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NOTES

THE ESTATE TAX STATUS OF MICHIGAN "NO-FAULT" SURVIVORS' LOSS BENEFITS

INTRODUCTION

Life insurance is an asset owned by the majority of American citizens, and the life insurance industry holds huge dollar reserves nationwide.¹ The popularity of life insurance ownership is attributable in part to the estate planning flexibility that life insurance provides.² To capitalize upon the popularity of life insurance as an estate planning tool, insurance companies actively compete for tax-conscious buyers with life insurance plans which promise to provide estate tax savings. The Treasury Department has responded by continuously scrutinizing the taxation of policy proceeds. The resulting friction between the taxpayer, the insurance industry, and the Internal Revenue Service (IRS) has given rise to a steady stream of tax litigation. As a result, Congress is presented with a continuing problem of taxing life insurance in the most propitious manner for all concerned.

The implementation of no-fault auto insurance in Michigan³ has introduced a new and unique life insurance taxation problem to Congress and to the courts. Recently, the IRS has taken the position that Michigan no-fault survivors' loss coverage constitutes a policy on the life of the insured for estate tax purposes.⁴ According to the

1. At the close of calendar year 1975, there were \$2,140 billion of life insurance, face value, in force in the United States, covering 145 million lives. INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 9 (1976). See also Groll, *Life Insurance: Incidents of Ownership and Economic Benefit*, 16 DEPAUL L. REV. 339 (1967).

2. See generally CREEDON, SOME USES OF LIFE INSURANCE IN ESTATE PLANNING (1974); CASNER, ESTATE PLANNING ch. VIII (3d ed. 1961).

3. MICH. COMP. LAWS ANN. §§ 500.3101-3179 (Supp. 1977).

4. Letter from the District Director of the Internal Revenue Service, Detroit, Michigan, to the Executrix of the Estate of Anonymous, form L-191A (Rev. 4-74) December 17, 1976.

Mr. Anonymous, an insured driver under Michigan law, met his death in an automobile accident on October 14, 1974. The decedent carried a standard "no-fault" automobile insurance policy with the Aetna Casualty and Surety Company which provided, in pertinent part, as follows:

The Company will pay, in accordance with Chapter 31 of the Michigan Insurance Code, to or on behalf of each eligible injured person, or his depen-

IRS, death benefits paid to surviving dependents of the insured under the auspices of the statute should be subject to estate taxation as life insurance proceeds.

The wisdom of the IRS position appears dubious in light of the historical development and application of the estate tax laws concerning life insurance and wrongful death. As will be seen, Michigan survivors' loss benefits do not fall within the concept of taxable life insurance proceeds as developed by Congress and the courts. Furthermore, the benefits represent a non-taxable award closely akin to recovery for wrongful death. Although excluding survivors' loss benefits from the taxable estates of deceased taxpayers may reduce total revenues collected by the Treasury Department, it would not create a significant disruption of the national estate tax scheme.

The purpose of this note is to survey the federal law on estate taxation of life insurance and determine whether or not Michigan "no-fault" survivors' loss benefits should be taxed as proceeds of a life insurance policy. The examination will analyze the relationship between wrongful death recovery and survivors' loss insurance in Michigan, and discuss the inconsistency of a Treasury Department policy that would tax survivors' loss benefits while wrongful death recovery remains a tax-exempt award. Also, the tax code criteria for taxing life insurance proceeds will be investigated; demonstrating that survivors' loss benefits should not be treated as taxable proceeds under the code. Before the tax status of survivors' loss insurance can be ascertained, however, it is necessary to become

dent survivors, personal protection benefits consisting of . . . (c) survivors' loss as a result of bodily injury caused by accident and arising out of the ownership, operation, maintenance or use . . . of a motor vehicle as a motor vehicle.

Under the terms of the policy the decedent's widow received \$1000 per month from the date of the accident as survivors' loss benefits. The payments were reduced by Michigan workman's compensation benefits and federal Social Security benefits received by the children of the decedent, as required by the no-fault statute:

Benefits provided or required to be provided under the laws of any state or of the federal government shall be subtracted from the personal protection insurance benefits otherwise payable for the injury.

MICH. COMP. LAWS ANN. § 500.3109 (Supp. 1977). The reduced payments would continue until the decedent's wife received the \$36,000 maximum survivors' loss award.

