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ESTATE TAXATION OF LIFE INSURANCE POLICIES HELD BY THE INSURED AS TRUSTEE

_Estate of Skifter v. Commissioner_

More than three years before his death, decedent made a complete, irrevocable assignment of nine insurance policies on his life to his wife. His wife predeceased him, and under her will the policies became part of a testamentary trust. The terms of Mrs. Skifter's will provided that the income from the trust was to be paid to her daughter for life, with principal to pass to such persons as her daughter might appoint by will. In default of appointment, the principal was to go to her daughter's living issue or, if there were none, to decedent or, if he were not then living, to other named beneficiaries. Decedent was named executor of his wife's estate and trustee under the trust, with broad powers over the distribution of income. In addition, he could terminate the trust by distributing all the principal to the income beneficiary. Until he died, decedent's only act as trustee was to receive dividends from one of the policies. The proceeds of the insurance policies were not included in the decedent's gross estate in his estate tax return.

The Commissioner determined that decedent at his death possessed "incidents of ownership" in the life insurance policies on his life within the meaning of section 2042(2) of the Internal Revenue Code of 1954, § 2042(2) provides in part:

2. 56 T.C. at 1191. As original owner, decedent had possessed the power to assign, surrender for cash value and borrow against the policies.
3. Mrs. Skifter's will provided:
   
   **Three:** A. I authorize my Trustee in his absolute discretion, at any time and from time to time, to pay over the whole or any part of the principal of the trust created by Article Two of this Will to any beneficiary entitled at the time of such payment to the current income from the principal so paid over whether or not any such payment shall result in the termination of the trust from which the payment is made. . . . It is my intention that any rules of trust law which may require impartiality as between income beneficiaries and remaindermen shall be disregarded, and that my Trustee shall exercise the authority herein given to him in the interests of the income beneficiaries and without regard to the interests of the remaindermen.
4. INT. REV. CODE of 1954, § 2042(2) provides in part:
   
   The value of the gross estate shall include the value of all property . . . (2) RECEIVABLE BY OTHER BENEFICIARIES. — To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the
Code of 1954 and that therefore the proceeds of the policies were includible in his gross estate for estate tax purposes. The Tax Court, however, held for the taxpayer, concluding that although the insured in his fiduciary capacity had broad powers to effect changes in the beneficial ownership of the policies or their proceeds, none of these powers could be used for his own benefit; consequently they would not qualify as "incidents of ownership" that would require inclusion of the policy proceeds in decedent's gross estate by reason of section 2042(2).

The Second Circuit affirmed the Tax Court's decision on appeal, holding that where powers which may not be exercised so as to benefit the decedent are conferred upon him in his capacity as trustee the "incidents of ownership" test of section 2042(2) is not met. The court
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 . . . .

5. The amount to be included in the gross estate where inclusion results under § 2042 is the full value of the proceeds payable to the beneficiary. Int. Rev. Code of 1954, § 2042; Treas. Reg. § 20.2042-1(a)(3) (1958). The proceeds of the policies on Skifter's life amounted to $121,923.52. The proceeds had been included in Mrs. Skifter's gross estate at a value of $20,620.32. The value was different because Mrs. Skifter was not the insured, and the policies were therefore included in her gross estate as property owned by her at death [see Int. Rev. Code of 1954, § 2033], rather than as insurance on the life of decedent. Valuation of insurance on the life of one other than the decedent is provided for in Treas. Reg. § 20.2031-8(a), T.D. 6680, 1963-2 Cum. Bull. 417.


Courts have found incidents of ownership when the insured possessed at his death the power (1) to alter the beneficiary under a policy, Commissioner v. Noel, 380 U.S. 678, 683 (1965); Commissioner v. Karagehussian, 233 F.2d 197 (2d Cir. 1956); (2) to surrender or cancel the policy, Commissioner v. Treganowan, 183 F.2d 288 (2d Cir. 1950), cert. denied, 340 U.S. 853 (1950); (3) to borrow from the insurer against the surrender value of the policy, Fried v. Granger, 105 F. Supp. 564 (W.D. Pa. 1952), aff'd, 202 F.2d 150 (3d Cir. 1953); and (4) to assign the policy, Commissioner v. Noel, 380 U.S. 678 (1965).
concluded that Congress did not intend to tax such an arrangement as a substitute for a testamentary disposition by the insured-decedent. While the court was willing to concede that non-beneficial powers retained in connection with a transfer of the beneficial interest in the policies might constitute incidents of ownership, it found that situation to be distinguishable from Skifter, where decedent gave up all rights in the policy and later received a grant of non-beneficial powers over the policy in connection with a transfer in trust.

