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ESTATE TAXATION OF LIFE INSURANCE UNDER §2042: RECENT DECISIONS DEFINING INCIDENTS OF OWNERSHIP

The proceeds of life insurance policies are taxed to the insured's gross estate under §2042(2) of the Internal Revenue Code of 1954[1] if the insured possessed at death any "incidents of ownership"[2] in the policies. Although Congress has never defined the term "incidents of ownership,"[3] §2042(2) does state that the term includes an insured's

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[1] INT. REV. CODE OF 1954, §2042(2) includes in a decedent's gross estate the amount receivable by beneficiaries other than the executor

> 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.

[2] *Id.* Section 2042(1) provides for the taxation to the gross estate of insurance proceeds payable to the executor. Life insurance is taxed to a decedent's estate under Code provisions in addition to §2042. The testamentary transfer of policies on the lives of persons other than the decedent may be taxed to the decedent's estate under INT. REV. CODE OF 1954, §2033 (which includes the value of all property in which the decedent had an interest). *See, e.g.,* California Trust Co. v. Riddell, 136 F. Supp. 7 (S.D. Cal. 1955) (discussing predecessor to §2033). The proceeds of life insurance policies may also be taxed to the insured's estate under §2035 of the Code as a transfer of property made in contemplation of death. *In re* Estate of Silverman, 521 F.2d 574 (2d Cir. 1975) (whole life insurance policy); Graves & Finley, *Irrevocable Term Life Insurance Trusts and Gifts in Contemplation of Death Under §2035*, 32 WASH. & Lee L. Rev. 855 (1975). In unusual circumstances, insurance policies may be taxable under §2036 (taxing property transfers with retained life estate), §2038 (taxing incomplete transfers of property), and §2041 (taxing certain powers of appointment) of the Code. *See* C. LOWNDES, R. KRAMER & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES §13.10 (3d ed. 1974) and cases cited therein.

[3] Committee reports under the Revenue Act of 1942, however, did contain an

reversionary interest worth more than five per cent of the value of the policy immediately before his death.[4] Other examples of incidents of ownership are set out in Treasury Regulation § 20.2042-1(c)(2),[5] which states that the term generally refers to the right of the insured to the economic benefits of the policy. Thus, the power of the insured to change the beneficiary, to surrender, cancel or assign the policy, to borrow against the cash value of the policy, or to pledge the policy as security for a loan have been all recognized as incidents of ownership.[6]

While there is little doubt that taxpayers may continue to rely on these examples of incidents of ownership, in recent years controversy has arisen concerning the tax treatment of two types of interests in life insurance policies that the insured cannot exercise for his own benefit. One interest gives the decedent under a group term life insurance policy the ability to elect a settlement option of making either large payments to the beneficiary for a short period of time, or smaller payments for a more extended period. In the settlement option cases[7] the decedent lacked the more usual incidents of ownership such as the ability to select or change beneficiaries or to cancel the policy.[8] The other type of interest subject to disagreement involves the con-

extensive discussion of the concept of incidents of ownership. *See* note 31 *infra*.

[4] *See* note 1 *supra*.

[5] Treas. Reg. §20.2042-1(c)(2) (1958), *as amended*, T.D. 7312, 1974-1 CUM. BULL. 277, 278, provides in pertinent part:

> [f]or purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured 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.

[6] *See* note 5 *supra*. The Commissioner has attempted to treat the power of an employee to cancel a group term life insurance policy by quitting his job as an incident of ownership. Rev. Rul. 54, 1969-1 CUM. BULL. 221, *superseding* Rev. Rul. 334, 1968-1 CUM. BULL. 403. *See* Commissioner v. Treganowan, 183 F.2d 288 (2d Cir.), *cert. denied*, 340 U.S. 853 (1950). The Court of Claims, in Landorf v. United States, 408 F.2d 461 (Ct. Cl. 1969), held that power not to be an incident of ownership. In Rev. Rul. 307, 1972-1 CUM. BULL. 307, the Commissioner modified Rev. Rul. 54, ruling that the employee's power to cancel the group life insurance policy by quitting his job was not an incident of ownership, but merely a collateral consequence of the termination of employment.

[7] Estate of Lumpkin v. Commissioner, 474 F.2d 1092 (5th Cir. 1973), *rev'g* 56 T.C. 815 (1971); Estate of Connelly v. United States, 398 F. Supp. 815 (D.N.J. 1975).

[8] *See* note 5 *supra*.

trol that an insured exercises over life insurance policies included in the principal of a trust for which he is trustee.[9]

In *Estate of Connelly v. United States*,[10] the United States District Court for New Jersey recently rejected contentions that such interests were incidents of ownership, and attacked as unsound[11] contrary decisions of the United States Court of Appeals for the Fifth Circuit.[12] *Connelly* is one of the latest decisions in an area that has become increasingly divided, with the New Jersey district court joining determinations of the Second[13] and Sixth[14] Circuits against those of the Fifth Circuit.[15] Although it now appears that only Supreme Court decision[16] or congressional action can fully resolve the tax status of these interests, analysis of the various cases and the legislative history suggests the non-taxable nature of the interests as incidents of ownership.

The Sixth Circuit initiated the current controversy in *Estate of Fruehauf v. Commissioner*[17] by rejecting the Tax Court position that powers over life insurance policies held by the insured as trustee should be taxed as incidents of ownership under §2042(2).[18] Vera Fruehauf was owner and beneficiary of six insurance policies on the life of her husband Harry. When Vera died, her will directed that the policies be assigned to a trust with her husband, designated co-executor of her will, as co-trustee. The trustees were given the power to make themselves beneficiaries or to surrender the policies for their

[9] Terriberry v. United States, 517 F.2d 286 (5th Cir. 1975), *rev'g* 34 Am. Fed. Tax R.2d ¶ 147,927 (M.D. Fla. 1974), *cert. denied*, 44 U.S.L.W. 3529 (U.S. Mar. 23, 1976) (No. 865); Rose v. United States. 511 F.2d 259 (5th Cir. 1975), *aff'g* 33 Am. Fed. Tax R.2d ¶147,878 (E.D. La. 1973); Estate of Skifter v. Commissioner, 468 F.2d 699 (2d Cir. 1972), *rev'g* 56 T.C. 1190 (1971); Estate of Fruehauf v. Commissioner, 427 F.2d 80 (6th Cir. 1970), *aff'g on other grounds* 50 T.C. 915 (1968).

