678 (1965).

pends on a general, legal power to exercise ownership, without regard to the owner's ability to exercise it at a particular moment."<sup>68</sup> The Court pointed out that it is possible for an insured to divest himself of all incidents of ownership and thus prevent inclusion, but noted that Noel's was not such a case.<sup>69</sup> The Court's emphasis on "a general, legal power" supports the conclusion that an "incident of ownership" entails some degree of control, albeit less than full ownership. Such a broad statement, however, is of little help in drawing the difficult line between an insignificant amount of control, and the degree of dominion tantamount to substantial ownership which justifies taxation.<sup>70</sup>

Courts have had no difficulty resolving some cases even in the absence of clearly drawn guidelines, as when the decedent retained all the incidents of ownership mentioned in the Regulations.<sup>71</sup> Similarly, cases in which the single incident of ownership retained is one specifically mentioned in the Regulations have been easily resolved. Thus, courts consistently have included insurance proceeds in the decedent's estate when he retained the right to change the beneficiary,<sup>72</sup> to surrender the policy for its cash surrender value or to obtain loans,<sup>73</sup> or to revoke or assign the policy.<sup>74</sup>

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68. *Id.* at 684. See also *Adeline S. Davis*, 27 T.C. 378, 382 (1956).

69. 380 U.S. at 684.

70. See generally *Berall, Use of Life Insurance in Estate Planning—Recent Developments*, 1973 N.Y.U. 31ST INST. FED. TAX. 793.

71. See, e.g., *Wilson v. United States*, 254 F. Supp. 822 (E.D. Pa. 1966), *rev'd on other grounds*, 372 F.2d 232 (3d Cir. 1967).

72. E.g., *Chase Nat'l Bank v. United States*, 278 U.S. 327 (1929); *Morton v. United States*, 457 F.2d 750 (4th Cir. 1972); *Nance v. United States*, 430 F.2d 662 (9th Cir. 1970); *Estate of Piggott v. Commissioner*, 340 F.2d 829 (6th Cir. 1965); *Farwell v. United States*, 243 F.2d 373 (7th Cir. 1957); *Commissioner v. Estate of Karagheusian*, 233 F.2d 197 (2d Cir. 1956); *Singer v. Shaughnessy*, 198 F.2d 178 (2d Cir. 1952); *Broderick v. Keefe*, 112 F.2d 298 (1st Cir.), *cert. dismissed*, 311 U.S. 721 (1940); *Hall v. Wheeler*, 174 F. Supp. 418 (D. Me. 1959); *Commercial Nat'l Bank & Trust Co. v. Johnson*, 123 F. Supp. 728 (S.D.N.Y. 1954); *Estate of Michael Collino*, 25 T.C. 1026 (1956); *Rev. Rul. 65-222*, 1965-2 C.B. 374; *LOWNDES*, *supra* note 4, at 330 n.37.

73. E.g., *Pritchard v. United States*, 397 F.2d 60 (5th Cir. 1968); *Commissioner v. Treganowan*, 183 F.2d 288 (2d Cir. 1950), *cert. denied*, 340 U.S. 853 (1951); *Liebmann v. Hassett*, 148 F.2d 247 (1st Cir. 1945); *Estate of Bryan S. McCoy, Sr.*, 30 T.C.M. (P-H) 237 (1961).

74. E.g., *Cockrill v. O'Hara*, 302 F. Supp. 1365 (M.D. Tenn. 1969). A power to revoke an assignment only in conjunction with the assignee, however, cannot be an incident of ownership or there could never be a divestiture of all incidents by assignment. *Landorf v. United States*, 408 F.2d 461, 470 (Cl. Ct. 1969). Many articles have been written on assigning group life insurance policies. See, e.g., *Lewis, Revenue Ruling 68-334 and Assignment of Group-Term Life Insurance Policies*, 47 TAXES 72 (1969); 34 *FORDHAM L. REV.* 269 (1965).

In many cases, however, the courts have encountered problems determining whether more tenuous types of control retained by the decedent are sufficient to warrant taxation. For example, courts disagree as to whether the retention of rights to control the timing or manner of payment of policy proceeds should result in inclusion.<sup>75</sup> Similarly, when the decedent's power is a negative one, such as the right to veto a sale or investment of policy proceeds, courts have had trouble deciding whether that power should be taxed.<sup>76</sup> It is now clearly established that the ability to terminate insurance by quitting a job, once considered sufficient control to justify taxation, is not of itself a taxable "incident of ownership."<sup>77</sup>

In *Estate of Lumpkin v. Commissioner*,<sup>78</sup> the Tax Court faced a factual situation that presented an equally troublesome problem in defining control. The decedent's employer had insured the decedent under a group term life insurance policy for which the employer paid all premiums and named the beneficiaries; the employee-insured's only power over the policy was a right to alter the monthly amounts to be paid to his wife in settlement of the policy at his death and, by reducing the amounts, to spread the payments over a longer period of time. The Tax Court, finding that the benefits provided by the policy were "carefully circumscribed"<sup>79</sup> and that exercise of the right to select between settlement options "could not benefit the decedent or his estate,"<sup>80</sup> held that decedent possessed no taxable incident of ownership.