Both the Tax Court and the Second Circuit admitted the presence of a novel question. Neither court, however, seems to have made adequate use of what source material was available to guide it in resolving the question. Little support can be found for their conclusion in the statute, the Treasury regulations, or the case law.

**Defining Incidents of Ownership**

Under the Internal Revenue Code of 1939 as amended by the Revenue Act of 1942, the value of the decedent's gross estate included the proceeds of life insurance if (1) the proceeds were paid to the decedent's estate, (2) the decedent paid the premiums on the policies or (3) he possessed any incidents of ownership in the policies.

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7. 72-2 U.S. Tax Cas. ¶ 12,893, at 8600. The purpose of section 2042 is to defeat a means of estate tax avoidance. See H.R. Rep. No. 767, 65th Cong., 2d Sess. 22 (1919). Life insurance makes such avoidance possible because it is not includable as property owned by the decedent at death. See Int. Rev. Code of 1954, § 2033 (providing for inclusion in the gross estate of property owned at death by decedent). Since the theory of the federal estate tax is to tax transfers made at death [see notes 27-29 infra and accompanying text], the decision as to whether an arrangement is in substance a testamentary disposition may provide a clue as to whether such arrangement is within the scope of the statute where the words of the statute are not clear. Cf. Porter v. Commissioner, 288 U.S. 436, 444 (1933) (holding that the power of Congress to tax substitutes for testamentary disposition was unquestionable).

8. 72-2 U.S. Tax Cas. ¶ 12,893, at 8600. The court reached this conclusion because of its view that where powers are retained, it is fair to treat the arrangement as a testamentary substitute. Id.

9. Id. at 8599; 56 T.C. at 1197.


11. Prior to 1942, insurance was included if taken out by the decedent on his own life. The 1942 change was made because of conflicting interpretations as to whether incidents of ownership or premium payments was the decisive factor. See generally 2 J. Mertens, The Law of Federal Gift and Estate Taxation §§ 17.03-04 (1959).

at his death. If the decedent continued to pay the premiums, the policy proceeds were included in his gross estate in proportion to the amount he had paid, even if he had made an irrevocable assignment of the policies on his life. Thus, once the insured began to pay premiums on a policy on his own life, it was not possible, by giving away all rights to and control over the policy, to remove all the proceeds from his gross estate. It became apparent that the premium payment test provided a permanent block to reducing the amount of the gross estate. Where any other type of property is concerned, a complete transfer of all rights and control in property more than three years before decedent’s death will bar inclusion of the property in his estate. Since this discrimination against life insurance was considered to be unjustified, the premium payment provision was eliminated in the 1954 code. This change left the incidents of ownership test as the sole determining factor of inclusion in decedent’s gross estate of policy proceeds payable to beneficiaries other than decedent’s estate.

Some definition of what powers or rights are included in the term “incidents of ownership” is provided by the regulations and the case law. The specific problem which arose in Skifter was whether the possession of powers which would qualify as incidents of ownership if conferred by the terms of the policy, but which were conferred by a trust instrument, will also cause the proceeds to be included in the insured’s gross estate. In holding that they would not, at least in the case where they could not be exercised by decedent for his own benefit, both courts were faced with the problem of reconciling Treasury regulations 20.2042-1(c)(2) and 20.2042-1(c)(4) with each other. Regulation section 20.2042-1(c)(2) provides that, in general, the

13. The insured’s only alternative was to surrender the policy and receive the cash surrender value. He could then give away the cash. However, this would cause a sacrifice of the benefits that flow from keeping the policy until death.


16. The assignment of the entire interest of decedent would normally remove the policy proceeds from the gross estate. Treas. Reg. § 20.2042-1(c)(1) (1958). The problem arose because of what the Tax Court termed the “fortuitous circumstance” that Mrs. Skifter died first and named Skifter as trustee of her testamentary trust. 56 T.C. at 1197.

17. Treas. Reg. § 20.2042-1(c)(2) (1958) provides:

For 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 bene-
term "incidents of ownership" refers to the right to economic benefits, while regulation section 20.2042-1(c)(4)\textsuperscript{18} indicates that decedent will be considered to have an incident of ownership in life insurance policies on his life held in trust if he has the power to change the beneficial ownership and enjoyment of the proceeds even though he may not have a beneficial interest in the trust.