[10] 398 F. Supp. 815 (D.N.J. 1975).

[11] *Id.* at 824, 827.

[12] Rose v. United States, 511 F.2d 259 (5th Cir. 1975); Estate of Lumpkin v. Commissioner, 474 F.2d 1092 (5th Cir. 1973).

[13] Estate of Skifter v. Commissioner, 468 F.2d 699 (2d Cir. 1972).

[14] Estate of Fruehauf v. Commissioner, 427 F.2d 80 (6th Cir. 1970).

[15] Terriberry v. United States, 517 F.2d 286 (5th Cir. 1975), *cert. denied.*, 44 U.S.L.W. 3529 (U.S. Mar. 23, 1976) (No. 865); Rose v. United States, 511 F.2d 259 (5th Cir. 1975); Estate of Lumpkin v. Commissioner, 474 F.2d 1092 (5th Cir. 1973).

[16] The Supreme Court, however, has denied certiorari in Terriberry v. United States, 517 F.2d 286 (5th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3529 (U.S. Mar. 23, 1976) (No. 865).

[17] 427 F.2d 80 (6th Cir. 1970), *aff'g on other grounds* 50 T.C. 915 (1968). *Fruehauf* is discussed in Note, *Federal Estate Taxation—Life Insurance Trusts*, 49 N.C.L. REV. 539 (1971).

[18] Estate of Harry R. Fruehauf, 50 T.C. 915, 926 (1968).

cash value.[19] In addition to acting as co-executor and co-trustee, Harry Fruehauf was also the life beneficiary of the trust. Fruehauf, however, died before the administration of his wife's estate was completed, and the Commissioner determined that there was a deficiency in his estate tax because Fruehauf's executors had failed to include the six insurance policies in his gross estate.

In sustaining the Commissioner's position, the Tax Court drew an analogy between §2042 and §2038,[20] which includes incomplete transfers of property in a decedent's gross estate. The Tax Court reasoned that both sections are part of the same tax scheme to include in the gross estate the value of property over which the decedent held the power to affect beneficial enjoyment.[21] Since §2038 expressly includes property the enjoyment of which the decedent could affect without regard to whether the power was exercised as a trustee or in a personal capacity, the Tax Court concluded that the capacity in which Fruehauf exercised control over the insurance policies was immaterial.

The Sixth Circuit affirmed,[22] but on different grounds. Under both the terms of the will and state law, Fruehauf, without breaching his fiduciary duty as trustee, could have surrendered the insurance policies for their cash value thereby increasing the trust corpus and his income as life beneficiary of the trust. Since Fruehauf could exercise control over the policies for his own benefit, the court of appeals held that the proceeds of the insurance policies were properly includible in his gross estate.[23] The court, however, disagreed with the Tax Court's rule that the insured's possession, solely in a trustee capacity, of powers in the nature of incidents of ownership always requires

[19] The trustees additionally had the power to borrow against the cash value of the policies and to convert any of the policies into fully paid policies in accordance with the terms of the original policies. 427 F.2d at 82.

[20] INT. REV. CODE OF 1954, §2038(a)(1) includes in the decedent's estate the value of all property:

> [t]o 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.

[21] 50 T.C. at 926.

[22] 427 F.2d 80 (6th Cir. 1970).

[23] *Id.* at 86.

inclusion of the proceeds.[24] Unlike the Tax Court, the Sixth Circuit recognized a distinction between transfers under §2038, where the decedent as transferor of the property retained the power to affect the enjoyment of the property, and Fruehauf's situation under §2042, where the decedent, in a trustee capacity, was the transferee.[25] The taxation of Fruehauf's powers as trustee under §2042 was also distinguished from §2038 treatment because his powers were not a substitute for a testamentary disposition by him.[26] Under the *Fruehauf* decision, then, if an insured was the transferee of the insurance policies and exercised ownership solely in a trustee capacity, the policies would not be taxed to his gross estate.

Two years after *Fruehauf*, similar questions confronted the United States Court of Appeals for the Second Circuit in *Estate of Skifter v. Commissioner.*[27] Like the decedent in *Fruehauf*, decedent Skifter, as trustee of a trust formed under his wife's will, possessed the power to cancel insurance policies on his life that his wife had formerly owned.[28] However, unlike Fruehauf, Skifter was unable to exercise his powers as trustee to benefit himself. This, the Tax Court found,[29] distinguished the case from *Fruehauf*. The Second Circuit affirmed. After reviewing Regulation §20.2042-1(c)(2),[30] derived from congressional committee reports[31] under the Revenue Act of 1942,[32] the court

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[24] 50 T.C. at 926.

[25] 427 F.2d at 84. Neither the Tax Court nor the Sixth Circuit commented upon the fact that §2038 as written draws no distinction between whether the decedent was transferor or transferee of the power. *See* INT. REV. CODE OF 1954, §2038(a)(1), *quoted* in note 20 *supra*.

[26] 427 F.2d at 84, *citing* Porter v. Commissioner, 288 U.S. 436, 444 (1933). Neither the Tax Court nor the Sixth Circuit decisions considered the effect of Treas. Reg. §20.2042-1(c)(4) (1958), which would seem to have required the inclusion of the policies. *See* note 35 *infra*.

[27] 468 F.2d 699 (2d Cir.. 1972), *rev'g* 56 T.C. 1190 (1971). *Skifter* is discussed in Comment, *Estate Taxation of Life Insurance Policies Held by the Insured as Trustee*, 32 MD. L. REV. 305 (1972); 40 BROOKLYN L. REV. 1471 (1974); 39 MO. L REV. 258 (1974); 48 NOTRE DAME LAW., 995 (1973).

[28] Skifter, as trustee, had the power to terminate the trust in whole or part by paying trust principal to the current income beneficiary. In addition, he was given power to sell and mortgage the trust principal. 468 F.2d at 701.

[29] Estate of Hector R. Skifter, 56 T.C. 1190, 1197 (1971). The Tax Court did not rely on this ground alone, but proposed the rough parallel analysis, 56 T.C. at 1199, which the Second Circuit adopted in its opinion. *See* text accompanying notes 36-53 *infra*.

[30] Treas. Reg. §20.2042-1(c)(2) (1958), *quoted* in note 5 *supra*.

