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LIFE INSURANCE: INCIDENTS OF OWNERSHIP AND ECONOMIC BENEFIT

RICHARD C. GROLL*

WHILE CONGRESS has been faced over the years with the task of taxing intricately complicated business schemes, corporate organizations and sophisticated tax avoidance devices and done reasonably well, it faces the continual problem of appropriately taxing life insurance proceeds. The problem of the appropriate estate taxation of life insurance proceeds commands, with reasonable justification, a position of deep concern. While most taxpayers can look with curious delight at the machinations of highly paid tax counsel in working out tax avoidance or tax reduction schemes for those in the highest wealth brackets, life insurance is an asset owned by the bulk of American citizens.¹ On this basis, life insurance occupies a position of diverse concern, and because of the dollar magnitude of its acceptance, the Treasury carefully scrutinizes the taxation of the proceeds.

Generally, one purchases a policy of insurance on his own life for the purpose of providing a fund of money to pass at his death to the objects of his bounty. The primary goal to be accomplished by the purchase and maintenance of such a contract is the creation of this fund and its passing at death. Since 1954 and the repeal of the premium payment test,² life insurance has become increasingly more popular as an estate planning tool because the insured can provide for the objects of his bounty and with comparative ease prevent estate tax liability.

CURRENT ESTATE TAX PROVISION

The current provision for the estate taxation of life insurance proceeds categorizes such proceeds as (a) those payable to the estate of the insured, and (b) those payable to named beneficiaries other than

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¹ KILSEY & DANIELS, *LIFE INSURANCE* (2d ed. 1964); in 1962, 65% of the American population owned more than \$675.9 billion in life insurance protection.

² GROLL, *Some Federal Tax Aspects of Life Insurance*, 15 DE PAUL L. REV. 48 (1965).

the estate.³ Insurance proceeds paid to the estate of the insured are fully taxable, but with regard to the proceeds payable to beneficiaries other than the insured's estate, the sole test for estate tax includability is whether the insured possessed at his death any incidents of ownership under the policy. If the insured possessed any of the incidents exercisable alone or in conjunction with any other person, the proceeds are includible in his gross estate for estate tax purposes.

The Regulations provide that the phrase "incidents of ownership" is not limited in application to ownership of the insurance contract in the technical property law sense; it has reference to the right of the insured to the economic benefit of the contract. According to the Regulations, the phrase 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.]"⁴

While the incidents of ownership test, as set forth in section 2042, may appear to be straightforward, it is deceptively complex when applied to the insurance arrangements currently in vogue. In this regard, concern has been expressed as to the true scope of the section,⁵ and it appears that this concern properly centers on the question of whether the phrase "incidents of ownership" is genuinely synonymous with the notion of economic ownership. The Regulations appear to indicate that the current estate tax treatment of life insurance proceeds was designed to make such proceeds subject to liability when the insurance policy was in fact, if not in law, an asset of the insured at the time of his death.⁶ This position is substantiated by the 1954 Senate Report, which preceeded the repeal of the premium payment test and the enactment of the current provision; the Report stated the matter as follows:

³ INTERNAL REVENUE CODE OF 1954, § 2042: "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."

⁴ Treasury Reg. § 20.2042-1(c) (2) (1958).

⁵ See Seeley & Locke, *Estate Planning with Employee Group Term Life Insurance*, 52 A.B.A.J. 485 (1966).

⁶ *Supra* note 4.

The proceeds of life insurance on a decedent are subject to tax in his estate under present law if the policy is payable to the executor, if the decedent paid the premiums on the policy (in this case includible in proportion to the amount paid), or if the decedent possessed any element of ownership in the policy at date of death. 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 and to discriminate against life insurance in this regard is not justified.⁷

POWER CONCEPT

While there may be support for classifying the test for estate tax liability of life insurance proceeds as involving a determination of economic ownership, question has been generated as to whether the magical phrase "incidents of ownership" sets down a broader standard. The question presented: Will insurance proceeds be included within the scope of section 2042 when the insured had a power to effect the distribution of the policy proceeds, but did not have economic benefits?