The Fifth Circuit Court of Appeals reversed and included the policy proceeds in the decedent-insured's estate.<sup>81</sup> The court examined the tax

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75. Compare, e.g., *Estate of Lumpkin v. Commissioner*, 56 T.C. 815 (1971), *rev'd*, 474 F.2d 1092 (5th Cir. 1973), with *Estate of Connelly v. United States*, 398 F. Supp. 815 (D.N.J. 1975), and *May Billings*, 35 B.T.A. 1147 (1937).

76. See *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7 (1st Cir. 1966). See also *Commissioner v. Estate of Karagheusian*, 233 F.2d 197 (2d Cir. 1956); *Du Charme's Estate v. Commissioner*, 164 F.2d 959 (6th Cir. 1947), *modified on rehearing*, 169 F.2d 76 (6th Cir. 1948); *Goldstein's Estate v. United States*, 122 F. Supp. 667 (Ct. Cl.), *cert. denied*, 348 U.S. 942 (1954); Rev. Rul. 75-70, 1975-1 C.B. 301.

77. Compare *Commissioner v. Treganowan*, 183 F.2d 288 (2d Cir.), *cert. denied*, 340 U.S. 853 (1950), with *Landorf v. United States*, 408 F.2d 461 (Ct. Cl. 1969) (position acquiesced to by Internal Revenue Service, Rev. Rul. 72-307, 1972-1 C.B. 307).

78. 56 T.C. 815 (1971).

79. *Id.* at 822.

80. *Id.* at 824.

81. 474 F.2d 1092 (5th Cir. 1973). See generally 10 Hous. L. Rev. 984 (1973).

effect of control over the timing of payment under other sections of the Internal Revenue Code. The Supreme Court had previously held that under section 2038<sup>82</sup> the retention of a power to accelerate or delay the time of enjoyment of property constituted a taxable "power to alter, amend, or revoke" within the statutory definition.<sup>83</sup> The Supreme Court had also ruled that the same sort of power, even if exercisable only over trust income but not corpus, was a significant power justifying taxation under section 2036.<sup>84</sup> Relying on these decisions and a perceived congressional intent to treat life insurance like other forms of property,<sup>85</sup> the Fifth Circuit stated: "Quite clearly the lesson to be drawn from [these cases] is that the right to alter the time and manner of enjoyment does give its holder a substantial degree of control . . ."<sup>86</sup>

Perhaps the most difficult problem of defining substantial control arises when the insurance policy is held in trust and the decedent-insured holds some trust powers in a fiduciary capacity. Generally, the powers granted in the trust instrument are the kind that would ordinar-

82. I.R.C. § 2038 provides in pertinent part:

(a) In General.—The value of the gross estate shall include the value of all property—

(1) Transfers After June 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), 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 (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.

83. *Lober v. United States*, 346 U.S. 335 (1953).

84. *United States v. O'Malley*, 383 U.S. 627 (1966). I.R.C. § 2036 provides in pertinent part:

(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 (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his 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—

(1) the possession or enjoyment of, or the right to the income from, the property, or

(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.

85. See notes 47-48 *supra* and accompanying text. *But see* *Bel v. United States*, 452 F.2d 683, 690 (5th Cir. 1971).

86. 474 F.2d at 1097.

ly be considered substantial control; the insured's right to exercise that control is qualified, however, because he holds it in a fiduciary capacity. As a fiduciary, the insured is restricted by a duty of loyalty, which prohibits self-dealing and requires that the trust property be administered solely in the best interests of the beneficiaries;<sup>87</sup> trustees' fiduciary duties are particularly stringent.<sup>88</sup> Although the trustee's duties and powers generally depend on the terms of the trust, the duty of loyalty arises not from express terms of the trust but from the fiduciary relationship itself.<sup>89</sup> Thus, when the insured-decedent is also a trustee, he is bound as a fiduciary to exercise his retained powers in the best interests of the beneficiaries and to avoid self-dealing.

Although neither Congress nor the Supreme Court has definitively established a single, specific definition of incidents of ownership, the legislative history, statutory changes, and court interpretations reveal a general framework within which proceeds are subject to the estate tax. Congress demonstrated a clear intent to treat life insurance like other property and for that reason eliminated the premium payment test for inclusion. The new test for inclusion, however, is not exactly the same as the test for inclusion of other property: insurance proceeds are includible in a decedent's gross estate if at death he possessed an "incident of ownership." An incident of ownership does not entail full legal title or ownership, but does require some degree of legal power to exercise ownership, whether or not exercisable in fact at any particular moment.<sup>90</sup> Though the power need not be exercisable by the decedent-insured alone, nor exercisable for his economic benefit, a purely *de minimis* power is not an incident of ownership. Thus, although a power to surrender or cancel a policy in some circumstances may be an incident of ownership, a power to terminate a group life insurance policy by quitting one's job is not an incident of ownership.<sup>91</sup> Some substantial degree of control or power is required before imposition of the tax is proper. Although the substantiality required is not quantifiable in an absolute sense, the estate tax's constitutional basis as an event tax requires that the degree of control at least be sufficient to comply with

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87. G.G. BOGERT & G.T. BOGERT, *LAW OF TRUSTS* § 95, at 343-50 (5th ed. 1973); A. SCOTT, *ABRIDGEMENT OF THE LAW OF TRUSTS* § 170, at 319 (1960).