[31] H.R. REP. No. 2333, 77th Cong., 2d Sess. 163 (1942) states:

> [t]here is no specific enumeration of incidents of ownership, the possession of which at death forms the basis for inclusion of insurance

of appeals found special significance in the reference point of the regulations:[33] the right of the insured to the economic benefits of the policy.[34] While Skifter as trustee had no right to the economic benefits of the policy, the court did not rest its decision on that ground alone. Treasury Regulation §20.2042-1(c)(4)[35] seemingly would require inclusion of insurance policies in the estate of any insured who, as trustee, had power to affect the enjoyment of the economic benefits of the policies even if the insured had no beneficial interest in the trust.[36] The Second Circuit avoided possible conflict between Regulations §20.2042-1(c)(2) and §20.2042-1(c)(4) by inferring, from the committee reports under the Internal Revenue Code of 1954,[37] a congressional intent to give insurance policies estate tax treatment that would roughly follow the treatment accorded other types of property by other estate tax sections.[38]

> 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 corporation of which the decedent is sole stockholder is an incident of ownership in the decedent. A reversionary interest is not to be considered an incident of ownership in the case of a decedent dying after the date of enactment of this act.

See S. Rep. No. 1631, 77th Cong., 2d Sess. 235 (1942), which contains essentially the same language.

[32] Revenue Act of 1942, ch. 619, §404, 56 Stat. 944, *amending* Int. Rev. Code of 1939, ch. 3, §811(g), 53 Stat. 122.

[33] 468 F.2d at 702.

[34] *Id.* at 701-02, *citing* Treas. Reg. §20.2042-1(c)(2) (1958), *quoted* in note 5 *supra*.

[35] Treas. Reg. §2042-1(c)(4) (1958) provides in part:

> [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.

[36] 56 T.C. at 1198.

[37] S. Rep. No. 1622, 83d Cong., 2d Sess. 124 (1954), *reprinted at* 1954 U.S. Code Cong. & Ad. News 4757. *See* H.R. Rep. No. 1337, 83d Cong., 2d Sess. 91 (1954), *reprinted at* 1954 U.S. Code Cong. & Ad. News 4117-18, which contains essentially the same language as the Senate report.

[38] Int. Rev. Code of 1954, §§2026-38, 2041. These estate tax sections are quoted

Prior to the 1954 Code, insurance proceeds were taxed to the decedent's gross estate if he possessed incidents of ownership or if he paid the premiums on the policy.[39] In explaining the decision to eliminate the premium payments test in the 1954 Code, the Senate Finance Committee stated:

> [n]o other property is subject to estate taxation 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.[40]

From this report, the Second Circuit drew a "very strong" inference that Congress intended §2042 to operate in a manner that "roughly parallels" related tax sections.[41] Thus, according to the *Skifter* court, the tax treatment of non-insurance property under §§2036,[42] 2037,[43] 2038,[44] and 2041[45] is determinative of the tax treatment of insurance

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in note 20 *supra* and notes 42-45 *infra*.

[39] Revenue Act of 1942, ch. 619, §404, 56 Stat. 944, *amending* Int. Rev. Code of 1939, ch. 3, §811(g), 53 Stat. 122.

[40] S. REP. No. 1622, 83d Cong., 2d Sess. 124 (1954), *reprinted at* 1954 U.S. CODE CONG. & AD. NEWS 4117-18.

[41] 468 F.2d at 702.

[42] INT. REV. CODE OF 1954, §2036(a) includes in a decedent's gross estate:

> 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.

[43] INT. REV. CODE OF 1954, §2037, includes the value of all property that the decedent has transferred for less than adequate consideration, when enjoyment of the property can be obtained only by surviving the decedent, and the decedent retained a reversionary interest in the property worth more than five per cent of the value of the property immediately before the decedent's death. The value of the decedent's interest is determined from actuarial tables promulgated by the Commissioner. *See* Treas. Reg. §§20.2037-1(c)-(e), 20.2031-1, 20.2031-7 and 20.2031-9. Property subject to the exercise of a general power of appointment (as defined by INT. REV. CODE OF 1954, §2041, *see* note 45 *infra*) held by a person other than the decedent is not included under §2037 if the power was exercisable immediately before the decedent's death.

[44] *See* note 20 *supra*.

[45] INT. REV. CODE OF 1954, §2041. Under §2041 the gross estate includes the value of all property over which the decedent held a general power of appointment. With

policies under §2042. An interest that would cause property to be taxed under these related tax sections would by analogy constitute an incident of ownership if it applied to insurance policies. The court found further support for its inference in Congress' decision to treat the possession of a reversionary interest worth more than five per cent of the value of the policy immediately before the death of the decedent as an incident of ownership,[46] treatment that was similar to that accorded other types of property under §2037.[47]

In response to the Second Circuit's "rough parallel" analysis, the Commissioner contended that since Skifter possessed a power to alter, amend, or terminate the trust,[48] §2038 acting through §2042 would cause the insurance policies to be included in Skifter's gross estate.[49] The Commissioner also argued that Regulation §20.2042-1(c)(4)[50] required the policies to be taxed to Skifter's gross estate. The court of appeals, however, held that Regulation §20.2042-1(c)(4) did not reach Skifter's powers as trustee, and rejected the Commissioner's contention that §2038 was applicable. While the Commissioner cited two Supreme Court cases[51] in support of his rough parallel argument, the Second Circuit noted that these cases were distin-

certain exceptions, §2041(b)(1) defines a general power of appointment as "a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate." Since §2041 applies only to general powers of appointment, all other powers of appointment are special powers which are not subject to estate taxation under §2041.

[46] "To place 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 [under §2037], also applicable to life insurance." S. REP. No. 1622, 83d Cong., 2d Sess. 124 (1954); *see* note 43 *supra*.

[47] *See* note 43 *supra*. Somewhat inexplicably, the Second Circuit also found support for its analysis in the examples of incidents of ownership that Congress listed in its committee reports because these were interests "that would cause other types of property to be included in a decedent's estate under" §§2036-38 and §2041. 468 F.2d at 702. However, there were no examples of incidents of ownership listed in the 1954 committee reports. The court of appeals must have been referring instead to the examples set out in the 1942 committee reports. *See* note 5 *supra*.