The First Circuit Court of Appeals in *United States v. Rhode Island Hospital Trust Company*⁸ discussed at some length the scope of the phrase "incidents of ownership." While the decision can hardly be described as a landmark, it is worthy of inquiry since the Treasury apparently conceded that the decedent insured possessed no economic benefit in the policy,⁹ and yet the court found the proceeds subject to estate tax liability under section 2042.

Charles A. Horton and his wife, Louise, had two sons—Holton W. Horton and A. Trowbridge Horton. In 1924, when Holton was 18 years old and Trowbridge was 19 years old, their father purchased a policy of life insurance in the face amount of \$50,000 on the life of each son. The death proceeds of each policy were payable to Charles and Louise, equally, or to the survivor of them. The avowed purpose of Charles' purchase of the insurance "was to assure that funds would be available for his wife, should he and either son die."¹⁰

Focusing on that policy issued on the life of Holton, Charles kept it in his safety deposit box and paid all premiums throughout his life. In January, 1952, Louise Horton died. Some two months after the death of Louise, Charles instructed Holton to go to the office of the insurance company and execute a change of beneficiary form. The amendment, executed by Holton, named Charles as primary beneficiary, Holton's wife and brother as successive beneficiaries, and the estate of

⁷ S. REP. NO. 1622, 83rd Cong., 2 Sess. 472 (1954).

⁹ *Id.* at 9.

⁸ 355 F.2d 7 (1st Cir. 1966).

¹⁰ *Id.* at 8.

the survivor as final beneficiary. Holton Horton died April 1, 1958, survived by his wife and father; Charles Horton died October 2, 1961.

In dealing with this fact situation, the District Court discussed the facts at length and pronounced that Horton, the decedent insured, did not possess any of the incidents of ownership in the policy and for estate tax purposes the proceeds were not includible in his gross estate.¹¹ At trial, Trowbridge Horton testified that while he and his late brother were students at preparatory school, his father purchased the policies, and "we did not recognize that we became the owners of those policies."¹² The court summarized the facts relevant to concluding that the insured, Holton, did not possess the requisite incidents of ownership by saying:

[H]e had his two sons execute applications for policies that were subsequently issued on their respective lives; that he paid the initial and all subsequent premiums thereon, retained the policies and that the sons saw said policies on only one occasion, prior to the death of Holton W. Horton; that there was no discussion between him and his sons about said policies until 1952 when his wife died. . . .¹³

The District Court concluded that the proceeds of the insurance policy on Holton's life were not includible in his gross estate, even though the policy provided, among other things, that: the right to change the beneficiary was reserved to Holton, the insured; the insured, Holton, had the option of disposing of policy dividends during his lifetime; the insurer could make a loan on the policy on the signature of Holton alone; if no beneficiary survived the insured, the proceeds were payable to his estate; and that by virtue of the policy the insured was a member of the company and was entitled to certain voting privileges.

Upon rendition of the decision of the District Court, the government appealed, and the Court of Appeals reversed.¹⁴ While the reversal was clearly in order, it is curious that the court failed to find that Holton was the economic owner of the policy. In reversing, the court indicated that Congress had not limited the scope of section 2042 to questions of technical ownership, but was attempting to include within the breadth of the section the "power" possessed by an insured, to effect the disposition of the policy proceeds; the court said:

First, it is clear that the reference to ownership in the "technical legal sense" is not abandoned and supplanted by reference to "economic benefits." Second,

¹¹ 241 F.Supp. 586 (D.C. R.I. 1965).

¹³ *Id.* at 589.

¹² *Id.* at 588.

¹⁴ *Supra* note 8.

the regulation goes on to list illustrative powers referred to by Congress in its reports. All of these powers which may or may not enrich decedent's estate, but which can affect the transfer of the policy proceeds.¹⁵

This language of the Court of Appeals sets forth the basic notion that if ownership of the insurance contract, in the technical property sense, is established, then nothing else need be shown for the proceeds to be includible for estate tax purposes. There can be little controversy with the court's position; if the insured has technical ownership, even if he does not choose to utilize the asset for his own benefit or to benefit his estate, he still has the right of utilization, and therefore, at death the product of that asset (i.e., the death proceeds) should be numbered in his gross estate for estate tax purposes.