The Tax Court saw the regulations as reconcilable in one of two ways. The first alternative would be to read the introductory phrase "generally speaking" in regulation section 20.2042-1(c)(2) as not meant to exclude the possibility of non-beneficial interests. If this alternative was not acceptable, then regulation section 20.2042-1(c)(4) must be limited to the situation where decedent retains powers under a transfer in trust. Under this reading, a non-beneficial power is taxable only if retained by decedent, and not where such a power is conferred upon him by the independent actions of another person.\textsuperscript{19}

Both courts rejected the first possibility of reconciling the regulations, reasoning that, except in the situation described by regulation section 20.2042-1(c)(4), section 2042 was intended to tax only beneficial interests.\textsuperscript{20} The requirement of regulation section 20.2042-1(c)(4) that non-beneficial powers be taxed was limited to apply only to

\begin{itemize}
\item 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. . . . (emphasis added).
\item 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. . . . (emphasis added).
\item Treas. Reg. § 20.2042-1(c)(4) (1958) provides:
\item 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. . . . (emphasis added).
\item Since Treas. Reg. § 20.2042-1(c)(4) (1958) is the only section which speaks of policies "held in trust" [see note 18 supra], it might be argued that this regulation was designed to deal with the special situation in which an insurance policy is placed in a trust. If this construction were correct, then there would be no conflict between Treas. Reg. §§ 20.2042-1(c)(2) and 20.2042-1(c)(4), and the Skifter case would be governed by Treas. Reg. § 20.2042-1(c)(4).
\item The Tax Court devoted more space to construing the regulation than did the Second Circuit, which was content to adopt the lower court's reasoning in this regard. \textit{Id}. Since the regulations, which are promulgated pursuant to statutory authority [\textsc{Int. Rev. Code} of 1954, § 7805], are a formal explanation of the statute, it would be preferable to reconcile them in order that they give some aid in interpreting the statute; however, if the regulations exceeded the scope of the statute they would be invalid. \textit{See}, \textit{e.g.}, Manhattan Gen. Equip. Co. v. Commissioner, 297 U.S. 129 (1936).
powers retained in connection with a transfer of the policies. Therefore, since the powers possessed by Skifter at his death were not retained powers, some power to benefit himself had to be found in order to tax the proceeds. The power possessed by decedent as trustee was a power to prefer the income beneficiary over the remaindermen, and the exercise of this power could not benefit Skifter; therefore, no inclusion resulted.

It is difficult to find support for this conclusion in the statute, the regulations, or any available evidence of legislative intent. The statute by its terms requires only that incidents of ownership be "possessed" at death; in other sections in which retention of some power or interest is a condition of inclusion, specific wording to that effect is present in the statute.\footnote{22} Moreover, the examples of "incidents of ownership" contained in the committee reports which accompanied the statute when the term was first introduced in 1942,\footnote{23} seem to be

\footnote{21. The Tax Court said:}

\footnote{\textit{However, (c) (4) casts a cloud upon (c) (2), and we are not sure precisely what (c) (4) was intended to achieve. . . . It may be that it was intended primarily to govern situations like the creation of a trust by the insured who transfers policies owned by him to the trust. . . . And since a transfer of property generally with reservations of powers by the transferor as trustee may be sufficient to bring the property within the gross estate regardless of whether such powers may be exercised for his own benefit, it would be entirely appropriate to give (c) (4) a reading that would treat insurance in the same manner.}}

56 T.C. at 1198-99.

\footnote{22. \textit{See}, e.g., \textit{INT. REV. CODE} of 1954, § 2036(a) (1), which causes inclusion in the gross estate of property in which the decedent retained an income interest in connection with an inter vivos transfer of the property.}


There is no specific enumeration of incidents of ownership, the possession of which at death forms the basis for inclusion of insurance proceeds in the gross estate, and 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. \textit{Incidents of ownership are not confined to those possessed by the decedent in a technical legal sense.} (emphasis added).

The language of the House Report is reiterated in S. Rep. No. 1631, 77th Cong., 2d Sess. (1942). The reference to the power to "change the beneficiary" would seem to include powers over the right to the economic benefits of the insurance even if the insured did not have the right to those benefits.

The examples of incidents of ownership listed in the House Committee report were used as the basis for the examples given in the regulations. \textit{See} Treas. Reg. § 20.2042-1(c) (2) (1958). One interesting discrepancy between the language in the
broad enough to include any power to affect the beneficial interest and enjoyment of the policies or proceeds thereof, regardless of whether decedent may benefit himself through exercise of the power. 24

Faced with this lack of direct authority, the Second Circuit turned elsewhere to find support for its theory. Because of the decision made by Congress in 1954 to treat life insurance in the same manner as other property, the court reasoned that some aid to construction of section 2042 might be found in the treatment of other types of property under other estate tax provisions. It found the support it needed in its construction of those other provisions.