88. A. SCOTT, *supra* note 87, § 2.5, at 24.

89. *Id.* § 164, at 308.

90. *Commissioner v. Estate of Noel*, 380 U.S. 678 (1965).

91. *See* note 77 *supra* and accompanying text.

the *Chase* rationale for taxation: Does termination of the decedent's control or power at his death free the beneficiaries from the possibility of its exercise and thus complete the shift of economic benefits from the decedent to the beneficiaries?<sup>92</sup> As Congress recognized when it refused to define an "incident of ownership" more explicitly,<sup>93</sup> this question is properly answered on a case-by-case basis.

### III. INCIDENTS OF OWNERSHIP HELD IN FIDUCIARY CAPACITY

After adoption of the incident of ownership test, several courts considered the tax consequences of insurance policies held in trust. The Tax Court ruled that the exercise of control inherent in the settlor's creation of a trust with the attendant restrictions and proscriptions of the trust instrument did not warrant inclusion in the decedent's gross estate.<sup>94</sup> In a later case, however, in which decedent's wife created a trust composed of several insurance policies on the decedent's life and reserved the right to alter the trust with the consent of the decedent and their daughter, the Second Circuit Court of Appeals reversed the Tax Court's decision that the proceeds were not includible in the decedent's estate. The Tax Court's rationale was that the statute taxed only incidents of ownership with respect to the policy; the Second Circuit, however, ruled that the power to change the beneficiary constitutes an incident of ownership whether the power is exercisable through amendment of the trust or is granted by the policy itself.<sup>95</sup>

In some situations, however, the policy is held in trust and the decedent-insured's powers are held in a fiduciary capacity. Two early decisions considering this set of facts held that the decedent retained no incident of ownership. In *Estate of Newcomb Carlton*,<sup>96</sup> the taxpayer created an irrevocable trust, transferred policies on his life to the trust, and granted the trustees all powers except the right to remove the trustee and appoint a new one, which he retained. The Tax Court excluded the policies from the decedent's gross estate, stating:

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92. *Chase Nat'l Bank v. United States*, 278 U.S. 327 (1929). See text accompanying notes 22-28 & 42-45 *supra*.

93. See note 54 *supra* and accompanying text.

94. *Estate of Powell Crosley, Jr.*, 47 T.C. 310 (1966).

95. *Estate of Miran Karagheusian*, 23 T.C. 806 (1955) (no incident), *rev'd*, 233 F.2d 197 (2d Cir. 1956) (finding an incident).

96. 34 T.C. 988 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).

Any control that decedent would have acquired over the insurance policies had he appointed himself cotrustee would have been control over the policies jointly with the corporate trustee as trustee only and such control would be solely for the benefit of the trust. Such control as trustee would not constitute incidents of ownership in the insurance policies except in his capacity as trustee for the benefit of the trust.<sup>97</sup>

Similarly, in *Estate of Bert L. Fuchs*,<sup>98</sup> the Tax Court excluded insurance proceeds from the decedent's gross estate on the ground that a fiduciary duty bound the decedent to exercise his powers over the policy for the benefit of the beneficiary. In *Fuchs*, two business partners agreed to purchase insurance on each other's life, with the insured partner retaining no rights in the policy. The insurance agent, however, neglected to alter the policies to eliminate each insured's rights in the policies. Nonetheless, the Tax Court found that the partners' agreement restricted the powers granted in the policies:

Each insured herein was under no less of a legal duty to respect the terms of the partners' agreement than a common trustee legally obligated to respect the terms of a trust indenture. Decedent merely had the same type of power over the . . . policies as a trustee's power to affect trust proceeds. We do not believe that this type of naked power alone is sufficient to bring the insurance proceeds within the decedent's gross estate.<sup>99</sup>

The first recent case directly considering the issue of incidents of ownership held in a fiduciary capacity was *Estate of Harry R. Fruehauf*,<sup>100</sup> the decedent's wife, who predeceased him by fourteen months, purchased several insurance policies on his life, and placed the policies in a testamentary trust which named the decedent co-trustee and income beneficiary. The trustees were empowered to retain or assign the policies, to pay the premiums, to designate themselves as beneficiaries, and to sell or convert the policies for their cash surrender value. Rejecting the taxpayer's argument that only a right to economic benefits can qualify as an incident of ownership, the Tax Court stated that the trustees' powers were clearly sufficient to constitute incidents of ownership justifying inclusion in the decedent's gross estate had the decedent

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97. *Id.* at 996.

98. 47 T.C. 199 (1966).

99. *Id.* at 204. See also 49 N.C. L. REV. 539 (1971); 48 NOTRE DAME LAW 995 (1973).

