
Taxation - Liability of Beneficiary of Life Insurance Policy for Unpaid Taxes of Decedent Determined - Commissioner v. Stern, 357 U.S. 39 (1958), and United States v. Bess, 357 U.S. 51 (1958)

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chain of causation. But, in *Werkman v. Howard Zink Corp.* the following statement is found:

Foreseeability in causation means foreseeability of intervening causes only; it does not include foreseeability of consequences. A consequence which follows directly either from defendant's act or from a foreseeably caused intervening act is proximate.¹⁸

In Illinois, the case of *Libby, McNeill and Libby v. Illinois District Telephone Co.*, although holding upon the facts that there was no foreseeability, stated:

Defendant's negligence is too remote to constitute the proximate cause where an independent illegal act of a third person, which *could not reasonably have been foreseen*, and without which such injury would not have been sustained, intervenes. A person is not bound to anticipate the malicious or criminal acts of others by which damage is inflicted, even though they are the acts of children. *But where an independent illegal act was of a nature which might have been anticipated and which it was the defendant's duty to provide against*, he will be liable for breach of such duty notwithstanding the production of injuries by the intervention of an act of the character described.¹⁹

Alabama, by this decision, holds, that insurance companies are liable to insured persons for injuries which result from the impetus given buyers of the insurance who have no insurable interest, to commit acts which public policy condemns and which by virtue of this same public policy, the insurance companies are bound to foresee. With the use of reasoning similar to that used by the Alabama court in the instant case, the majority of courts which hold such insurance contracts void as against public policy (including Illinois whose public policy is much more vigorous in its condemnation) may very well hold insurance companies liable under similar factual arrangements.

¹⁸ 97 Cal. 2d 418, 218 P. 2d 43, 48 (1950). See also, *Watson v. Southern Bus Lines*, 186 F. 2d 981 (C.A. 6th, 1951); *Di Gironimo v. American Seed Co.*, 96 F. Supp. 795 (E.D. Pa., 1951); *Eads v. Marks*, 39 Cal. 2d 807, 249 P. 2d 257 (1952); *De La Torre v. Valenzuela*, 102 Cal. App. 2d 586, 228 P. 2d 13 (1951).

¹⁹ 249 Ill. App. 93, 13 N.E. 2d 683 (1938) (emphasis supplied).

TAXATION—LIABILITY OF BENEFICIARY OF LIFE INSURANCE POLICY FOR UNPAID TAXES OF DECEDENT DETERMINED

Two recent Supreme Court cases have finally settled the question of liability of the beneficiary of a life insurance policy for the unpaid income taxes of the decedent.

In the first case, the decedent was a resident of Kentucky. Six years after his death the Tax Court held that he had been deficient in his income

taxes for the years 1944 through 1947 and was liable for \$32,777.51, including interest and penalties.¹ The Commissioner proceeded under Section 311 of the Internal Revenue Code of 1939² against the taxpayer's widow, as beneficiary of life insurance policies held by decedent. The right to change the beneficiary and to draw on the cash surrender value of the policies had been retained. The Supreme Court held that the widow, as beneficiary, was not liable for the tax deficiencies. *Commissioner v. Stern*, 357 U.S. 39 (1958).

In the second case the facts are essentially the same, except for the fact that the Commissioner had demanded payment of back taxes during the decedent's lifetime. Here the Supreme Court held the beneficiary liable for the tax deficiencies. *United States v. Bess*, 357 U.S. 51 (1958).

Although the Code provisions for enforcement of transferee liability³ are purely procedural,⁴ there has been conflict between the Courts of Appeal and the Tax Courts on whether the substantive liability of the beneficiary of a life insurance policy is to be determined by state or by federal law. The Courts of Appeal that have decided the question hold that state law rather than federal law determines the substantive liability in transferee cases.⁵ The Tax Courts, however, have held that such cases should be governed by federal law.⁶

In the *Stern* and *Bess* cases, the Supreme Court expressly decided this

¹ *Stern v. Commissioner*, (1955 P-H T.C. Memo. Dec., par. 55,040).

² 26 U.S.C.A. § 311 (a) (1) (f) (1956) which provides. "(a) Method of collection. The amounts of the following liabilities shall except as hereinafter in this section provided, be assessed, collected, and paid for in the same manner and subject to the same limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

"(1) Transferees. The liability at law or in equity, of a transferee of property of a taxpayer, in respect to the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

"(f) Definition of transferee. As used in this section, the term transferee includes heir, legatee, devisee, and distributee."

³ *Ibid.*

⁴ *Phillips v. Commissioner*, 283 U.S. 589 (1931); *Tooley v. Commissioner*, 121 F. 2d 350 (C.A. 9th, 1941); *Liquidators of Exchange National Bank v. United States*, 65 F. 2d 316 (C.A. 5th, 1933); *Hatch v. Morosco Holding Co.*, 50 F. 2d 138 (C.A. 2d, 1931).

⁵ *United States v. Truax*, 223 F. 2d 229 (C.A. 5th, 1955); *Rowen v. Commissioner*, 215 F. 2d 641 (C.A. 2d, 1954); *Tyson v. Commissioner*, 212 F. 2d 16 (C.A. 6th, 1954); *United States v. New*, 217 F. 2d 166 (C.A. 7th, 1954).