GENERAL PATTERN OF ESTATE TAXATION

The Second Circuit in Skifter concluded that it was the intent of Congress in eliminating the premium payments test as a factor in the taxation of life insurance proceeds to parallel the estate taxation of life insurance with that of other property. 25 From this conclusion report and the language of the regulations may be an intentional change. In the committee report "the right . . . to the economic benefits of the insurance" and "the power to change the beneficiary" (which is not necessarily a beneficial power) are both listed as separate examples of incidents of ownership. The regulations state that "generally speaking, the term has reference to the rights of the insured . . . to the economic benefits of the policy," and then refer to "the power to change the beneficiary" as one of several examples which are within the meaning of the term. See Treas. Reg. § 20.2042-1(c)(2) (1958) reproduced in note 17 supra. Possibly this change means that the Treasury intended that powers such as the right to change the beneficiary, which are not necessarily exercisable for the benefit of the holder of the power, are within section 2042(2) only if they may be exercised for the benefit of the insured. However, such a conclusion is difficult to reach from what may have been an unintentional change in language.

24. Support for this proposition was advanced in United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7, 11 (1st Cir. 1966), wherein the court said:

Plaintiffs seize on Section 20.2042-1(c)(2) of the Treasury Regulations on Estate Tax, which says . . . 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. Plaintiffs urge that there must be 'a real control over the economic benefits.' To this there are two answers. 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, 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. (emphasis added).

25. See note 14 supra and accompanying text. The theory that concepts applicable to other estate tax sections should be used in construing the life insurance section is worthy of closer examination than the court's statement might indicate. It is arguable that the legislative history concerning the elimination of the premium payments test is
the court reasoned that in construing section 2042 it should "look to the experience under the statutory scheme governing the application of the estate tax to other types of property." The Commissioner also accepted the argument that other sections of the Code might provide a guide to interpretation of section 2042(2); he contended that the tax pattern established by these sections provided support for the conclusion that incidents of ownership include the power to affect the beneficial enjoyment of others, even though the decedent could not benefit himself. To determine the effect of this scheme, it is necessary to examine the language and application of the various estate tax sections to determine exactly what powers and interests Congress intended to include under the estate tax section of the Code.

too skimpy to support the conclusion that Congress intended that the whole body of law regarding inclusion of other types of property under sections 2033 through 2038 be incorporated wholesale into section 2042. Only two statements are available concerning the change. The first is the statement by the committees that the change was made because "[n]o 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." S. Rep. No. 1622, 83d Cong., 2d Sess. 124 (1954). The other is the explanation by the committee of the incorporation into section 2042(2) of the section 2037 rule that reversionary interests qualify for inclusion only if their value exceeds five percent of the value of the property. In this respect the committee stated that "[t]o place life-insurance policies in an analogous position to other property, however, it is necessary to make the 5-percent reversionary rule, applicable to other property, also applicable to life insurance." S. Rep. No. 1622, 83d Cong., 2d Sess. 124 (1954). The Second Circuit, while admitting that "this legislative history is hardly conclusive upon the matter," [72-2 US TAX CAS. ¶ 12,893, at 8599] found additional support for the analogy in the fact that the examples of incidents of ownership set forth in the committee reports accompanying the 1942 change were the same types of powers that cause inclusion of other types of property under sections 2036, 2037, 2038 and 2041. See note 23 supra.

One argument which might be made in support of the conclusion that section 2042 must be construed without reference to other sections is the argument that life insurance is inherently testamentary. Life insurance is not like other property since the essence of a purchase of life insurance is the receipt of benefits after the death of the insured; life insurance is thus by its nature a will substitute. This was the theory advanced by a minority of the members of the House Ways and Means Committee in the debate over the 1954 enactment. See H.R. Rep. No. 1337, 83d Cong., 2d Sess. B14 (1954). However, the rejection of this theory by Congress is evidenced by the section that was eventually adopted, since that section subjects life insurance to estate taxation only in certain specific circumstances.

The Second Circuit's theory that other sections may aid in construction of section 2042(2) seems to be basically sound. Since section 2042 is designed to foreclose another means of estate tax avoidance [see note 7 supra], it seems reasonable to conclude that it should be construed in a manner which will best make it fit the general tax pattern.

26. 72-2 U.S. TAX CAS. ¶ 12,893, at 8599.
The federal estate tax is imposed on the privilege of transferring property at death. Adopted in 1916, the tax initially had as its basic plan the inclusion in the decedent's gross estate of any property he transferred at death. However, this tax could be easily avoided by transferring the property before death. Technically the transfer would not be testamentary, but the decedent, by retaining interests in or control over the property after the transfer, would have all the advantages of disposing of the property by will since he could postpone possession or enjoyment by the transferees until his death.