As executrix of the decedent's estate, the decedent's wife filed an estate tax return with the IRS. Upon review of that return, the IRS examining agent proposed an increase in the decedent's gross estate of \$36,000. The agent maintained that survivors' loss benefits represent taxable life insurance proceeds under section 2042 of the Internal Revenue Code of 1954. Consequently, a tax increase in excess of \$5,000 was charged to the decedent's estate. At this writing, the IRS determination of deficiency is under official protest by the wife of the decedent.

familiar with the provisions of the Michigan no-fault automobile insurance law.

THE MICHIGAN NO-FAULT AUTOMOBILE INSURANCE LAW

In 1972 the State of Michigan revised its insurance code to provide for no-fault automobile insurance.⁵ The law was passed to permit expeditious compensation of motor vehicle accident victims for a certain portion of their economic loss and medical expenses without regard for fault.⁶ The law also preempts certain tort actions that were available to accident victims prior to passage of the no-fault act and limits the nature and measure of damages recoverable in the actions which remain available.⁷

5. MICH. COMP. LAWS ANN. §§ 500.3101-.3179 (Supp. 1977). The act applies to all motor vehicle accidents occurring on or after October 1, 1973. *Id.* § 500.3179. Passage of the act made Michigan the 19th state to adopt some form of no-fault statute. See Forkosch, *Torts: Annual Survey*, 20 WAYNE L. REV. 647, 647 n.2 (1974). For a comparative analysis of the various no-fault statutes see M. WOODROOF, J. FONSECA & A. SQUILLANTE, *AUTOMOBILE INSURANCE AND NO-FAULT LAW* (1974).

6. Personal protection insurance and property protection insurance are specifically provided without regard for fault. MICH. COMP. LAWS ANN. §§ 500.3105(2), .3121(2). Personal protection benefits are due within 30 days after the insurer receives proof of the accident and of the amount of the loss sustained. *Id.* § 500.3142.

7. The no-fault act abolishes all common law tort liability arising from the ownership, maintenance or use of a motor vehicle except for three specific instances. Liability still exists for intentional torts to person or property. *Id.* §§ 500.3105(4), .3135(2)(a). However, the statute modifies the common law definition of "intent" through incorporation of the common law privileges of self-defense and defense of others. A person does not intentionally cause injury under the statute if he acts or refrains from action for the purpose of avoiding injury to any person, including himself, or to tangible property.

Tort liability is also retained for non-economic loss (pain and suffering, loss of companionship) when the injured person has suffered death, serious impairment of body function or permanent serious disfigurement. *Id.* § 500.3135(1). "Non-economic loss" and "serious impairment of body function" are not defined by the statute. It has been suggested that "the vagueness and potential breadth of the Michigan language will invite litigation over the meaning of the terms themselves, and appears destined to spawn a large volume of actions on the merits." Forkosch, *TORTS: ANNUAL SURVEY*, 20 WAYNE L. REV. 647, 659 (1974).

Finally, tort liability is preserved for economic losses in excess of the monthly limitations placed on no-fault recovery for work loss and survivors' loss. MICH. COMP. LAWS ANN. § 500.3135(2)(c).

If a no-fault claimant recovers in tort for accidental bodily injury after he has received no-fault personal protection benefits "based on" the same injury, the claimant must reimburse the insurer out of his tort recovery a sum equal to the insurance benefits previously received. *Id.* § 500.3116. The utility of this provision is uncertain. Personal protection benefits are paid for economic loss only. Under § 500.3135, tort actions are maintainable only for non-economic loss, intentional torts, and economic loss above the no-fault statutory maximum. Accordingly, it is impossible to construct a

The cost of the program is distributed among all motor vehicle owners, each of whom must by law maintain a no-fault policy on his vehicle.⁸ Benefits are received by the insured from his own insurance company, thus replacing the three-party tort liability scheme with a two-party compensation system.⁹ Operation of an uninsured motor vehicle subjects the owner or operator to revocation of his driver's license as well as to other misdemeanor penalties.¹⁰

The statute provides three types of insurance coverage: personal protection,¹¹ property protection,¹² and residual liability,¹³ each providing its own special benefits. Personal protection insurance, the subject of present concern, compensates for accidental bodily injury occurring anywhere in the United States and Canada and arising out of the ownership, operation, maintenance or use of a motor vehicle.¹⁴ Personal protection coverage pays for "all reasonable charges" for the injured person's "care, recovery or rehabilitation" and funeral expenses of up to \$1000.¹⁵ Compensation is also provided for loss of employment income, payable for the first three years after the accident up to a maximum of \$1000 per month.¹⁶ The work-loss figure also includes up to \$20 a day to obtain personal services

hypothetical in which tort recovery for negligent injury and personal protection recovery would compensate for the same injury, unless § 500.3116 would reimburse economic loss insurers with the funds from non-economic tort recovery. That such a result was intended by the Michigan legislature is doubtful.