100. 50 T.C. 915 (1968), *aff'd*, 427 F.2d 80 (6th Cir. 1970). See generally 32 MD. L. REV. 305 (1972).

not held the powers in his capacity as trustee.<sup>101</sup> Considering the effect of the trustee capacity, the court looked to analogous cases under section 2038 in which the taxpayer had argued that property subject to a limited power to alter, amend, or revoke held in a fiduciary capacity should not be taxed.<sup>102</sup> This argument was rejected in one section 2038 case on the ground that the capacity in which the power could be exercised was immaterial because the section specifies only the existence of the power, not the capacity in which it is exercised.<sup>103</sup> Because section 2042 also makes no specific reference to the capacity in which incidents of ownership are held, the Tax Court ruled that application of section 2042 is appropriate whenever such incidents of ownership exist.<sup>104</sup>

In a concurring opinion, one judge agreed with the result only because, under the specific facts presented in *Fruehauf*, the decedent's power as trustee to surrender the policies could be exercised for his personal benefit. The decedent could surrender the policies for their cash value and, by increasing the amount of cash in the corpus, directly increase his income from the trust; in this situation the power, even though held in a fiduciary capacity, could be used for personal benefit and therefore should be taxed.<sup>105</sup> The concurring judge cautioned, however, that "the case should not be read to hold that any power in the nature of an incident of ownership exercisable by an insured decedent in his fiduciary capacity causes the proceeds of the policy to be included in his gross estate."<sup>106</sup>

The Sixth Circuit affirmed the Tax Court solely on the basis of the concurring opinion.<sup>107</sup> The court noted that the Tax Court had relied

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101. 50 T.C. at 919-20 (citing *Estate of Myron Selznick*, 15 T.C. 716 (1950), *aff'd per curiam*, 195 F.2d 935 (9th Cir. 1952) (power to cancel)); *Estate of Michael Collino*, 25 T.C. 1026 (1956) (right to change beneficiary); see *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7 (1st Cir. 1966) (several powers including right to change beneficiary); *Liebmann v. Hassett*, 148 F.2d 247 (1st Cir. 1945) (right to cash surrender value); *Hall v. Wheeler*, 174 F. Supp. 418 (D. Me. 1959) (right to change beneficiary); *Fried v. Granger*, 105 F. Supp. 564 (W.D. Pa. 1952), *aff'd*, 202 F.2d 150 (3d Cir. 1953) (right to change beneficiary).

102. 50 T.C. at 924.

103. *Id.* at 924-25 (citing *Estate of Albert E. Nettleton*, 4 T.C. 987, 991 (1945)). See also *Van Beuren v. McLoughlin*, 262 F.2d 315 (1st Cir. 1958), *cert. denied*, 359 U.S. 991 (1959); *Loughridge's Estate v. Commissioner*, 183 F.2d 294 (10th Cir.), *cert. denied*, 340 U.S. 830 (1950); *Union Trust Co. v. Driscoll*, 138 F.2d 152 (3d Cir. 1943), *cert. denied*, 321 U.S. 764 (1944); *Welch v. Terhune*, 126 F.2d 695 (1st Cir. 1942).

104. 50 T.C. at 924.

105. *Id.* at 926.

106. *Id.*

107. 427 F.2d 80 (6th Cir. 1970). At least one commentator has approved denial of

on cases arising under section 2038 and its predecessor to support its "broad *per se* rule that possession by a decedent of powers constituting incidents of ownership in insurance policies on his life, regardless of the capacity in which they are held, always requires inclusion of the proceeds of the policies in the decedent's gross estate."<sup>108</sup> The court rejected the Tax Court's *per se* rule. The Sixth Circuit reasoned that section 2038 cases are distinguishable since section 2038 applies only to a decedent who is the transferor of the property, whereas the decedent in *Fruehauf* held the power solely as a fiduciary transferee, so that termination of his power at death was not a substitute for a testamentary disposition by him.<sup>109</sup> The court also considered the broad *per se* rule inappropriate because the Tax Court had held in *Fuchs* and *Carlton* that fiduciary restraints upon incidents of ownership result in exclusion of the proceeds from the decedent's estate.<sup>110</sup> Though it rejected a *per se* rule of inclusion regardless of the capacity in which the proceeds are held, the Sixth Circuit nonetheless held that inclusion of the proceeds in *Fruehauf*'s estate was justified because he could have used the power for his personal economic benefit.<sup>111</sup> The Court of Appeals rejected the taxpayer's argument that because the estate had never distributed property to the trust the decedent was unable to exercise his power or receive benefit, ruling that the existence of the power, not the ability to exercise it at any particular moment, is the crucial factor for tax purposes. The court also rejected the taxpayer's argument that a general fiduciary duty of loyalty prevented the decedent from exercising the power for his personal benefit. Recognizing the general rule that fiduciaries may not benefit from their positions, the court nevertheless stated that the general rule is inapplicable when the trust instrument empowers the trustees to benefit themselves, as in *Fruehauf*.<sup>112</sup>

The Sixth Circuit's opinion in *Fruehauf* appropriately rejected a broad *per se* rule in favor of case-by-case analysis of specific facts.

