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PRESENT FEDERAL ESTATE TAX includes proceeds of insurance on the life of a decedent in his gross estate in two instances: if the proceeds are payable to the estate of the insured; or if he possessed "incidents of ownership" at the time of death.[1] The "premium payments" test of the 1939 Code was omitted from the 1954 Code. However, if decedent had transferred his insurance but continued to pay the premiums thereon, other sections of the Code may result in inclusion of the proceeds or some portion thereof in the estate, even if neither condition of Section 2042 is met. The greatest danger is when the transfer is one deemed in contemplation of death.[2] The Commissioner has argued that a transfer of life insurance may be in contemplation of death and the courts have upheld this contention.[3]

Ordinarily when a donor lives for three years after the transfer, section 2035(b) says the gift cannot be attacked as being made in contemplation of death. However, if the transferor of an insurance policy continues to pay the premiums after the transfer several questions are presented. Should each of these payments be regarded as a further gift, with the payments during the last three years considered as gifts in contemplation of death? If so, what amount would be included in the donor's estate because of the subsequent premium payments? Neither question has been answered by the courts. This paper attempts to suggest a possible solution.

The initial inquiry must be whether the premium payments during the last three years were paid in contemplation of death. Even if the original transfer was to avoid estate taxes, a different motive might be involved in paying the donee's premiums.[4] Yet it is probable that the courts will relate the premium payments back to the original purpose of estate tax avoidance. Therefore,

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1 I.R.C. § 2042 (1954).

2 I.R.C. § 2035 (1954).

3 Garrett's Estate v. Commissioner, 180 F. 2d 955 (2d Cir. 1950).

4 Brow & Sherman, Payment of Premiums as Transfers in Contemplation of Death, 101 Trusts & Estates 790 (1962).

as gifts in contemplation of death, some amount will be included in the decedent's gross estate.

One theory would include a pro rata portion of the proceeds themselves as the amount to be included.[5] For example, the insured transfers his policy two years after issue, dying seven years later. If he continues paying the yearly premiums until his death, under the pro rata theory his gross estate would include one-third of the proceeds. Of course, the longer the donor lives, the less the proportion of the proceeds that will be included in his gross estate. In *Liebmann v. Hassett*[6] the donee paid the policy premiums from time of transfer. Although the transfer was held to be in contemplation of death, ". . . the proportionate part of the insurance purchased by the [premiums paid by the donee] should be excluded from the gross estate."[7]

Another view, although extreme, would include the entire proceeds, rather than only a pro rata share, in the estate of the subsequent premium payer.[8] The theory behind this contention is that the policy would have lapsed if the premiums had not been paid.

A final alternative would be to include only the cost of the premiums themselves in the gross estate. Since there must be a transfer of an interest in property under section 2035, it seems doubtful if the subsequent payment of premiums amounts to such a transfer. The donor has already divested himself of the incidents of ownership of the policy within the meaning of section 2042. If the donor no longer owns an interest in the policy, that which he is transferring by premium payment can only be a sum of money.

A recent case demonstrates the tendency of the courts not to treat a transfer of premiums as a transfer in the interest of the policy. In *Goodnow v. United States*,[9] a husband transferred insurance policies on his life to an unfunded insurance trust of which his wife was the life beneficiary. From the date of transfer, the wife had paid all the premiums. As the husband had kept incidents of ownership, the proceeds were includible in his

[5] Bowe, Tax Problems in Ownership of Life Insurance Contracts by Persons other than the Insured, 49 Geo. L. J. 1, 20 (1960).

[6] 148 F. 2d 247 (1st Cir. 1944).

[7] *Id.* at 251.

[8] Warren & Surrey, Federal Estate and Gift Taxation, 537 (1961).

[9] 302 F. 2d 516 (Ct. Cls. 1962).

gross estate. However, the Commissioner contended that the trust was includible also in the life beneficiary's estate under section 2036(a)(1) of the 1954 Code as an inter vivos transfer with a retained life interest. The court rejected this view holding that the life interest she had in the trust income was not equivalent to the interest transferred by the premium payments.

This ruling makes sense since an insurance contract has elements of risk protection. Therefore the amount of the premiums paid bears no necessary relation to the amount of the proceeds. Nevertheless, at least some return is guaranteed even though the return of the premiums cannot be specifically determined.

Suppose the transferor furnishes the beneficiary with sufficient money to pay the premiums. With this device, the connection between the premiums and proceeds would not be so readily apparent as in direct payments by the insured. However, the success of this method is very unlikely. In *Loeb v. Commissioner*,[10] the proceeds were included in the donor's estate, even though the beneficiary claimed she could have used the funds given to her for any purpose. Although decided under the premium payment test of 1939 Code, its reasoning appears applicable to any indirect payment situation.

Conclusion

It might appear that those who advocate inclusion of subsequent premiums in the donor's gross estate are attempting to restore the discarded "premium payment" test. Yet, it is not on any theory of reacquiring ownership, but rather on the contemplation of death section that inclusion is based. For just this reason, the *Liebmann* theory of a pro rata share of the proceeds as the amount to be included must be rejected. The *Goodnow* case with its emphasis on the distinction between transfer of a sum of money as compared with a transfer of an interest in the policy should be controlling in this area. Therefore, the amount included in the donor's estate should be only the amount of the premiums paid by the donor within three years of his death.

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[10] 261 F. 2d 232 (2d Cir. 1958).