8. MICH. COMP. LAWS ANN. § 500.3101 (Supp. 1977).

9. Provision is also made for the vehicle owner to post security and be a self-insurer. *Id.* § 500.3101(4). Pedestrians involved in motor vehicle accidents are protected by an "assigned claims" provision of the statute. *Id.* §§ 500.3171-.3176.

10. MICH. COMP. LAWS ANN. § 500.3102 (Supp. 1977).

11. *Id.* §§ 500.3105-.3115.

12. *Id.* §§ 500.3121-.3127. Coverage of up to \$1,000,000 per accident is provided for loss of the use of tangible property through physical injury or destruction "arising out of the ownership, operation, maintenance or use of a motor vehicle. . . ." *Id.* § 500.3121(1), (2), (3). The amount recoverable is the lesser of repair or replacement, less depreciation, plus the value of the loss of the property's use. *Id.* § 500.3121(5). Collision insurance and vehicle contents coverage is excluded. *Id.* § 500.3123(1)(a).

13. MICH. COMP. LAWS ANN. § 500.3131 (Supp. 1977). Residual liability insurance provides Michigan drivers with whatever coverage is required by the foreign jurisdictions they may enter. Within Michigan the residual clause provides liability insurance against the tort actions retained in § 500.3135.

14. *Id.* § 500.3105.

15. MICH. COMP. LAWS ANN. § 500.3107(a) (Supp. 1977).

The "reasonable charges" requirement allows for practically unlimited medical coverage. If the cost can be justified in medical records, it will probably be allowed. See MICH. COMP. LAWS ANN. §§ 500.3157 & .3158(2). This characteristic of the Michigan no-fault plan distinguishes it from the plans of many other states.

16. *Id.* § 500.3107(b).

that the insured would have rendered to himself or his dependents had the accident not occurred.¹⁷ Benefits are not paid to the injured's estate for any loss of work or services after the date on which the injured person dies.¹⁸

If an accident results in the death of the insured, personal protection "survivors' loss benefits" are payable directly to the dependents of the deceased policyholder.¹⁹ Survivors' loss includes compensation for lost services of the deceased of up to \$20 per day, plus "contributions of tangible things of economic value, not including services, that dependents of the deceased at the time of his death would have received for support. . . ."²⁰ As in the case of non-fatal injury, survivors' loss benefits may not exceed a maximum payment of \$1000 per month and are not payable beyond the first three years after the date of the accident.²¹ Determination of dependency is made according to provisions of the statute,²² and payments are made directly to surviving dependents after they apply for benefits with the deceased's insurer.²³

SURVIVORS' LOSS BENEFITS AND WRONGFUL DEATH

The Michigan no-fault plan will continue to serve the public with full force and effect only if the IRS is made aware of the true nature of survivors' loss benefits. Any attempt to tax survivors' loss as life insurance ignores the fact that survivors' loss coverage represents a legislative extension of the Michigan wrongful death scheme. As a *de facto* statutory embodiment of what was once recovery for wrongful death, survivors' loss benefits should be subject to the same tax exclusion that governs amounts received under a wrongful death judgment.

Estate Taxation and Wrongful Death: The Rule of Connecticut Bank & Trust Co. v. United States

Since survivors' loss benefits represent a part of the damage amount that would be otherwise recovered in wrongful death, they should be excluded from the estate of the insured for the same

17. *Id.*

18. *Id.*

19. *Id.* § 500.3108.

20. *Id.*

21. *Id.* To insure that all losses are accounted for, benefits are paid as the loss accrues. *Id.* § 500.3142(1). The right to future benefits is not assignable. *Id.* § 500.3143.