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inclusion where the settlor-trustee merely retained purely administrative powers. Berall, *Use of Life Insurance in Estate Planning—Recent Developments*, 1973 N.Y.U. 31st INST. FED. TAX. 1053, 1070.

108. 427 F.2d at 83.

109. *Id.* at 84 (citing *Porter v. Commissioner*, 288 U.S. 436 (1933); and *Commissioner v. Chase Nat'l Bank*, 82 F.2d 157, 158 (2d Cir. 1936)).

110. *Id.* (citing *Estate of Newcomb Carlton*, 34 T.C. 988 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962) (trust); and *Estate of Bert L. Fuchs*, 47 T.C. 199 (1966) (partnership purchase agreement creating fiduciary relationship)).

111. *Id.* at 85.

112. *Id.* at 86 (citing, *inter alia*, G.G. BOGERT, *TRUSTS AND TRUSTEES* § 129 (2d ed. 1965); 2 A. SCOTT, *SCOTT ON TRUSTS* §§ 170.23, 170.9 (3d ed. 1967)).

Further, the court correctly rejected the analogy to section 2038 cases: the statutory language of the sections is materially different; the legislative history of section 2042 suggests only that life insurance should be treated like other property, not that section 2042 is to be interpreted like the other estate tax sections; and neither the statute nor legislative history indicates that the two sections are to be construed in *pari materia*. The court properly looked at the degree of control legally exercisable in light of fiduciary restrictions, without regard to the taxpayer's physical power to exercise that control for his economic benefit. The court erred, however, in considering the source of the decedent's power. The decedent's status as transferee or transferor is irrelevant under the language of the statute,<sup>113</sup> which imposes a tax whenever a person dies possessing an incident of ownership, regardless of how or why he acquired possession. The source of the power of ownership is also irrelevant under the constitutional rationale set out in *Chase*: the taxable event occurs when death terminates the decedent's power over the property and completes the transfer of benefit to the beneficiary. As long as the decedent possessed such a power, his death has this consequence regardless of how he acquired the power.

The issue raised in *Fruehauf* was presented again under slightly different facts in *Estate of Skifter v. Commissioner*.<sup>114</sup> The decedent in *Skifter* purchased policies on his own life but assigned all interest in the policies to his wife. She predeceased him and created a testamentary trust naming him trustee. The trust instrument gave the decedent broad powers to ignore his general fiduciary duty to balance the remainder and income beneficiary interests and instead to pay the entire corpus to the income beneficiary if he chose. Unlike the trust in *Fruehauf*, however, none of the powers could be exercised for the decedent's personal benefit, and he had no interest in the trust income or corpus.<sup>115</sup> The Tax Court discussed the legislative history of section 2042 and Congress' intent to treat life insurance not as inherently testamentary but like all other property; the court emphasized that Congress had chosen this scheme with the knowledge that it would result in substantial reduction of federal revenues.<sup>116</sup> The court felt that the concurring

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113. See I.R.C. § 2042, quoted in note 1 *supra*.

114. 56 T.C. 1190 (1971), *aff'd*, 468 F.2d 688 (2d Cir. 1972). See generally 40 BROOKLYN L. REV. 1471 (1974); 39 MO. L. REV. 258 (1974).

115. 56 T.C. at 1190-95. See text accompanying notes 100-01 *supra*.

116. 56 T.C. at 1196 (citing S. REP. NO. 1622, 83d Cong., 2d Sess. 124 (1954)).

opinion in *Fruehauf* was inapplicable because no potential for self benefit was present in *Skifter*.<sup>117</sup> The Commissioner argued that the case was governed by Regulation 20.2042-1(c)(4):

A decedent is considered to have an "incident of ownership" in an insurance policy on his life held in trust if, under the terms of the policy the decedent (either alone or in conjunction with another person or persons) has the power (as trustee or otherwise) to change the beneficial ownership in the policy or its proceeds, or the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust.<sup>118</sup>

The Tax Court, however, maintained that to reconcile 20.2042-1(c)(2)<sup>119</sup> with 20.2042-1(c)(4), and with the legislative history of section 2042, Regulation 20.2042-1(c)(4) must be construed to apply only to transfers of property by the decedent with reservation of powers by the transferor.<sup>120</sup> Thus, the court suggested that when, as in *Fruehauf*, the decedent's trustee powers were not reserved by him when he transferred property to a trust but merely transferred to him by his wife, Regulation 20.2042-1(c)(4) does not apply and the proceeds are excluded.

The Second Circuit Court of Appeals affirmed the exclusion of the life insurance proceeds in *Skifter*.<sup>121</sup> The court reasoned that the "reference point" of the regulations was the right to economic benefits, and that *Skifter* had no such right.<sup>122</sup> The Second Circuit also accepted the Tax Court's distinction of Regulation 20.2042-1(c)(4), interpreting the legislative history, the elimination of the premium payments test, and the introduction of the incidents of ownership test as evidence of Congress' intent that the treatment of insurance under section 2042 parallel its treatment under other estate tax sections, particularly sections 2036, 2037, 2038, and 2041.<sup>123</sup> Applying these principles to the facts of *Skifter*, the court considered the result that would be reached under

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117. *Id.* at 1197 (citing, *inter alia*, Estate of Bert L. Fuchs, 47 T.C. 199 (1966) and Estate of Newcomb Carlton, 34 T.C. 988 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962)).