Today, certain sections of the Code specifically tax these types of transfers as substitutes for testamentary dispositions. For example, under section 2040 property owned by decedent and another as joint tenants with a right of survivorship is fully taxed to the estate of the deceased joint tenant if he supplied the consideration for the property. Even though there is no "transfer" to the surviving joint tenant, this section taxes as a substitute for a testamentary disposition the increased right of possession or enjoyment which passes to the surviving tenant as a result of the death of the decedent. Similarly, section 2035 taxes property in which the decedent has given up all interest and control to another person by inter vivos transfer in contemplation of death. Although there is no transfer at death, the section is applied


29. There were many early constitutional objections to Congress applying a tax to an inter vivos transfer. One argument was that when the estate tax was applied to an inter vivos transfer, it was a direct tax and must be apportioned. Another line of reasoning urged that such a tax violated the due process clause of the fifth amendment. See United States v. Manufacturer's Nat'l Bank, 363 U.S. 194 (1960); Helvering v. Bullard, 303 U.S. 297 (1938).

30. INT. REV. CODE of 1954, § 2040 provides that: "the value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants by the decedent and any other person . . . ."


32. INT. REV. CODE of 1954, § 2035 states:
   (a) The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer . . . in contemplation of his death.
   (b) If the decedent within a period of 3 years ending with the date of his death . . . transferred an interest in property, relinquished a power, or exercised or released a general power of appointment, such transfer, relinquishment, exercise or release shall, unless shown to the contrary, be deemed to have been made in contemplation of death . . .
to transfers made within three years prior to the decedent’s death in order to include within the scope of the estate tax transfers for which the decedent had a “testamentary motive.” Since these transfers are substitutes for a will, the estate tax is applied. Exactly what Congress intended to achieve in the overall estate tax picture by enacting section 2042(2) can best be determined by comparing the language of that section to the use of similar language in other sections of the Code.

Two of the estate tax sections specifically require that the decedent retain an interest in the transferred property before taxation will result. For purposes of inclusion of property in the gross estate by reason of section 2036 the decedent must retain for life the right to income from property he transfers, or the right to designate the persons who shall possess or enjoy the income. Similarly, section 2037 taxes a transfer whereby possession or enjoyment of the property can be obtained by the transferee only by his surviving the decedent-transferor. Here too it is specifically provided that as a prerequisite for inclusion under this section the transferor must retain a reversionary interest in the transferred property.


34. See Porter v. Commissioner, 288 U.S. 436 (1933).

35. Int. Rev. Code of 1954, § 2036 states:

(a) The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer . . . 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.

36. Int. Rev. Code of 1954, § 2037 provides in part:

(a) General Rule — The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent . . . made a transfer . . . by trust or otherwise if—

(1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and

(2) the decedent has retained a reversionary interest in the property . . . and the value of such reversionary interest immediately
Since Congress specifically used the word "retained" in these two sections, the Second Circuit's reasoning in Skifter that in order for section 2042(2) to apply the decedent's powers must be retained is subject to criticism. Unlike sections 2036 and 2037, section 2042(2) requires inclusion where "the decedent possessed at his death" incidents of ownership. It seems probable that if Congress had meant to tax only the retention of powers it would have used the word "retain" instead of "possess"; the forerunners of sections 2036 and 2037, which required retention, were in existence before the incidents of ownership test was placed in the Code. By choosing the word "possess" Congress must have intended to broaden the scope of the insurance section.

Since retention was not expressly required in section 2042(2), it is likely that this section was patterned upon the predecessor section to section 2038, which required only that the enjoyment of the property transferred by the decedent be subject at the date of his death to change through the exercise of a power to alter, amend or revoke. The theory that retention is not required where the literal language of the statute does not call for retention was first tested in White v. Poor. In that case the settlor created a trust which could be terminated by the joint action of three trustees, one of whom was the settlor. She resigned, and a successor trustee was chosen. At a later time before the death of the decedent exceeds 5 percent of the value of such property.

(b) Special Rules — For purposes of this section, the term "reversionary interest" includes a possibility that the property transferred by decedent—
(1) may return to him or his estate, or
(2) may be subject to a power of disposition by him. (emphasis added).

37. The "incidents of ownership" test was placed in the insurance section in 1942. See notes 10 & 11 supra and accompanying text. The forerunners of sections 2036 and 2037 were contained in the Internal Revenue Code of 1939 [see Int. Rev. Code of 1939, § 811(c)] and had been in effect in some form since 1916. See 2 J. MERTENS, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 20.01 (1959).

38. Revenue Act of 1926, ch. 27, § 302(d), 44 Stat. 71 [hereinafter cited as Revenue Act of 1926], as amended Int. Rev. Code of 1954, § 2038(a)(1), which, for transfers after June 22, 1936, includes in the decedent's estate the value of all property:
To the extent of any interest therein of which the decedent has at any time made a transfer . . . by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (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. (emphasis added).

this trustee resigned and the other trustees reappointed the settlor. The Supreme Court held that the settlor's power to terminate, possessed by her at death, was a result of her appointment by the remaining trustees and not a power which she had reserved to herself in the trust instrument, and that no taxation should result. The Court thus interpreted the language of the section as requiring retention of a power. This decision prompted Congress to enact in its next session an amended version of the section which provided for inclusion of property subject to a power "in whatever capacity [the power was] exercisable," and "without regard to when or from what source decedent acquired such a power."40 The inference which may be drawn from this specific congressional response is that where no retention is required by a section, possession rather than retention is intended to cause taxation.