This basic notion could have been applied to resolve the instant case. Since Holton, the insured, was the policy owner and possessed almost every conceivable contract right, the policy of life insurance should be considered one of his assets, and the proceeds of the policy of life insurance should be subject to estate tax liability.¹⁶ This result should follow simply from the application of this basic ownership notion, even though Holton might have felt morally obligated not to utilize the asset for his own benefit during his lifetime or to benefit his estate or creditors at death.¹⁷ The court, however, went beyond the application of the ownership test in resolving the controversy; the court discussed at least indirectly the situation where the decedent insured possesses one or more contract rights, but does not have technical ownership of the insurance policy.¹⁸ The court expressed the concept that the proceeds of a life insurance contract will be estate tax includible where the decedent insured, though not the owner, possessed a power "which can affect the transfer of the policy proceeds."¹⁹

DIVESTMENT OF BENEFIT BUT NOT POWER

While the scope of section 2042 is not limited to the technical property ownership of insurance contracts, the general tenor of the Regulations²⁰ and the Congressional reports,²¹ which preceded enactment of the incidents of ownership test, indicate an intention that economic benefit be the taxing criterion. The court, in *Rhode Island*,

¹⁵ *Id.* at 11.

¹⁶ *Id.* at 9.

¹⁷ *Id.* at 8.

¹⁸ *Supra* note 4 and corresponding text.

¹⁹ *Supra* note 15.

²⁰ *Supra* note 4 and corresponding text.

²¹ *Supra* note 7. Also, H.R. REP. NO. 2333, 77th Cong., 2d Sess. 163 (1942) and S. REP. NO. 1631, 77th Cong., 2d Sess. 235 (1942).

has touched upon the concept that the scope of section 2042 does include the taxation of a power and is not limited to the economic benefit standard.

Consider the following fact situation: A purchases a policy of insurance on the life of B; A reserves all contract rights under the policy and names himself beneficiary of the death proceeds. Suppose, however, that A subsequently grants to B the right to change the beneficiary. Of all the contract rights, there is probably more authority for classifying the right to change the beneficiary as an incident of ownership under section 2042 than any other right.²² Therefore, upon B's death, the proceeds would be included in his gross estate for estate tax purposes. In this connection, it should be remembered that an incident of ownership need only be possessed in order to include the death proceeds of a policy of life insurance; the word retained is not used in the section.²³

Suppose the situation is complicated by the addition of one small fact: even though B, the insured, has the right to change the beneficiary, he does not have the right to name either himself, his creditors, or his estate as beneficiary. By the addition of this fact, we are faced with a genuine test of whether section 2042 does indeed tax a power over proceed distribution in the absence of economic benefit. By the reasoning set forth by the Court of Appeals in *Rhode Island*, the death proceeds should be subject to estate tax liability, since the insured possesses the right to effect the transfer of the death proceeds.²⁴ The question may be asked: Where is the economic benefit? If economic benefit is the criterion, then the proceeds should escape estate tax liability.

INCIDENTS OF OWNERSHIP

The above hypothetical might be compared to the situation where the power to change a beneficiary is the sole incident of ownership possessed by an insured, and such power is lost. In the latter case, the proceeds should become free of estate tax liability under section 2042. An insured may rid himself of this incident of ownership by making an irrevocable designation of the beneficiary.²⁵ Such irrevocable designation has been held sufficient even where the irrevocably designated

²² For a collection of cases see: LOUNDES & KRAMER, *FEDERAL ESTATE & GIFT TAXES* (2d ed. 1962) at 280 n. 34.

²³ *Supra* note 3.

²⁴ *Supra* note 15 and corresponding text.

²⁵ Estate of Michael Collino, 25 T.C. 1026 (1956).

beneficiary owner gave the insured a right to designate a relative to receive one-half the proceeds. In *Estate of John C. Morrow*,²⁶ the decedent's employer purchased an insurance policy on his life in the face amount of \$10,000. The insurance policy provided that the death proceeds should be paid to the employer "for its sole benefit with the right to exercise any options herein, and to receive all payments of whatsoever nature that may become due without the consent of the insured."²⁷ The decedent insured had no right to change the beneficiary, and the employer paid all policy premiums.