118. Treas. Reg. § 20.2042-1(c)(4) (1974).

119. See notes 54 & 55 *supra* and accompanying text.

120. 56 T.C. at 1198.

121. 468 F.2d 699 (2d Cir. 1972).

122. *Id.* at 701-02 (citing Treas. Reg. § 20.2042-1(c)(2) (1954)).

123. *Id.* at 702. I.R.C. § 2036 taxes transfers with a retained life estate (*see* note 84 *supra*); § 2037 taxes transfers taking effect at death; § 2038 taxes revocable transfers (*see* note 82 *supra*); and § 2041 taxes powers of appointment.

those other sections. The court determined that if *Skifter* had possessed a power exercisable for his own benefit or the benefit of someone he selected, his power would be equivalent to a power of appointment that would require inclusion of non-insurance property under section 2041.<sup>124</sup> The decedent in *Skifter*, however, had no such power. Furthermore, the decedent had no power that would justify inclusion of non-insurance property under either sections 2036 or 2038: Section 2036 applies only to retained powers; and section 2038, despite statutory language suggesting a contrary result,<sup>125</sup> is inapplicable to powers created after the decedent has divested himself of all rights in the property.<sup>126</sup> Because no other section of the estate tax would require inclusion of non-insurance property, the court concluded that the result in *Skifter* should not be different merely because the property consisted of life insurance.

Although the result reached by the Second Circuit in *Skifter* may be proper, the court's analysis was faulty. As noted above, section 2042 should not be construed to tax only insurance property that would be taxed under one of the other estate tax sections if it were not life insurance; Congress intended to treat life insurance like other property, not to ensure that section 2042 is applied like other estate tax sections.<sup>127</sup> Furthermore, even if the court's dictum that section 2038 applies only to powers created by the transferor is correct, section 2042 taxes life insurance whenever the decedent possessed incidents of ownership at death regardless of who created the incident or how the decedent acquired it. The court strained to accept the Tax Court's distinction of Regulation 20.2042-1(c)(4); the Regulation explicitly states that a decedent is to be treated as possessing an incident of ownership over a policy held in trust if he has the power, as trustee or otherwise, to change the beneficial ownership or the time of payment, regardless of whether he has any beneficial interest in the trust itself.<sup>128</sup> Nothing in the Regulation limits its application to powers reserved by the decedent as transferor. Instead, the court should probably have invalidated the

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124. 468 F.2d at 703. See also *Survey of 1974 Federal Estate & Gift Tax Developments*, 32 WASH. & LEE L. REV. 1017, 1063 (1975).

125. See note 82 *supra*.

126. 468 F.2d at 703. In *Estate of Reed v. United States*, 75-1 U.S. Tax Cas. 87,477 (M.D. Fla. 1975), the court accepted the argument that § 2038 applies solely to retained powers. Surprisingly, the Commissioner has not appealed this decision.

127. See notes 47-49 *supra* and accompanying text.

128. Treas. Reg. § 20.2042-1(c)(4) (1974), *quoted in text* accompanying note 118 *supra*.

Regulation as contrary to the Supreme Court's definition of an incident of ownership as "a general, legal power to exercise ownership." A decedent who holds such power in a fiduciary capacity may be disabled from exercising "ownership," as that term is defined in *Chase*,<sup>129</sup> by his fiduciary duty. If the decedent's only "ownership" power is held in a fiduciary capacity, it is questionable whether his death completes any transfer and gives rise to a constitutionally taxable event. Given the facts of *Skifter*, the court may have decided correctly that the decedent's fiduciary duty, absent a contrary expression in the trust instrument, prevented his exercise of any ownership power. The provision of the trust agreement granting decedent express power to prefer the income beneficiary to the remainderman without regard to the general fiduciary duty, however, suggests that *Skifter* may have been a proper case for taxation. That determination would properly depend on a detailed analysis of the trust instrument and the trustees' powers.

One year after the Second Circuit's decision in *Skifter*, the Fifth Circuit Court of Appeals decided *Estate of Lumpkin v. Commissioner*,<sup>130</sup> which did not involve a trust. The court relied on analogies to cases under sections 2038 and 2036, and held that the right to alter the time and manner of enjoyment of life insurance proceeds constituted an incident of ownership. The court stated without discussion that section 2038 applies only to retained powers, and found that the sole difference between sections 2036, 2038, and 2042 was that the two former provisions require retention of a power while section 2042 permits inclusion whenever the decedent possesses an incident of ownership at death, regardless of the source of such power.<sup>131</sup> Although the court recognized in a footnote that *Skifter* and *Fruehauf* take a contrary position,<sup>132</sup> the Fifth Circuit maintained that whether the decedent was transferor to himself, or merely transferee, was irrelevant.