Not only does the language of section 2038 seem to require taxation where the decedent possesses qualifying powers regardless of whether they were retained in connection with a transfer, but section 2038 seems directed toward taxation of any power which may affect the beneficial ownership of property, rather than only those powers which the decedent may use to benefit himself economically. Section 2038(a) (1) requires taxation of all interests transferred by the decedent whose enjoyment by the transferee is subject to any change through the exercise of a power to alter, amend, revoke or terminate.41 The Treasury regulations interpret the section as applicable "to any power affecting the time or manner of enjoyment of property or its income, even though the identity of the beneficiary is not affected."42 The Supreme Court has also applied the section to powers through which the donor has retained control over the economic benefits transferred, even though he could not benefit himself.43 Thus there

41. INT. REV. CODE of 1954, § 2038(a) (1) states:
The value of the gross estate shall include the value of all property ... [t]o the extent of any interest therein of which the decedent has at any time made a transfer ... 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.
43. See Lober v. United States, 346 U.S. 335 (1953). In that case the decedent transferred property to a trust for the benefit of his children, and retained as trustee the powers to accumulate the income and to distribute corpus to the beneficiaries. The Court held that the decedent's control over the property rendered it subject to
seems to be no greater merit to an argument that section 2038 is concerned with whether powers are beneficial than there is to the theory that the section requires retention.44

Nevertheless the Second Circuit found that non-beneficial power over property would not be taxed under section 2038 unless it was retained by the decedent. The court responded to the congressional change in the language of the section by stating that the section "has not been applied when the power possessed by decedent was created and conferred on him by someone else long after he had divested himself of all interest in the property subject to the power."45 Thus the court, finding that section 2038 would not have reached the Skifter situation had the insurance been ordinary property, concluded that the tax pattern required that section 2042(2) not be applicable.

The court's theory is subject to sharp criticism; it is difficult to see how the fact that no case could be found applying section 2038 to this type of situation provides any support for the theory that it should not be so applied, at least in the absence of any case even considering the argument. It is a theory which is especially difficult to maintain in light of the specific congressional response to White v. Poor; Congress emphatically rejected a judicial attempt to limit the broad scope of section 2038. Regardless of the merit of the court's argument that no testamentary disposition is involved where the powers are not retained, the theory of section 2038 seems to be that control over the economic

44. Sections 2036 and 2037 also apply regardless of whether decedent's power could be exercised so as to benefit himself. Section 2036(a)(2) deals with powers to designate who shall possess or enjoy the property transferred by decedent. Under this section a decedent who has the power to shift income between an income beneficiary and a remainderman will be held to have a taxable power even though he could not benefit himself, since he is able to determine who among the potential takers will possess or enjoy the income. See Treas. Reg. § 20.2036-1(b)(3), T.D. 6501, 1960-2 CUM. BULL. 271. See also C. LOWNDES & R. KRAMER, supra note 31, § 8.19, at 156. Similarly, under section 2037 the reversionary interest which decedent must retain is defined to include powers of disposition which are not necessarily beneficial to the decedent. C. LOWNDES & R. KRAMER, supra note 31, § 7.5, at 108-09. See also Morristown Trust Co. v. Manning, 104 F. Supp. 621, aff'd, 200 F.2d 194 (3d Cir. 1952), cert. denied, 345 U.S. 939 (1953); Estate of Elizabeth D. Hill, 23 T.C. 588, aff'd, 229 F.2d 237 (2d Cir. 1956).

Although these sections provide support for the theory that no power to benefit oneself is necessary under the general tax pattern, they would not reach a case such as Skifter since both sections expressly require retention of the powers. See notes 35-37 supra and accompanying text.

45. 72-2 U.S. TAX CAS. ¶ 12,893, at 8601. The court limited the 1936 amendment to the situation where powers originally possessed by the decedent were given away and then reconferred upon him. Id.
benefits of property by a person who has at one time owned the property is sufficiently testamentary to cause taxation, regardless of where he obtained this control.\textsuperscript{46}

The statutory scheme would therefore seem to provide support for the conclusion that 2042(2) should be construed so as to tax the insurance proceeds in \textit{Skifter}. The arrangement in \textit{Skifter} is a testamentary disposition of the type that the tax pattern is designed to reach. Despite the fact that this transaction was not a will substitute in the sense of an intentional device to retain the benefits of ownership of the property until death, the discretionary control over the enjoyment of property possessed by the decedent until his death was testamentary; because of \textit{Skifter}'s powers the interests of the beneficiaries were subject to change until his death.