[48] INT. REV. CODE OF 1954, §2038, *quoted* in note 20 *supra*.

[49] 468 F.2d at 702-03.

[50] *See* note 35 *supra*.

[51] United States v. O'Malley, 383 U.S. 627 (1966) (decedent transferred non-insurance property to a trust for which he was co-trustee; trust property was included in his gross estate under the predecessor to §2036 because he had the power to change beneficiaries by electing either to pay or accumulate trust income); Lober v. United States, 346 U.S. 335 (1953) (decedent transferred non-insurance property to trusts for which he was trustee; trust property was included in his gross estate under the predecessor to §2038 because he retained the power to revoke the trust at any time by turning the principal over to the beneficiaries).

guishable. Both involved a power that the decedent had retained at the time of the original transfer rather than, as in *Skifter*, a power that was created by someone else and transferred to the decedent after he had divested himself of all interest in the policies.[52] In addition, unlike a §2038 analysis, Skifter's powers as trustee could not be viewed as a substitute for testamentary disposition. Finally, the court concluded that Regulation §20.2042-1(c)(4) applied only when the decedent transferred the policies to the trust; then §2038, when read into §2042, would operate to include the policies in the decedent's gross estate.[53]

In *Estate of Lumpkin v. Commissioner*,[54] the United States Court of Appeals for the Fifth Circuit partially adopted the "rough parallel" analysis of the Second Circuit but reached an inconsistent result. The decedent in *Lumpkin* was not a trustee, rather his only interest was the right to elect a settlement option under a group term life insurance policy. At the time of his death Lumpkin was covered by group term life insurance for which his employer paid the premiums. Lumpkin had no power to direct that the proceeds of the policy by paid to his estate, nor could he derive any economic benefits from the policy or change the beneficiary.[55] In fact, he possessed none of the examples of incidents of ownership set out in the Treasury Regulations.[56] His only power was an optional settlement provision that permitted him to reduce the monthly benefits payable to his beneficiary thereby extending the payments over a longer period of time than otherwise possible.[57]

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[52] 468 F.2d at 703-04.

[53] *Id.* at 704-05. Section 2038 of the Code as written does not require that a decedent retain the power to alter or amend the enjoyment of the property before it will be taxed. *See* note 20 *supra*. Since the only cases that had been found to include property under §2038 involved interests reserved by the decedent as a transferor, the Second Circuit read a requirement into §2038 that the decedent must have retained the interest at the time of the original transfer. 468 F.2d at 704-05.

[54] 474 F.2d 1092 (5th Cir. 1973), *vacating and remanding* 56 T.C. 815 (1971). The *Lumpkin* decision is discussed in Note, *Federal Estate Tax—"Incidents of Ownership" in Group Life Insurance, A Phrase Searching for Definition*, 52 N.C.L. Rev. 671 (1974).

[55] The group policy automatically provided for the payment of the proceeds to the insured's spouse. If the spouse was dead, the proceeds would then be paid to other predetermined relatives of the insured. The settlement option, however, was applicable only to the payment of proceeds to the spouse. Payments to other beneficiaries were unalterable. 474 F.2d at 1093.

[56] *See* Treas. Reg. §20.2042-1(c)(2) (1958), *quoted* in note 5 *supra*.

[57] The portion of the benefits not immediately paid to the spouse would be accumulated with interest during the normal payment period of the benefits. When the normal period expired, this additional fund would then be paid monthly to the spouse

In ruling that the insurance proceeds were includible in Lumpkin's gross estate, the Fifth Circuit adopted without analysis[58] the Second Circuit's conclusion in *Skifter* that Congress intended §2042 to give life insurance tax treatment roughly equivalent to that accorded other types of property. Relying upon the same Supreme Court cases that had failed to persuade the Second Circuit,[59] the Fifth Circuit determined that Lumpkin's power to alter the time and manner of enjoyment of the policy proceeds gave him a "substantial degree of control" that, if held over non-insurance property, would have been taxable under §§2036 and 2038.[60] In addition, according to the court of appeals, Congress intended §2042 to include policies over which the decedent possessed a significant amount of control.[61] Thus, the control which Lumpkin exercised by analogy to §§2036 and 2038 required taxation of the proceeds of the policies under §2042. The perceived congressional intent to grant life insurance tax treatment parallel to that accorded other property would be violated if Lumpkin's power were not taxed under §2042.[62] The Fifth Circuit, however,

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until it was exhausted. If the spouse beneficiary died before the supplemental fund was exhausted, the balance of the fund would be paid to the spouse's estate. 474 F.2d at 1093.

[58] The Fifth Circuit merely stated "[t]hat Congress had such an intent with respect to §2042 has been recognized in" Estate of Skifter v. Commissioner, 468 F.2d 699 (2d Cir. 1972). 474 F.2d at 1095 n.9.

[59] United States v. O'Malley, 383 U.S. 627 (1966); Lober v. United States, 346 U.S. 335 (1953). *See* note 51 *supra*.

[60] 474 F.2d at 1097. Contrary to the intimations of the Fifth Circuit, however, if Lumpkin's right to alter the time and manner of enjoyment were held over non-insurance property, it would not have been taxable under §2036 and probably not under §2038 either. Lumpkin did not retain the enjoyment of the insurance policy or the right to designate the beneficiaries of the policy and §2036 clearly would not apply. Additionally, since the insurance policy was owned and paid for by Lumpkin's employer, Lumpkin never made any inter vivos transfer of property which could trigger the provisions of §2036 or 2038. *See* text of §2036 *quoted* note 42 *supra*; text of §2038 *quoted* note 20 *supra*.

[61] 474 F.2d at 1095. In support of its determination, the Fifth Circuit cited United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7, 10 (1st Cir. 1966). The *Rhode Island* case, however, nowhere uses the term "substantial control." The *Rhode Island* court thought that Congress was attempting to reach the same types of power to transfer property that the Supreme Court canvassed in Chase National Bank v. United States, 278 U.S. 327 (1929). 355 F.2d at 10. Lumpkin's mere power to select a settlement option, however, would appear to be an interest of lesser magnitude than those which the Supreme Court discussed in *Chase*. *See* notes 96 & 106 *infra*.

In Estate of Connelly v. United States, 398 F. Supp. 815 (D.N.J. 1975), the district court cited the *Rhode Island* case in reaching a decision contrary to that in *Lumpkin*. 398 F. Supp. at 820, 828.