Before death, the decedent was notified by his employer that it was its purpose "in the event of your [decedent's] death to pay one-half of the proceeds of the insurance to your family."²⁸ The decedent was requested to designate a family member to receive the \$5,000 payment, and the decedent designated his wife. The decedent's wife predeceased him, and upon her death, he wrote to his employer requesting that his daughter replace his deceased wife as recipient of the payment; the request was granted.

The Commissioner contended that the \$5,000 death payment should be included in the decedent's gross estate as proceeds of a life insurance contract over which the decedent possessed incidents of ownership within the scope of section 811(g).²⁹ Even though the decedent apparently could control the designation of the recipient, the court concluded that he possessed no incidents of ownership in the involved policy. In reaching this result, the court took note of the fact that the decedent was not the owner of his corporate employer,³⁰ and it is asserted that the inarticulated controlling factor was the absence of economic benefit in the decedent.

The question presented is whether the cases interpreting the magical phrase "incidents of ownership" have expanded the taxing scope to include more than economic benefit. One often cited case is *Commissioner v. Treganowan*,³¹ in this case, question arose as to a \$20,000 payment made to certain members of the decedent's family by reason of his death. The decedent had been a member of the New York Stock Exchange, and its constitution provided for a "Gratuity Fund" from

²⁶ 19 T.C. 1068 (1953).

²⁷ *Id.* at 1069.

²⁸ *Ibid.*

²⁹ Internal Revenue Code of 1939, § 811(g), which provided for inclusion of life insurance proceeds where the decedent possessed incidents of ownership in the policies as similarly provided by section 2042 of the current Code, *supra* note 3.

³⁰ *Supra* note 26, at 1068, 1071.

³¹ 183 F.2d 288 (2d Cir. 1950).

which a death benefit would be made payable by virtue of the contributions of surviving members. The decedent had no right to designate, in any way, the recipient of this death benefit; the constitution of the Exchange prescribed the family members to receive the death payment.

While the executrix of the decedent's estate excluded the \$20,000 payment from the gross estate, the Commissioner sought inclusion on the grounds that (a) the death payment constituted the proceeds of life insurance, and (b) the decedent possessed certain powers with respect to the "Gratuity Fund" which constituted incidents of ownership within the application of section 811(g) of the 1939 Code.³² In dealing with this situation, the Tax Court³³ held that the death payment was not life insurance, since no insurance risk was presented;³⁴ upon review, however, the Court of Appeals held that the plan contained the essential elements of life insurance, since the risk of death was shifted to, or diffused among, a group of people. Once concluding that the benefit constituted life insurance, the court went on to determine that the decedent did possess the requisite incidents of ownership, and found the payment to be subject to estate tax liability.

In finding that the decedent did possess the requisite incidents of ownership so as to include the policy proceeds within his taxable gross estate, the court seized upon the fact that the decedent could sell his Exchange seat, and thereby cancel the policy and the beneficial interests created in favor of his family members.³⁵ On this basis, this case might be cited in support of the proposition that the incidents of ownership test does include the taxation of the power to effect distribution of the policy proceeds; however, the court put the matter as follows:

An Exchange member does have the power to sell his seat, thus divesting his beneficiary of any right to payments, and entitling the purchaser to the same insurance which the seller has had. This power to cancel one's own engagement and substitute another seems to us an incident of ownership, within the statutory meaning. The purchase price of a seat on the Exchange is necessarily the sum of the value of the bundle of rights which such a seat comprises. One of these rights is that of having the sum of \$20,000 paid to his family upon a member's death. Thus the seller receives a cash consideration, however difficult to evaluate, for terminating this insurance. It seems impossible to distinguish this consideration from the surrender value paid upon cancellation of an old line . . . policy.³⁶

³² *Supra* note 29.

³³ Estate of Strauss, 13 T.C. 159 (1949).

³⁴ Groll, *supra* note 2, at 79.

³⁵ *Supra* note 4 and corresponding text.