⁶ *Stoumen v. Commissioner*, 27 T.C. 1014 (1957), pend. C.A. 2d; *Rowen v. Commissioner*, 18 T.C. 874 (1953), rev'd supra; *Tyson v. Commissioner*, (1953 P-H T.C. Memo. Dec., par. 53, 198). In the *Stoumen* case the Tax Court reconsidered the question thoroughly, noting its awareness of the appellate decisions to the contrary, and reasserted its prior decision.

question, which it had previously left open,⁷ in accordance with the view expressed by the United States Court of Appeals.⁸ In following this view the Court used the rationale expressed in *Erie R. Co. v. Tompkins*:

Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest Court in a decision is not a matter of Federal concern. There is no Federal general common law.⁹

As already mentioned, the Internal Revenue Code of 1939 provisions for enforcement of transferee liability are purely procedural. Therefore, since Congress has not laid down a specific law governing these matters, the laws of the states must be referred to in solving questions of this nature.

In the *Stern* case, the Court decided that under the applicable Kentucky statute¹⁰ the widow was not liable as a transferee for any part of the decedent's unpaid taxes. The court reached the same conclusion in the *Bess* case under appropriate New Jersey law.¹¹ However, in the latter case the Internal Revenue Service had given notice and made demand for taxes during the decedent's lifetime, and since he had not made payment, a lien against the cash surrender value of his life insurance policy came into being. This lien was in accordance with the Internal Revenue Code of 1939, which states: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States, upon all property and rights to property, whether real or personal, belonging to such person."¹²

The question now arises, did the decedent have "property or rights to

⁷ Phillips v. Commissioner, 283 U.S. 589 (1951).

⁸ Commissioner v. Stern, 357 U.S. 39 at 40-47 (1958); United States v. Bess, 357 U.S. 51 at 53-54 (1958).

⁹ 304 U.S. 64, 78 (1938).

¹⁰ Ky. Rev. Stat. (1956) § 297.140 provides: "A policy of insurance for the benefit of a married woman shall inure to her separate use and benefit . . . independently of her husband or his creditors . . . subject to the provision that an amount equal to any premiums paid by any person in defraud of creditors, shall inure to their benefit." § 297.150— "The lawful beneficiary thereof . . . shall be entitled to the proceeds against the creditors affecting the same."

¹¹ 17 N.J. Stat. Anno. (Perm. Ed.) § 34-28—Beneficiary's Right to Proceeds: "When a policy of insurance is effected by any person on his own life . . . in favor of a person other than himself having an insurable interest therein, the lawful beneficiary thereof . . . shall be entitled to its proceeds, against the creditors and representatives of the person effecting it . . . subject to the Statute of Limitations, the amount of any premium for insurance paid in fraud of creditors, shall inure to their benefit from the proceeds of the policy." § 34-29—Policies to Inure to Benefit of Married Women: "Every policy of life insurance to or for the benefit of a married woman . . . shall inure to her separate use and benefit, and to that of her children. . . ."

¹² 26 U.S.C.A. § 3660 (1938).

property" in his insurance policies to which the lien might attach? In *Rowen v. Commissioner*,¹³ it was held that the insured never has a right to the proceeds of his insurance policy. Using this reasoning in the *Bess* case, the Court held that the proceeds could not come under the meaning of property as used in the Internal Revenue Code.¹⁴ As for the cash surrender value of the policy, however, the Court felt that this was "property" of the insured. Numerous courts have held that a lien attaches to the cash surrender values of insurance policies, since these are clearly assets of the decedent during his lifetime.¹⁵ These surrender values are not wiped out upon the death of the insured, but rather, merge in the proceeds. As a result, the lien remains attached, because the transfer of property subsequent to the attachment of a lien does not affect the lien.¹⁶ For "it is of the very nature and essence of a lien, that no matter into whose hands the property goes, it passes *cum onere*; if this were not the case it would cease to be a lien."¹⁷ Therefore, the surrender values merge in the proceeds with the lien attached, and the lien remains enforceable.¹⁸

Thus, the Supreme Court has finally settled the question of the liability of a transferee of an insurance policy for the unpaid taxes of the decedent. It will be interesting to note the different decisions that will arise in the Tax Courts because of the diversity of the laws of the several states.

¹³ 215 F. 2d 641 (C.A. 2d, 1954).

¹⁴ Authority cited note 12, *supra*.

¹⁵ *United States v. Royce Shoe Co.*, 137 F. Supp. 786 (D.N.H., 1956); *Knox v. Great West Life Assur. Co.*, 109 F. Supp. 207 (E.D. Mich., 1952), *aff'd per curiam* 212 F. 2d 784 (C.A. 6th, 1954); *Smith v. Donnelly*, 65 F. Supp. 415 (E.D. La., 1946); *United States v. Ison*, 67 F. Supp. 40 (S.D.N.Y., 1946); *United States v. Prudential Ins. Co. of America*, 54 F. Supp. 662 (E.D. Pa., 1944); *United States v. Trout*, 46 F. Supp. 484 (S.D. Cal., 1942).

¹⁶ *Blacklock v. United States*, 208 U.S. 75 (1908); *United States v. Snyder*, 149 U.S. 210 (1893).

¹⁷ *Burton v. Smith*, 13 Pet. (U.S.) 462, 483 (1839).

¹⁸ *United States v. Hoper*, 242 F. 2d 468 (C.A. 7th, 1957); *United States v. Behrens*, 230 F. 2d 504 (C.A. 2d, 1956).