[62] 474 F.2d at 1097.

rejected the Second Circuit's conclusion that insurance policies under §2042 were always to be treated in the same manner as other property. The only significant distinction that the Fifth Circuit found between §2038 and §2042 was that under the former section a decedent must have made an incomplete transfer of property, while under the latter no transfer was necessary.[63] Following the language of the statutes, the *Lumpkin* court noted that under §2038 the decedent must have retained an interest in the transferred property whereas under §2042 it was sufficient if he merely possessed the interest. Thus, the means by which the decedent came into possession of his interest was irrelevant.[64]

In *Rose v. United States*,[65] the Fifth Circuit applied the *Lumpkin* decision to reach a result irreconcilable with those of the Sixth Circuit in *Fruehauf* and the Second Circuit in *Skifter*. Like the decedents in *Fruehauf* and *Skifter*, the decedent in *Rose* possessed as trustee the power to cancel insurance policies on his life.[66] As in *Skifter*, the decedent in *Rose* also possessed no beneficial interest in the policies. Relying on *Lumpkin*, and refusing to follow the other courts of appeals, the Fifth Circuit held that the proceeds of the insurance policies were includible in the decedent's gross estate under §2042. Appellant Rose argued that since the decedent as trustee was unable to gain any economic benefit, the policies should not have been included in his estate. However, the court noted that the decedent in *Lumpkin* also was unable to benefit himself from the policies, yet the policies

[63] *Id.*

[64] *Id.* The Fifth Circuit determined that Congress' intent in 1954 to read into the concept of incidents of ownership property interests reached by §§2036-38 and 2041 effectively overruled May Billings, 35 B.T.A. 1147 (1937), *acquiesced in*, 1937-2 CUM. BULL. 3, *acquiescence withdrawn and non-acquiescence substitued*, 1972-1 CUM. BULL. 3. In that decision, the Board of Tax Appeals had determined that the mere right under a *Lumpkin*-type settlement option to affect when the insurance proceeds would be paid to the beneficiary was too insignificant to be an incident of ownership. *Id.* at 1152. *See* 474 F.2d at 1096-97. Although the Commissioner waited thirty-five years to withdraw the acquiescence, and in fact only withdrew it after the litigation in *Lumpkin* had already commenced, this had no legal effect. *Id.* at 1096 n.11, *citing* Dixon v. United States, 381 U.S. 68 (1965).

[65] 511 F.2d 259 (5th Cir. 1975), *aff'g* 33 Am. Fed. Tax. R.2d ¶147,878 (E.D. La. 1973). *Rose* is discussed in 55 B.U.L. REV. 864 (1975), and 7 ST. MARY'S L.J. 621 (1975).

[66] The decedent as trustee additionally possessed the power to cancel or convert the policies, and to borrow against their cash value. 511 F.2d at 261. The decedent in *Rose*, unlike the decedents in *Fruehauf* or *Skifter*, never owned the policies in a personal capacity. The decedent's brother had established the trusts for the decedent's children, and it was in his capacity as trustee that the decedent had purchased the insurance policies. *Id.* at 260.

were nevertheless included in his gross estate.[67] The court further found that the "substantial control" test applied in *Lumpkin* operated in *Rose* to include the proceeds of the insurance policies. In addition, the Fifth Circuit held that Treasury Regulation §20.2042-1(c)(4), which the Second Circuit had read restrictively in *Skifter*, required the same result.[68] Again as in *Lumpkin*, the *Rose* court concluded that §2042 included insurance whenever the decedent possessed the property interest, while under other sections the concern of Congress was whether the decedent retained any interest.[69]

The United States District Court for New Jersey, in *Estate of Connelly v. United States*,[70] rejected the arguments that had been successful in *Lumpkin* and *Rose*. In *Connelly*, the Commissioner attempted to include in the decedent's gross estate proceeds payable under the same group term life insurance policy provided by the same employer as in *Lumpkin*. In holding for the taxpayer, the district court classified *Lumpkin* as "not sound,"[71] and attacked the *Rose* decision in dictum.[72] The court noted that settlement options such as those in *Connelly* and *Lumpkin* had never been listed as an incident of ownership in the Treasury Regulations.[73] Furthermore, the court concluded that the failure of Congress to list such interests in the 1942 committee reports[74] from which the Treasury Regulations were drawn[75] was intentional.[76]

In addition to determining that Congress never intended the concept of incidents of ownership to include settlement options under group term life insurance policies, the *Connelly* court also found the reasoning of the Fifth Circuit in *Lumpkin* unpersuasive. While the Commissioner again cited Supreme Court cases,[77] the court found these relatively easy to distinguish from the facts in *Connelly*.[78] The

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[67] 511 F.2d at 263.

[68] *Id.* at 265. *See* note 35 *supra*.

[69] The Fifth Circuit did follow the Second Circuit's determination that, despite its wording, §2038 applied only to property interests that the decedent created. 511 F.2d at 264 n.11.

[70] 398 F. Supp. 815 (D.N.J. 1975).

[71] *Id.* at 824, 827.

[72] *Id.* at 828.

[73] *Id.* at 822.

[74] *See* note 31 *supra*.

[75] *Compare* Treas. Reg. §20.2042-1(c)(2) (1958), *quoted* in note 5 *supra*, *with* H.R. REP. No. 2333, 77th Cong., 2d Sess. 163 (1942), *quoted* in note 31 *supra*.

[76] 398 F. Supp. at 822, 828.

[77] United States v. O'Malley, 383 U.S. 627 (1966); Lober v. United States, 346 U.S. 335 (1953). *See* note 51 *supra*.

[78] The district court noted that *O'Malley* and *Lober* concerned a decedent's power

Commissioner also argued that failure to tax Connelly's interest in the policy, given congressional intent to tax the transfer of life insurance proceeds in a manner roughly parallel to other property, would lead to an anomalous result. Noting that many provisions of the Internal Revenue Code of 1954 are anomalous, the court declined to accord this argument any weight.[79] Moreover, even if Congress did intend to establish parallel tax treatment, the district court found that the analogy between §2042 and §§2036 and 2038 suggested by the Commissioner was faulty. A more apt analogy could be drawn between the employment insurance benefits in *Connelly* and qualified employment annuities which §2039(c)[80] of the Code excludes from a decedent's gross estate. While the benefits in *Connelly* were insurance and not annuity payments, in substance the two were closely analogous.[81] Under both qualified §2039(c) annuities and the policy in *Connelly*, the decedent's employer and not the decedent paid for the benefits. In addition, the actual transfer of the benefits in *Connelly* did not occur in a lump sum as with many other insurance policies, but rather as periodic payments similar to an annuity.[82] The district court, therefore, concluded that since the more accurate analogy was to §2039(c) arrangements that excluded benefits from a decedent's gross estate, the insurance proceeds in *Connelly* should also be excluded from the decedent's estate.