³⁶ 183 F.2d at 292-93.

Thus, it would appear that the court found that the decedent insured possessed incidents of ownership based on his right to secure an economic benefit from the "Gratuity Fund." Tax liability for the \$20,000 death payment followed since, in the court's view, the decedent possessed the power to sell the right to secure the death payment and such sale monetarily would benefit the decedent. The result did not follow from the mere fact of possession of a power to terminate or cancel the right to receive the payment. It seems justified to conclude that in each case, the courts have been looking to see whether the insured had the economic benefit of the involved policy of life insurance, though he does not have technical legal ownership. The approach has not been the taxation of a power, in the absence of economic benefit.

While the courts have found inclusion of policy proceeds where the insured held indirect control over the contract of insurance, they have denied inclusion where the insured possessed the right to give investment advice to a trustee of an insurance trust. In *Estate of Mudge*,³⁷ the decedent created an irrevocable trust for the benefit of his wife for life, and upon her death each of two sons was to receive one-half the trust income for his life with the corpus passing to such persons as the son might by will appoint. With respect to the management of the property, the trust instrument vested the trustee with certain discretionary powers but provided that "during the lifetime of [the Donor], shall follow any instructions he [the Donor] may give."³⁸

In weighing the estate tax liability of the insurance proceeds in light of the incidents of ownership test, the court discussed the power reserved to the decedent and stated: "This seems to us so clearly limited to investment advice and not to include any 'economic benefits' that we cannot construe it as, to any extent, an incident of ownership retained by decedent."³⁹ The court, thereby, concluded that since the decedent could not economically benefit from the retention of the right, he did not possess any incidents of ownership, even though his actions certainly could effect the beneficial interests. Similarly, in *Estate of Carlton*,⁴⁰ the court held that a veto power held by a decedent insured over changes of investments by a trustee of an insurance trust did not constitute an incident of ownership.

In exploring the economic benefit notion and the right to change the beneficiary: in cases prior to 1942, in which the insured could change

³⁷ 27 T.C. 188 (1956).

³⁸ *Id.* at 191.

³⁹ *Id.* at 193.

⁴⁰ 298 F.2d 415 (2d Cir. 1962).

the beneficiary only by securing the consent of the presently designated beneficiary, the requirement of securing consent was considered to have deprived the insured of this incident of ownership.⁴¹ In 1942, the Internal Revenue Code was modified, and it now provides that the proceeds of life insurance on the life of a decedent will be included in an estate tax computation if the decedent possessed incidents of ownership "either alone or in conjunction with any other person."⁴² In interpreting this added phrase, it has been held that a decedent possessed incidents of ownership in policies transferred to a trust which could be altered, amended, or revoked only upon the consent of the decedent insured, his wife, and daughter.⁴³ This change has caused an expansion of the estate taxation of life insurance proceeds, and estate tax liability should follow where an insured can change the beneficiary only upon securing the approval of the present beneficiary or where an insured's approval is necessary before a change of beneficiary can take place.

In *Goldstein's Estate*,⁴⁴ the named beneficiary was given every conceivable contract right under the policy of life insurance, including the right to change the beneficiary; however, no change of beneficiary was allowed unless the consent of the insured was granted. In weighing the taxability of the insurance proceeds in the estate of the insured in light of the added language of the taxing provision, the court held the proceeds liable to taxation, and stated:

To say that his control was "negative" or in the nature of a veto power does not diminish its effectiveness as an incident of ownership. It was, during his life, exactly equivalent to the control of the named beneficiary. Neither could act without the concurrence of the other.⁴⁵

While it may be more difficult to state that the insured, in *Goldstein*, possessed economic benefits in the policy, it can reasonably be argued that by or through his action the insured can secure benefits from the contract (i.e., he has not placed the policy beyond his control as to securing benefits for himself). If, however, one concludes that the added phrase "in conjunction with another" can bring about tax liability in instances where economic benefit is absent, this conclusion

⁴¹ *Pennsylvania Co. for Insurances on Lives & Granting Annuities, Ex'rs v. Comm'r.*, 79 F.2d 295 (3rd Cir. 1935), *cert. denied*, 296 U.S. 651 (1935).