22. See MICH. COMP. LAWS ANN. § 500.3110 (Supp. 1977).

23. See MICH. COMP. LAWS ANN. §§ 500.3141-.3142 (Supp. 1977).

reasons that wrongful death proceeds are excluded. In *Connecticut Bank & Trust Co. v. United States*,²⁴ the Second Circuit held that the pre-trial settlement proceeds under a Connecticut wrongful death action were not includable in the estate of the deceased taxpayer under section 2033 of the Internal Revenue Code,²⁵ which includes in the estate of the decedent all interests in property held by him at death.²⁶ The court in *Connecticut Bank* found that the Connecticut wrongful death act created an action which arises *after* the death of the deceased, and hence recovery under the act was not to be considered taxable under § 2033.²⁷

The Treasury Department elected not to lobby for a congressional rewording of the tax code that would overturn the *Connecticut Bank* rule and include wrongful death proceeds in the section 2033 definition of property held at death. Instead, the Department acquiesced in the rule that tort damages paid as compensation for premature death are not includable in the decedent's gross estate.²⁸ The Treasury's decision is politically in tune with public opinion concerning estate taxation. Historically, the Anglo-American taxation of estates has drawn its strength from several public policy concerns: a puritanical abhorrence of idleness, thought to be the child of unearned wealth; a belief that the economic well-being of society requires that all of its members earn their own livings; and a democratic insistence upon equality of opportunity.²⁹ It is doubtful, however, that the majority of Americans would favor extending those egalitarian principles to the tragedy of wrongful death. It follows that Congress would not enthusiastically embrace a proposed change in the tax code that promised to offend the emotional sensibilities of taxpaying voters.

Both the Michigan³⁰ and Connecticut³¹ wrongful death acts operate on the principle that the action arises after and because of death and can only be brought by a representative of the deceased's

24. 465 F.2d 760 (2d Cir. 1972). See Comment, *Federal Estate Taxation of Wrongful Death Proceeds*, 1973 WASH. U.L.Q. 445 (1973).

25. INT. REV. CODE OF 1954, § 2033.

26. For the purposes of the section, "Property" has been interpreted to include tort actions held by the decedent at the time of his death. See Rev. Rul. 69-8, 1969-1 CUM. BULL. 219.

27. 465 F.2d at 763-64.

28. Rev. Rul. 75-127, 1975-1 CUM. BULL. 297.

29. BITTKER & STONE, FEDERAL INCOME, ESTATE AND GIFT TAXATION 984-85 (4th ed. 1972).

30. MICH. COMP. LAWS ANN. § 600.2922 (Supp. 1977).

31. CONN. GEN. STAT. REV. § 52-555 (Supp. 1969).

estate for the benefit of dependent survivors. Therefore the *Connecticut Bank* result should apply to damages recovered under the Michigan Wrongful Death Act.³² It follows that if survivors' loss benefits represent a portion of the possible recovery in wrongful death, then they should likewise be excluded from federal taxation under the *Connecticut Bank* rule.

The Working Relationship Between Survivors' Loss and Recovery in Wrongful Death

While an action for wrongful death³³ remains possible in Michigan notwithstanding the no-fault insurance law,³⁴ the no-fault

32. The Treasury Department's own revenue rulings are supportive of this position. See Rev. Rul. 75-127, 1975-1 CUM. BULL. 297 (proceeds paid under a "survival" type wrongful death statute of any state will not be included in the decedent's gross estate); Rev. Rul. 75-126, 1975-1 CUM. BULL. 296 (damages recovered under the Arizona wrongful death statute are not included in the decedent's gross estate); Rev. Rul. 69-8, 1969-1 CUM. BULL. 219 (damages recovered for wrongful death under the Federal Death on the High Seas Act are not includible in the decedent's gross estate); Rev. Rul. 54-19, 1954-1 CUM. BULL. 179 (proceeds of a settlement under the New Jersey wrongful death act, very similar to the Michigan act, are not includible in the decedent's gross estate).

33. The Michigan Wrongful Death Act reads as follows:

(1) Whenever the death of a person or injuries resulting in death shall be caused by wrongful act, neglect or default, and the act, neglect or default is such as would, if death had not ensued, have entitled the party injured to maintain an action and recover damages, in respect thereof, then and in every such case, the persons who, or the corporation which would have been liable, if death had not ensued, shall be liable to an action for damages, notwithstanding the death of the person injured, and although the death shall have been caused under such circumstances as amount in law to felony. All actions for such death, or injuries resulting in death, shall be brought only under this section.