Three days after *Connelly*, in *Terriberry v. United States*,[83] the Fifth Circuit reaffirmed its position. Although prohibited by the terms of the trust instrument from exercising any incidents of ownership, the trustee decedent in *Terriberry* was empowered to elect a settlement option which permitted him to pay out as annuities the value of life insurance policies held in the trust. Relying on *Lumpkin* and *Rose*, the court of appeals held that the power to elect the settlement option, despite the prohibition against exercising any incidents

to terminate the trust or to shift benefits from one beneficiary to another. These powers paralleled the powers listed in Treas. Reg. §20.2042-1(c)(2) (1958) to cancel the policies or to change the policy beneficiary. The court found that neither *O'Malley* nor *Lober* extended beyond "the explicitly parallel language" to reach interests such as the decedent possessed in *Lumpkin* and in *Connelly*. 398 F. Supp. at 825.

[79] *Id.*

[80] INT. REV. CODE OF 1954, §2039(c).

[81] 398 F. Supp. at 826.

[82] *Id.*

[83] 517 F.2d 286 (5th Cir. 1975), *rev'g* 34 Am. Fed. Tax. R.2d ¶147,927 (M.D. Fla. 1974), *cert. denied*, 44 U.S.L.W. 3529 (U.S. Mar. 23, 1976) (No. 865). The decision of the district court is discussed in *Life Insurance Proceeds Under § 2042, Survey of 1974 Federal Estate and Gift Tax Developments*, 32 WASH. & Lee L. Rev. 1059, 1060 (1975).

of ownership, was a power to affect the time and manner of enjoyment of the policies requiring their inclusion in the decedent's gross estate under §2042.[84] Over a strong dissent,[85] the Fifth Circuit found that the settlor's absolute power to remove the decedent as trustee or to revoke the trust did not require a different result. Since the settlor's power was unexercised at decedent's death, the decedent still possessed the ability to exercise the settlement option.

Connelly, Skifter, and *Fruehauf* not only are incompatible with *Lumpkin, Rose,* and *Terriberry,* but the former decisions are not even consistent with each other. The cause of this conflict is §2042 and its legislative history,[86] both of which are silent on the question of whether the interests involved in these six cases are to be considered incidents of ownership. In the cases discussed, only the district court in *Connelly* considered the pre-1942 history of incidents of ownership. This history, it is suggested, may assist in resolving the issue.

The proceeds of life insurance policies were first subjected to the federal estate tax by §402(f) of the Revenue Act of 1918.[87] That Act included in the gross estate of the insured "insurance under policies taken out by the decedent upon his own life."[88] Although this phrase was re-enacted without change four times[89] prior to the Revenue Act of 1942, inconsistent court and Treasury constructions led one commentator in 1941 to summarize the history of the section as "twenty-two years of confusion."[90] The simplistic and ambiguous language of the operative phrase "policies taken out by the decedent" produced great uncertainty.

Originally, the Treasury interpreted "taken out by the decedent" to represent Congress' intent to include only the proceeds of insurance policies on which the decedent had paid the premiums.[91] In the

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[84] 517 F.2d at 289.

[85] *Id.* at 290 (Ainsworth, J., dissenting).

[86] *See* notes 87-121 *infra* and accompanying text.

[87] Revenue Act of 1918, ch. 18, §402(f), 40 Stat. 1098.

[88] *Id.* The Act also reached insurance proceeds paid to the executor, much as under the current Code §2042(1). Insurance policies payable to beneficiaries other than the executor were given a $40,000 exemption. *Id.*

[89] 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. 27, §302(g), 44 Stat. 71; Int. Rev. Code of 1939, ch. 3, §811(g), 53 Stat. 122.

[90] Schlesinger, *Taxes and Insurance: A Suggested Solution to the Uncertain Cost of Dying,* 55 HARV. L. REV. 226, 227, (1941). This article contains a helpful discussion of the changes in the Treasury's estate taxation approach to life insurance during the 1930's and early 1940's. *See also* Paul, *Life Insurance and the Federal Estate Tax,* 52 HARV. L. REV. 1037 (1939).

[91] Treas. Reg. 37, Art. 32 (1919).

1929 case of *Chase National Bank v. United States*,[92] however, the Supreme Court introduced the concept of retention of incidents of ownership as a justification for taxing life insurance proceeds. In *Chase*, the Court was presented with the argument[93] that including the proceeds of life insurance policies payable to beneficiaries other than the decedent's estate was constitutionally void as an unapportioned direct tax on property.[94] Holding the tax constitutional, the Court noted that the statute taxed transfers of property, not the property itself, and that the termination by death of the decedent's power to change beneficiaries was a proper subject for a transfer tax.[95] The Court then reviewed the decedent's other "legal incidents of ownership,"[96] and held that the termination of the decedent's ability to exercise his ownership effected a transfer of property no less within the taxing power of Congress than were other transfers that occur at death.[97]

Chase was primarily concerned with the constitutionality of estate taxation of insurance policies and only secondarily considered statutory interpretation. The Treasury, however, apparently took advantage of the decision by introducing in its regulations the retention of legal incidents of ownership as a test of when life insurance policies would be deemed to have been "taken out" by the decedent. Closely following the language of the *Chase* decision,[98] the Treasury listed as legal incidents of ownership:

> a power to change the beneficiary, to surrender or cancel the policies, to assign them, to revoke an assignment of them, to

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[92] 278 U.S. 327 (1929).

[93] *Id.* at 334.

[94] U.S. CONST. art. I, §9. No truly satisfactory definition of a direct tax has ever been suggested. Even the framers of the Constitution were puzzled. *See* the following extract from DEBATES IN THE FEDERAL CONVENTION OF 1787 AS REPORTED BY JAMES MADISON, *reprinted in* THE MAKING OF THE AMERICAN REPUBLIC: THE GREAT DOCUMENTS, 1774-1789, at 580 (C. Tansill ed. 1972): "Mr. King asked what was the precise meaning of *direct* taxation? No one answered."