Following the *Lumpkin* decision, the specific issue presented in *Fruehauf* and *Skifter* arose in the Fifth Circuit on slightly different facts. Unlike cases in which the decedent acquired powers over life insurance policies on his life from his wife, in *Rose v. United States*<sup>133</sup> the de-

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129. See notes 22-26 *supra* and accompanying text.

130. 474 F.2d 1092 (5th Cir. 1973). See notes 78-86 *supra* and accompanying text.

131. 474 F.2d at 1097.

132. *Id.* at n.18.

133. 33 Am. Fed. Tax R.2d 74-1413 (E.D. La. 1973), *aff'd*, 511 F.2d 259 (5th Cir. 1975). See generally 43 J. Tax. 49 (1975); 7 ST. MARY'S L.J. 621 (1975).

cedent's brother had created three irrevocable trusts naming decedent as trustee. Decedent used trust funds to purchase policies on his own life, naming his children as beneficiaries after they reached age 18, and he could convert the policies from whole life to either limited payment or endowment insurance. The policies themselves also granted the decedent some powers; he could, for example, obtain a loan from the insurer on the policy, and withdraw dividends.

The Eastern District of Louisiana held that the policy proceeds were includible in the decedent's gross estate, reasoning that the power to alter the time and manner of enjoyment of the proceeds through exercise of the right to withdraw dividends, obtain loans, or convert the policies was an incident of ownership under the *Lumpkin* analysis.<sup>134</sup> Because *Lumpkin* controlled the incident of ownership question, the sole issue before the court was whether the trustee capacity sufficiently restricted that incident of ownership to prevent inclusion. The court felt that this question, too, was controlled by *Lumpkin*, because the Fifth Circuit had stated that neither the manner in which decedent acquired the incidents of ownership nor the capacity in which they could be exercised were material.<sup>135</sup> The court recognized that *Fruehauf* and *Skifter* held to the contrary, but considered itself bound by the *Lumpkin* decision.<sup>136</sup>

The Fifth Circuit affirmed the lower court's inclusion of the policy proceeds in the decedent's estate,<sup>137</sup> reiterating that *Lumpkin* had established that a power to alter the time or manner of enjoyment constitutes an incident of ownership. The court also agreed with the decision in *Lumpkin* and *Skifter* to interpret section 2042 so that life insurance receives parallel treatment to that accorded other property under sections 2036, 2037, 2038, and 2041. The court went a step further, however, and explicitly stated that the decedent's status as trustee, not present in *Lumpkin*, did not prevent application of the *Lumpkin* rule: a power to alter the time or manner of enjoyment of policy proceeds is an incident of ownership whether or not the exercise of such power is subject to fiduciary restraints.<sup>138</sup> The court noted that the Sixth Circuit drew the opposite conclusion in *Fruehauf*, but reasoned that the mere existence of a fiduciary capacity does not automatically deprive the exer-

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134. 33 Am. Fed. Tax R.2d at 74-1415.

135. *Id.*

136. *Id.*

137. 511 F.2d 259 (5th Cir. 1975).

138. *Id.* at 262.

cisable control of the substantiality required for inclusion under section 2042. The taxpayer contended that because his fiduciary capacity prevented the decedent from obtaining economic benefit from his powers, he did not have "substantial control" meriting taxation.<sup>139</sup> Rejecting this argument, the court noted that non-economic benefits are also taxable under the Regulation,<sup>140</sup> and concluded that 20.2042-1(c)(4)<sup>141</sup> applied. Applying 20.2042-1(c)(4) to the facts of *Rose*, the Fifth Circuit expressly rejected the *Skifter* conclusion that 20.2042-1(c)(4) applies only to "reservations of powers by the transferor as trustee,"<sup>142</sup> and ruled that sections 2036 and 2038 apply only to retained powers but that section 2042 applies to all incidents of ownership, whether retained or after-acquired.<sup>143</sup> Thus, while the court agreed that section 2042 should be construed so that life insurance is taxed in a manner paralleling the estate taxation of other forms of property, it recognized intentional and cognizable differences in the three sections' treatment of different forms of property.<sup>144</sup>

Substantially the same issue reappeared in the Fifth Circuit in *Terrberry v. United States*.<sup>145</sup> The decedent's wife created a revocable trust composed of insurance policies on decedent's life. Decedent was made co-trustee solely because Florida law did not permit the grantor-wife to create a revocable trust naming herself sole grantor, trustee, and beneficiary. In light of fluctuations in the estate taxation of life insurance, however, the trust instrument specifically prohibited the decedent from exercising in his individual capacity any of the incidents of ownership he held as trustee. The grantor also retained sole power to alter, amend, or revoke the trust and to remove the decedent-insured as co-trustee.

The taxpayer paid the estate tax assessed by the Commissioner, including the tax on the insurance policies, and sued for a refund in the Middle District of Florida. In an opinion rendered after the district court decision but prior to the Fifth Circuit's decision in *Rose*, the district court excluded the insurance proceeds from the decedent's es-

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139. *Id.* at 263.