⁴² *Supra* note 7.

⁴³ *Estate of Karagheusian*, 233 F.2d 197 (2d Cir. 1956).

⁴⁴ 129 Ct. Cl. 264, 122 F.Supp. 677 (1954), *cert. denied*, 348 U.S. 942 (1955).

⁴⁵ 122 F.Supp. at 678.

should not interfere with the premise of this article that incidents of ownership should be defined as equivalent to economic benefit.

In a further attempt to define the scope of the taxing phrase "incidents of ownership," the Regulations specifically indicate that the Treasury contemplates inclusion of the proceeds of a policy where the policy is owned by a corporation of which the insured is the sole stockholder;⁴⁶ however, in *Estate of Knipp*,⁴⁷ it was held that ownership of a fifty percent share of a partnership by an insured does not constitute an incident of ownership over policies owned by the partnership entity. The court stated that the insured partner had no rights in the policy, except "those flowing from his partnership interest,"⁴⁸ and such rights were insufficient for estate tax inclusion under the incidents of ownership test. It is apparent that the insured in *Knipp* could exercise some degree of control affecting the distribution of policy proceeds; however, such control would be to benefit the partnership entity, the policy owner, and therefore, the court concluded that the proceeds escaped estate tax liability.

Clearly, Congress could have couched the language of section 2042 so as to tax the power as it has under sections of the Internal Revenue Code dealing with powers of appointment.⁴⁹ While the estate tax provisions relating to powers of appointment have gone from the mild to the severe to the moderate, a look at the taxing provisions under the 1942 Act is in order.⁵⁰ Under this provision, the exercise and non-exercise of a power of appointment was subject to estate taxation, and such powers were generally taxed even though the power be a special power.⁵¹

With certain exceptions, the 1942 Act put the property subject to a power of appointment, whether a general power or a special power, under the shadow of estate tax liability for inclusion in the donee's gross estate. While this rather extreme taxing provision has been

⁴⁶ Treasury Reg. § 20.2042-1(c)(2) (1958).

⁴⁷ 25 T.C. 153, *aff'd. on other grounds*, 244 F.2d 436 (4th Cir. 1957), *cert. denied*, 355 U.S. 827 (1957).

⁴⁸ 25 T.C. at 168.

⁴⁹ INTERNAL REVENUE CODE of 1954, § 2041.

⁵⁰ 403, Revenue Act of 1942, 56 Stat. 942 (1942).

⁵¹ 403, Revenue Act of 1942, excluded from tax liability such powers of appointment where the donee could only appoint to members of his immediate family or that of the donor or to a charity and powers which could be exercised by a fiduciary in favor of a restricted class of individuals. For a discussion see: LOUNDES & KRAMER, *supra* note 22, at 260.

altered, and by the terms of the current Code provision only general powers of appointment are subject to estate tax liability in the estate of the donee,⁵² the court in the *Rhode Island* case would, at least impliedly, draw analogy to section 2042. Referring to the enactment of the incidents of ownership test, that court said:

[I]t was not trying to tax the extent of the interest of the decedent. That it knew how to do this is evident, for example, from a reading of section 2033 . . . which includes in the gross estate of the decedent "the value of all property . . . to the extent therein. . ." What it was attempting to reach in section 2042 and some other sections was the power to dispose of property. . . .⁵³

CONCLUSION

It would be easiest to merely proffer the suggestion that the reasoning of the Court of Appeals in the *Rhode Island* case is error, and that the enactment of section 2042 demonstrates an intention that economic benefit should be the guiding principle in the estate tax liability of life insurance proceeds. While Congress did not limit the scope of section 2042 to mere ownership principles as under section 2033,⁵⁴ it did not grant the same breadth as was granted under section 403 of the 1942 Act, which taxed powers of appointment to the estate of the donee irrespective of economic benefit.