[95] 278 U.S. at 334.

[96] The Court stated, 278 U.S. at 335:

> [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 . . . subject them in part to the payment of his debts . . . is by no means the least substantial of the legal incidents of ownership . . . .

[97] *Id.* at 337.

[98] *See* note 96 *supra*.

pledge them for loans, or to dispose otherwise of them and their proceeds for his own benefit, etc.[99]

From 1929 until the Revenue Act of 1942, the Treasury Regulations vacillated between premium payments and incidents of ownership as tests for determining when insurance was "taken out" by the decedent.[100] With the passage of the Revenue Act of 1942, Congress finally modified the old estate tax treatment of insurance and provided for the inclusion of insurance proceeds in the decedent's gross estate if he either paid the premiums for the policy or possessed[101] any incidents of ownership in the policy. With minor change, Congress adopted the concept of incidents of ownership as it had been developed in the Treasury Regulations which followed *Chase*.[102]

Prior to the Internal Revenue Code of 1954, then, there had been no major change in the concept of incidents of ownership introduced in 1929. During that twenty-five year history, there was little discussion of whether the power to elect a settlement option like that in *Lumpkin* and *Connelly* was an incident of ownership. The only case to consider the issue was a 1937 Board of Tax Appeals decision[103] which held that the power to elect was not an incident of ownership.

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[99] Treas. Reg. 70, Art. 27 (1929).

[100] During this period the regulations made only one significant alteration in the concept of incidents of ownership. Treas. Reg. 70, Art. 25 (1934), changed the determination of taxability from retention of incidents of ownership by the decedent to possession of them at death. This change has been carried forward into the present Code, §2042(2). *See* note 1 *supra*.

[101] *See* note 100 *supra*.

[102] *See* note 31 *supra*. *But see* Estate of Myron Selznick, 15 T.C. 716, 728 (1950), *aff'd sub nom.* Selznick's Estate v. Commissioner, 195 F.2d 735 (9th Cir. 1952) (per curiam), where the Tax Court stated that the Revenue Act of 1942 worked a "fundamental change" in the concept of incidents of ownership; and Pedrick, *Major Aspects of Life Insurance in Estate Planning*, 27 TAXES 1143, 1144 (1949), which characterized the 1942 Act as a "complete departure from the past."

The Tax Court found that Congress made a "fundamental change" by eliminating the requirement that the incidents of ownership be "legal." This change, however, is not fundamental because most interests in life insurance policies are legal interests. The change would not affect powers in the nature of incidents of ownership held solely in a trustee capacity, as a trustee traditionally exercises only legal powers. *See, e.g.*, G. BOGERT & G. Bogert, The Law of Trusts and Trustees §146 (2d ed. 1965). Likewise, the treatment of legal interests such as the settlement options in *Lumpkin* and *Connelly* would not seem to be changed. In addition, the statement in Pedrick's article is "too broad." 2 J. MERTENS, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION §17.04 n.35 (1959). While the Act was a complete departure from the previous statute, it was not a departure from previous case law concerning incidents of ownership. *Id.*

[103] May Billings, 35 B.T.A. 1147 (1937).

With the Commissioner's acquiesence in the case,[104] there was no further consideration of the matter until acquiesence was withdrawn during the litigation in the *Lumpkin* case in 1972.[105] *Chase*, the paradigm for the development of incidents of ownership, provides no direct answer to whether the power to elect the settlement option is an incident of ownership. That power, nevertheless, seems clearly to be an interest of lesser magnitude than those which the Supreme Court reviewed in *Chase*.[106] The pre-1954 Code history thus indicates that the power to elect such settlement options was not considered to be an incident of ownership.[107]

Determining the pre-1954 Code status of incidents of ownership held only in a trustee capacity is more difficult. As was largely true of *Lumpkin*-type settlement options, the early case law is barren. Beyond dispute, however, the powers that a trustee exercises are similar to the taxable incidents of ownership.[108] The question is whether Congress intended to tax the proceeds of life insurance policies to an insured's estate because he possessed powers equivalent to incidents of ownership although the ownership could be exercised only in a trustee capacity. The Supreme Court's decision in *Chase* again supplies the answer. The focus of the Court's attention in *Chase* was clearly on the decedent's power to exercise ownership "as completely as if he were himself the beneficiary,"[109] and a trustee lacks this power.[110] When a trustee dies possessing powers in the nature of incidents of ownership, he has not made a transfer such as those

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[104] 1937-2 CUM. BULL. 3.

[105] 1972-1 CUM. BULL. 3. *See* note 64 *supra*.

[106] *See* note 96 *supra*. The *Chase* decision does contain language which can be read to include Lumpkin's settlement option. *See* 278 U.S. at 338, where the Court states that "so long as [the decedent] retains control over those benefits with power to direct their future enjoyment until his death," an estate tax is proper. Lumpkin's settlement option was arguably a power to direct the enjoyment of the insurance proceeds. Since he failed to assign his ability to elect the settlement option, he did retain the power until his death. To read *Chase* in this manner, however, would go beyond the Court's concept of incidents of ownership. The control to direct the enjoyment of insurance policies referred to by the Court was the "outstanding power" to "recall a gift after it is made" by changing the beneficiary. 278 U.S. at 336. Lumpkin's settlement option was not such an outstanding power. Furthermore, Lumpkin never possessed an "interest in the policies which gave him the power of disposition of them and their proceeds as completely as if he were himself the beneficiary of them" *Id.* at 334.

[107] *But cf.* note 102 *supra*.

[108] *Compare* G. BOGERT & G. Bogert, The Law of Trusts and Trustees §§551-66 (2d ed. 1965) *with* Treas. Reg. §20.2042-1(c)(2) (1958), *quoted* in note 5 *supra*.

[109] 278 U.S. at 334.

[110] *See, e.g.*, G. BOGERT & G. Bogert, The Law of Trusts and Trustees §146 (2d ed. 1965).

considered in *Chase*, for at no time was he ever free to exercise ownership in any manner except to profit the beneficiary.[111] Unless Congress intended the 1954 Code to effect a marked expansion in the concept of incidents of ownership, it would therefore seem that neither the decedent's possession of powers in the nature of incidents of ownership solely in a trustee capacity, nor his power to elect a *Lumpkin*-type settlement option, is an incident of ownership that would cause the proceeds to be taxed.