**Decedent As A Fiduciary**

Another element in the \textit{Skifter} court's decision was the fact that the decedent's powers were held in his capacity as trustee, and thus were fiduciary powers exercisable only for the benefit of others. The Second Circuit's conclusion was similar to the reasoning used by the Sixth Circuit in its recent decision in \textit{Estate of Fruehauf v. Commissioner}.\textsuperscript{47} In that case, decedent's wife had purchased life insurance on her husband's life and named herself and her children as beneficiaries. The wife kept control of the policies and paid all the premiums until her death. In her will, decedent was named income beneficiary of the policies, which were placed in trust. Decedent was further named as one of the co-trustees who were given powers to sell, assign or surrender the policies as well as to cause themselves to be designated beneficiaries.\textsuperscript{48} While the Sixth Circuit found that the decedent possessed taxable incidents of ownership because the decedent as trustee could have exercised the powers in a manner to benefit himself as income beneficiary, the court rejected the theory that mere possession of incidents of ownership invariably requires inclusion in the decedent's gross estate, especially when, as trustee, he has the duty to act for the benefit of others.\textsuperscript{49}

\textsuperscript{46} See Rev. Rul. 70-348, 1970-2 \textsc{Cum. Bull.} 193, holding that Int. Rev. Code of 1954, § 2038 applied to securities transferred by the decedent to his minor children under the Uniform Gifts to Minors Act which were held by him as successor custodian at the time of his death.

\textsuperscript{47} 427 F.2d 80 (6th Cir. 1970), aff'g 50 T.C. 915 (1968).

\textsuperscript{48} The Commissioner ruled that these powers constituted "incidents of ownership" under Int. Rev. Code of 1954, § 2042.

\textsuperscript{49} 427 F.2d at 85.
The court of appeals in *Fruehauf* based its conclusion on the earlier tax court cases of *Estate of Newcomb Carlton* and *Estate of Bert L. Fuchs*, both of which had held that insurance proceeds were not includible in an insured-decedent's gross estate when the only powers he had over the policies were required to be exercised in a fiduciary capacity or for the benefit of another. In *Carlton*, decedent created an inter vivos trust into which he placed life insurance policies on his life and securities with which to pay the premiums on the policies. He originally possessed certain powers over the policies but by subsequent instruments relinquished all rights except the right to income in excess of that necessary to pay the premiums on the policies and the right to appoint a co-trustee, including himself, for a co-trustee who had resigned. The trustees had broad powers to deal with the policies. But for the fact that at the time of his death the powers he retained were unexercised, decedent could have had powers equal to "incidents of ownership." However, the Tax Court determined that even if the insured had exercised his right to appoint himself trustee, his control over the policies would have been exercised jointly with the other trustee and, so applied, could only benefit the trust and not himself. Although the case was reversed on other grounds, the Tax Court's opinion in this respect was approved, intimating that such control in the limited capacity as trustee would not constitute taxable incidents of ownership in the decedent.

In *Fuchs*, the Tax Court was faced with a situation in which two partners had taken out reciprocal life insurance policies to fund a buy-

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50. 34 T.C. 988 (1960), rev'd on other grounds, 298 F.2d 415 (2d Cir. 1962).
52. The trustees had the power to receive premium payments on the policies, surrender a policy for its cash value, obtain loans and invest and reinvest the principal of the trust in their discretion. 34 T.C. at 990.
53. *Id.* at 996.
54. 298 F.2d 415 (2d Cir. 1962).
55. Judge Medina in a concurring opinion apparently approved the Tax Court's opinion regarding incidents of ownership, intimating that control as trustee would not cause inclusion in the gross estate, when he stated:

In the paragraph wherein the grantor stated his intention to part with, and transfer to the trustees, all rights to the insurance policies, the right to surrender them for their cash surrender values and the right to obtain loans on them are listed; however, these rights could of course be exercised only as directed by the grantor elsewhere in the trust instrument and in conformity with the purpose and intent of the trust. In other words, subject to the primary and clearly implied direction that the policies be preserved for and the proceeds paid to the grantor's son, the beneficiary.