140. Treas. Reg. § 20.2042-1(c)(2) (1974). See notes 54-56 *supra* and accompanying text.

141. Treas. Reg. § 20.2042-1(c)(4) (1974). See notes 118-20 *supra* and accompanying text.

142. 511 F.2d at 265.

143. *Id.*

144. *Id.* at 266.

145. 74-2 U.S. Tax Cas. 85,759 (M.D. Fla. 1974), *rev'd*, 517 F.2d 286 (5th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976).

tate.<sup>146</sup> The court adopted the *Fruehauf* and *Skifter* rule, distinguishing *Lumpkin* and the district court opinion in *Rose*. The court interpreted Regulation 20.2042-1(c)(4) to apply only to transferor-created incidents of ownership, and distinguished *Lumpkin* as not involving ownership held in a fiduciary capacity.<sup>147</sup> Although *Rose* involved a fiduciary capacity, the district court distinguished it because the decedent in *Rose* acted as sole trustee whereas the decedent in *Terriberry* acted only as co-trustee. Further, and perhaps more importantly, *Rose* involved an irrevocable trust whereas in *Terriberry* the trust was revocable; thus, the decedent's power was wholly ephemeral and the property had been fully taxed in the wife's estate.<sup>148</sup>

The Fifth Circuit heard the case on appeal after its decision in *Rose*. Considering itself bound by that decision, it reversed the district court and included the proceeds in the decedent's gross estate.<sup>149</sup> The court stated that *Lumpkin* established that a power to alter the time or manner of enjoyment was an incident of ownership; *Rose* established that an insured who transferred that power to himself as trustee nevertheless retained an incident of ownership; and the fact that a third party was the trust grantor did not dictate a different result.<sup>150</sup> One judge dissented on the basis of the district court opinion.<sup>151</sup>

The Fifth Circuit's analysis in *Rose* and *Terriberry* was erroneous. The court improperly ignored both the effect of capacity on "the general legal power to exercise ownership"<sup>152</sup> and the specific facts that affected the degree of control exercisable by the decedent. The court was correct to refuse to treat life insurance under section 2042 as other property is treated under other estate tax sections, due to discernible and intentional differences in treatment. Likewise, the court correctly rejected the taxpayer's argument that section 2042 should be interpreted to apply only to decedent-created incidents and not to incidents held only as transferee. In determining how life insurance should be treated, however, the court ignored the effect of the capacity

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146. *Id.* See generally 28 TAX LAW. 607 (1975).

147. 74-2 U.S. Tax Cas. at 85,761-62.

148. The court noted that the wife would pay income tax on the trust property under §§ 677(a) and 673(a) and estate tax under § 2038. *Id.* at 85,762.

149. 517 F.2d 286 (5th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976).

150. 517 F.2d at 289.

151. 517 F.2d at 290.

152. *Commissioner v. Estate of Noel*, 380 U.S. 678, 684 (1965). See notes 66-70 *supra* and accompanying text.

in which an incident of ownership is held upon the taxability of that power as an incident of ownership.

#### IV. CONCLUSION

Because the Supreme Court denied certiorari in *Terriberry*,<sup>153</sup> the current conflict among the circuits over the taxation of incidents of ownership held in a fiduciary capacity is likely to continue. Estate planning requires certainty and predictability, but for the immediate future only uncertainty is certain. The best estate planning advice to an insured client who wishes to avoid tax on insurance proceeds, therefore, is to avoid being named as trustee of any trust containing insurance policies on his life.

When a decedent-insured has not planned so carefully, however, courts considering the taxability of incidents of ownership held in a fiduciary capacity should look at the specific facts of each case, including the precise terms of the trust instrument. Though the source of the powers the decedent possessed at death is irrelevant, the degree of ownership exercisable through those powers must be considered.<sup>154</sup> In any such consideration the capacity in which the powers are exercisable, including restraints such as the fiduciary's duty of loyalty, must be given appropriate weight.

The Supreme Court's denial of certiorari in *Terriberry* means that, at least in the Fifth Circuit, courts will not consider capacity. This is undesirable, but Congress is the only body with power to alter the situation unless the Supreme Court hears another case with similar facts. Congress should reconsider the statute and make its intent regarding the estate taxation of life insurance more clear. The legislature should spell out the ways in which life insurance is to be treated like other property: whether the section taxing life insurance is to be construed similarly to sections taxing other forms of property; whether life insurance is to be taxed only when the incidents of ownership are created by the transferor and not merely by a transferee of the policy, as in other sections; and whether the capacity in which an incident is held should affect taxability. Consistent with court interpretations of the statute and the constitutional basis of the estate tax, Congress should consider the decedent's

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153. 517 F.2d 286 (5th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976).

154. *But see Note, Federal Estate Tax: Application of the Section 2042 Incidents of Ownership Concept to the Insured Fiduciary's Estate*, 60 IOWA L. REV. 1319 (1975).

power in light of any restraints on its exercise, but ought not to weigh the source of the power when considering whether to include the property in the decedent's gross estate. The legislature should speak to this issue, affirming or rejecting the courts' analysis, but in any event stating a clear, certain, and predictable test for taxation when the decedent-insured's powers are only fiduciary.