The Second Circuit,[112] however, found that Congress in effect expanded the definition of incidents of ownership by adding to the historical concept of incidents of ownership[113] an intent to make the estate tax treatment of insurance roughly parallel to that accorded other types of property. The Fifth Circuit[114] adopted this view in *Lumpkin, Rose*, and *Terriberry*. Those decisions rest upon the validity of the Second Circuit's view, for if Congress in 1954 did not so expand the concept of incidents of ownership, the pre-1954 Code history would indicate that those cases were wrongly decided.

There are a number of reasons for disagreeing with the "rough parallel" analysis. The inference that the Second Circuit drew from the committee reports describing the decision to eliminate the premium payments test[115] seems to rest upon a weak base. When Congress decided to expand the concept of incidents of ownership by including reversionary interests, it made specific provision for this in §2042.[116] There is no apparent reason, and the Second Circuit's discussion supplied none, why Congress could not also have provided in the statute for the expansion of incidents of ownership that the rough parallel analysis entails.[117] More likely, Congress instead intended only to end the perceived discrimination against life insurance that resulted from the premium payments test. In addition, the support that the Second Circuit found in the codification of a five per cent reversionary interest as an incident of ownership[118] seems misplaced. Congress in 1954 rejected an amendment to §2042 that would have made the tax treatment of reversionary interests in insurance policies more like the treatment of other reversionary interests under §2037[119]

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[111] *Id.*

[112] *See* text accompanying notes 27-53 *supra*.

[113] *See* notes 92-102 and accompanying text *supra*.

[114] *See* text accompanying notes 54-69 & 83-85 *supra*.

[115] *See* text accompanying note 40 *supra*.

[116] INT. REV. CODE OF 1954, §2042(2). *See* note 1 *supra*.

[117] *See* note 20, 42-43 & 45 *supra*.

[118] *See* note 46 *supra* and accompanying text.

[119] Proposed Amendments to H.R. 8300, The Internal Revenue Code of 1954, Pre-

than that which was finally adopted.[120] This action seems unusual if Congress actually intended to establish parallel tax treatment. Furthermore, Congress refused to accord §2042 transfers the advantages that §2043 gives to transfers for insufficient consideration.[121] Property transfers under §§2035-38 and §2041, however, were given this beneficial treatment. This, too, seems unusual if parallel tax treatment were intended.[122]

Thus, contrary to the reasoning of the Fifth and Second Circuits, it is apparent that Congress did not intend the 1954 Code to give life insurance policies tax treatment parallel to that of other types of property under the Code. Life insurance was to be included in the gross estate under §2042[123] basically as it had been under the predecessors to §2042, with reference to the possession of incidents of own-

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sented to Senate Finance Committee on Behalf of the Life Insurance Companies by the American Life Convention and the Life Insurance Association of America, April 23, 1954, *Hearings on H.R. 8300 Before the Senate Comm. on Finance*, 83d Cong., 2d Sess. 192, 206-07 (1954).

[120] INT. REV. CODE OF 1954, §2042(2). *See* note 1 *supra*.

[121] INT. REV. CODE OF 1954, §2043(a) provides that :

> [i]f any one of the transfers, trusts, interests, rights, or powers enumerated and described in sections 2035 to 2038, inclusive, and section 2041 is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

[122] The distinction that the Fifth Circuit drew between the taxation in §2042 of interests that the decedent possessed and the emphasis in §§2036 and 2038 on retained interests, *see* text accompanying notes 64 & 69 *supra*, is undercut when it is recognized that the 1934 Treasury Regulations first employed the term "possession" in lieu of retention. *See* note 100 *supra*. Congress in 1954 probably intended the use of the word "possessed" to continue to have the same connotation as it had had for twenty years before the 1954 Code. It seems unlikely that Congress intended to employ the "conspicuous variety in statutory idiom" perceived by the Fifth Circuit in Rose v. United States, 511 F.2d at 265. *See also* 55 B.U.L. REV. 864, 870 (1975). Even if the parallel analysis is accepted, the Fifth Circuit's decision in *Rose* was "unsupported by precedent." *Id.* at 873.

[123] The interpretation of incidents of ownership suggested here is not reconcilable with Treas. Reg. §20.2042-1(c)(4) (1958), *quoted* in note 35 *supra*. In reference to Reg. §20.2042-1(c)(4), *see* D. KAHN & E. Colson, *Federal Taxation of Estates, Gifts, and Trusts* ¶ 1.801, at 102 (2d ed. 1975), which states that the validity of Reg. 20.2042-1(c)(4) is "very much in doubt." The Treasury may have been misled by the same problems as the Fifth Circuit. *But cf.* United States v. Cartwright, 411 U.S. 546, 550 (1973) (Treasury regulations will be upheld if a reasonable implementation of congressional intent).

ership, and without regard to how other types of property were treated under other Code sections. Thus, the status of the decedent as transferor or transferee of an interest in an insurance policy is immaterial.[124] Whether the interest constitutes a tax-triggering incident should still be determined, as before the 1954 Code, without regard to how the decedent acquired the interest.

Connelly best reflects the history of §2042 by considering the development of the concept of incidents of ownership before as well as after the Revenue Act of 1942. The district court correctly concluded that neither *Lumpkin*-type settlement options nor managerial control of insurance policies exercised solely in a trustee capacity should be taxed as incidents of ownership. Until either Congress or the Supreme Court directly considers the tax treatment of such interests, however, reliance on any analysis of their tax status must be considered uncertain at best. With the rapid development of an opposite viewpoint on this aspect of estate tax law by the Fifth Circuit, the Second and Sixth Circuit decisions may be subject to challenge. Thus, regardless of whether one lives in the Second, Fifth, or Sixth Circuits, or even in New Jersey where *Connelly* spreads a protective wing, prudent estate planning continues to dictate a most cautious approach to life insurance.

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[124] While the status of the decedent as transferor or transferee would be immaterial for purposes of the taxation of insurance policies under §2042, it might be determinative with regard to the taxation of insurance policies under other estate tax sections. *See* note 2 *supra*.