*Id.* at 420.
sell agreement. Although they intended each policy to be owned by the partner who was named as beneficiary and not by the insured partner, several powers, including the right to change the beneficiary, were left with the insured by mistake. The court emphasized that, regardless of what the policy said, each insured was under a legal duty to respect the terms of the partnership agreement, which, as a practical matter, prevented any action by the insured contrary to the parties' original intent. Although the case did not involve a trust, the court drew an analogy between the insured's position in that case and that of a common trustee obligated to respect the terms of the instrument granting him power, observing, "decedent merely had the same type of power over the . . . policies as a trustee's power to affect trust proceeds. We do not believe this type of naked power alone is sufficient to bring the insurance proceeds within decedent's gross estate." 56

The results in these cases to some extent turn upon the rationale that decedent does not possess taxable incidents of ownership if he is not able to benefit himself through the exercise of his powers. However, there is also a slightly different element involved in these decisions; particularly in Fuchs, the theory is developed that powers which might otherwise constitute incidents of ownership will not be taxed where they are exercisable by the decedent only in a fiduciary capacity. The basis for this argument seems to be that the power of a fiduciary is not as great as the power would be if held by another since a fiduciary is answerable for his actions in a court of equity. 57

The theory that the fiduciary nature of the powers itself prevents taxation is somewhat faulty. The Treasury regulations interpreting section 2042 specifically state that it is irrelevant whether or not the decedent's powers are exercisable in his capacity as a trustee. 58 These regulations paraphrase what is accepted doctrine under the other sections of the estate tax. 59 The mere fact that a power is fiduciary has no appreciable effect upon the scope of the power, par-

56. 47 T.C. at 204. See also National Metropolitan Bank v. United States, 87 F. Supp. 773 (Ct. Cl. 1950). In that case a son had taken out insurance on his mother's life and the policies reserved the usual rights and powers to the mother as the insured. Included among these powers was the right to change beneficiaries. However, since it was understood by the parties that the policies belonged to the son, the court refused to apply the estate tax at the mother's death, reasoning that she would never have tried to exercise any of the reserved rights to benefit herself.


particularly in cases which involve family situations or powers that are stated to be discretionary by the instrument which confers them. 60

A different theory is the doctrine that fiduciary powers the exercise of which is controlled by an ascertainable standard are not taxable. The courts have developed the theory under the other estate tax sections that a power which would otherwise be within the scope of the Code will not be taxed where it may be exercised only in accordance with a definite and ascertainable standard which will be enforced by a court of equity. 61 The reasoning is that there is no discretionary control where the actions of the holder of the power are limited by an external standard which can be enforced against him. 62

There is no persuasive argument against applying this doctrine in the insurance area. Where the decedent's actions can be controlled by those whose interests they affect, his power seems to be too insubstantial to be termed an incident of ownership. Moreover, since many of the concepts of section 2042 are taken from the other estate tax sections, 63 there is logical force to the argument that the ascertainable standard doctrine should also be carried over into the taxation of insurance.

However, even if this doctrine is applicable to insurance, it should not prevent taxation in the Skifter situation. Although by the terms of the trust Mrs. Skifter indicated that the income beneficiary should be favored, the decedent was authorized in his complete discretion to distribute all or any part of the principal of the trust to the income beneficiaries, to retain, sell, mortgage, lease or otherwise dispose of the property, 64 and in general to exercise all rights and powers as if he were the absolute owner of the policies. 65 The terms of the trust expressly exonerated the decedent from the application of any rules of trust law which would require him to act impartially as between

60. The terms of the instrument creating the fiduciary's powers can authorize him to do that which, in the absence of such provisions, would be a breach of the fiduciary's duties. 2 H. Scott, THE LAW OF TRUSTS §§ 170.9-.10 (3d ed. 1967). In addition, in the family situation, additional power may be given to the decedent by factors outside of the trust instrument.


62. Id. at 1079.

63. See notes 36-40 supra and accompanying text.

64. See note 3 supra.

65. Part of Mrs. Skifter's will provided:

Six: A. . . . I authorize my Executor and also my Trustee, as the case may be, in his absolute discretion, with respect to any property, real or personal, . . . generally to exercise all such rights and powers and to do all such acts as I might do with respect to such property if I were living and the absolute owner thereof.

56 T.C. at 1192.
income beneficiaries and remaindermen. Because of these provisions, the decedent's power was not subject to a standard that a beneficiary could enforce in a court of equity. Therefore the fact that Skifter was a trustee should have had no effect on taxation of the insurance policies on his life.

CONCLUSION

Although the Skifter decision at first glance seems to provide a favorable result for taxpayers, the confusion which is inherent in the distinctions drawn by the court is less heartening. The holding that non-beneficial, non-retained powers are the point at which the line between taxability and non-taxability will be placed introduces further technicality into a section which is already complex. In addition, the fact that the court's reading of the statute is ill-founded means that the case might be dangerous precedent upon which to rely in future controversies; it also indicates that perhaps further congressional action to clarify this area of the estate tax is needed. Despite the result reached in Skifter, it seems that placing the decedent as trustee of a trust which contains insurance policies on his life is not careful tax planning.

66. See note 3 supra.