The Court of Appeals in *Rhode Island* was attempting to strike at the basic difference between the taxation of ownership interests under the application of section 2033 and the distinct provisions for the taxation of life insurance proceeds under section 2042. Contracts of life insurance are basically different from other assets, and therefore, warrant a special Code provision. While the Senate Report, which preceded the enactment of section 2042, sought to place the taxation of life insurance proceeds on the same basis as other assets,⁵⁵ the position was shattered by the minority report, which stated in part:

It is sought to justify this 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.⁵⁶

⁵² *Supra* note 50 and see: LOUNDES & KRAMER, *supra* note 22, at 261.

⁵³ *Supra* note 8, at 10.

⁵⁴ INTERNAL REVENUE CODE OF 1954, § 2033: "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."

⁵⁵ *Supra* note 7.

⁵⁶ H.R. REP. NO. 1337, 83rd Cong., 2d Sess., A316 (1954).

Since life insurance is deemed to be a distinctive type asset, it might be argued that section 2042 is not limited to legal ownership and economic benefit principles, but must be broader in application. However, the very thrust of the Regulations and the Congressional Reports indicates that an attempt was made to place the taxation of life insurance proceeds on a par with the taxation of other assets; the special provision was tailored to take cognizance of the difference in the nature of the life insurance contract only to the extent of including proceeds where the insured, though not the legal owner of the policy, did possess the economic benefit of ownership. Where economic benefit is missing, the proceeds should go untaxed.

If the phrase "incidents of ownership" is not defined to be synonymous with notions of economic benefit, but includes the power, possessed by an insured to effect distribution schemes of the policy proceeds, one can concoct realistic problems involving the definition and limit of this power concept. In this regard, serious question has arisen as to the scope of section 2042 and its application to group term insurance arrangements,⁵⁷ which might be touched upon here. The Treasury Regulations indicate that one incident of ownership is the right of the insured "to surrender or cancel the policy."⁵⁸ Consider the following situation where an insured does have the power to effect distribution schemes through an ability to cause cancellation of the policy, but does not have economic benefit in the contract of insurance.

First, A purchases a group term life insurance policy on his own life through his employer, naming B as beneficiary; such policy is subject to cancellation upon termination of employment. Assume further that A validly assigns the policy to B, and thereafter B possesses every conceivable contract right. A can work a cancellation of the policy by voluntarily terminating his employment. Does A, therefore, possess incidents of ownership sufficient to warrant inclusion of proceeds in his gross estate?

Second, A purchases a policy of life insurance on B's life and A names himself beneficiary. Assume further that A possesses every conceivable contract right, but B makes the premium payments. Suppose, subsequently, B stops paying the premiums; B's action in discontinuing the premium payments causes the cancellation of the policy. Does B hold the requisite incidents of ownership in the policy, because of his power to cause a cancellation?

⁵⁷ *Supra* note 5.

⁵⁸ *Supra* note 4 and corresponding text.

There has been suggestion that life insurance proceeds should be subject to broader estate tax liability than mere legal and economic ownership, since life insurance is inherently testamentary.⁵⁹ The purchase of life insurance on one's own life is generally made for the avowed purpose of providing for a fund of money to pass at death to the objects of one's bounty. Life insurance was devised and perpetuated in popularity as an effective mechanism for creating and maintaining this fund of money. The basic concept of life insurance is the accomplishment of this goal, and all other attributes are secondary in importance. Once concluding that life insurance is inherently testamentary, it is urged that it should receive the tax treatment consistent with this basic characteristic; the premium payment test or a variation thereof is most appropriate.⁶⁰

While it can be argued cogently that the premium payment test is the most appropriate method of taxing life insurance proceeds, especially when coupled with the incidents of ownership test for estate tax inclusion, the current provisions of section 2042 should not be distorted in order to broaden the scope of the section beyond principles of taxing legal and economic ownership. To capture within the taxable gross estate life insurance schemes which fall outside of the breadth of economic ownership, the premium payment test can be re-enacted; however, such re-enactment should be the product of Congressional action, and not by virtue of court interpretation.

⁵⁹ Schlesinger, *Taxes and Insurance: A Suggested Solution to the Uncertain Cost of Dying*, 55 HARV. L. REV. 266, 230-35 (1941).

⁶⁰ Groll, *Some Federal Tax Aspects of Life Insurance*, 15 DE PAUL L. REV. 48, 57-61 (1965).