(2) Every such action shall be brought by, and in the names of, the personal representatives of such deceased person, and in every such action the court or jury may give such damages, as, the court or jury, shall deem fair and just, under all of the circumstances to those persons who may be entitled to such damages when recovered including damages for the reasonable medical, hospital, funeral and burial expenses for which the estate is liable and reasonable compensation for the pain and suffering, while conscious, undergone by such deceased person during the period intervening between the time of the inflicting of such injuries and his death. The amount of damages recoverable by civil action for death caused by the wrongful act, neglect or fault of another may also include recovery for the loss of the society and companionship of the deceased. Such person or persons entitled to such damages shall be of that class who, by law, would be entitled to inherit the personal property of the deceased had he died intestate. The amount recovered in every such action shall be distributed to the surviving spouse and next of kin who suf-

act modifies wrongful death recovery to a substantial degree. In Michigan there exist four basic elements of damage for wrongful death: medical and funeral costs to the decedent's estate, conscious pain and suffering of the decedent before death, and loss of the decedent's companionship by his next of kin.³⁵ The no-fault law per-

ferred injury and in proportion thereto. Within 30 days after the entry of such judgment, the judge before whom such case was tried or his successor shall certify to the probate court having jurisdiction of the estate of such deceased person the amount and date of entry thereof, and shall advise the probate court by written opinion as to the amount thereof representing the loss suffered by the surviving spouse and all of the next of kin, and the proportion of such total loss suffered by the surviving spouse and each of the next of kin of such deceased person, as shown by the evidence. After providing for the payment of the reasonable medical, hospital, funeral and burial expenses for which the estate is liable, the probate court shall determine as provided by law the manner in which the amount representing the total loss suffered by the surviving spouse and next of kin shall be distributed, and the proportionate share thereof to be distributed to the surviving spouse and next of kin. The remainder of the proceeds of such judgment shall be distributed according to the intestate laws.

MICH. COMP. LAWS ANN. § 600.2922 (Supp. 1977).

34. MICH. COMP. LAWS ANN. §§ 500.3101-.3179 (Supp. 1977).

35. In early Michigan, as in other common law jurisdictions, there was no civil cause of action for the death of a human being caused by the wrongful act or negligence of another. *Hyatt v. Adams*, 16 Mich. 180, 184-85 (1867). Nor did Michigan common law permit the survival of actions for personal injury. *Dolson v. Lake Shore & Mich. So. Ry.*, 128 Mich. 444, 452, 87 N.W. 629, 632 (1901). However, as early as 1838, the legislature provided for survival of actions by statute; by 1885 an action for "negligent injuries to the person" was included among those actions expressly surviving. *See, e.g.*, 3 Comp. Laws 1915 § 12383; 2 Comp. Laws 1871 § 6724. Then in 1848 the first wrongful death act, a typical "Lord Campbell's Act," was passed in Michigan. *See e.g.*, 3 Comp. Laws 1929 § 14061; Comp. Laws 1897 § 10427. *See also* *In Re Onley's Est.*, 309 Mich. 65, 73, 14 N.W.2d 574, 577 (1944); *Dolson v. Lake Shore & Mich. So. Ry.*, 128 Mich. 444, 448-63, 87 N.W. 629, 630-36 (1901).

Under the early statutes, the distinction between a survival action and a wrongful death action turned on the time of death of the injured party. *See* *Estate of Stewart v. Armstrong*, 384 Mich. 709, 713, 187 N.W.2d 223, 224-25 (1971); *In Re Onley's Est.*, 309 Mich. 65, 74, 14 N.W.2d 574, 578 (1944). Theoretically, the Wrongful Death Act provided a statutory action for pecuniary injury caused to those persons having a beneficial interest in the decedent's life, while the Survival Act preserved to the decedent's estate the claims which he held at the time of his death for injuries to his person or property, including conscious pain and suffering. Instantaneous death required an action for wrongful death, and a lingering death meant that recovery would come under a survival action. *See* *Schumacher, Rights of Action Under Death and Survival Statutes*, 23 MICH. L. REV. 114 (1925).

As both actions were "dependent on the [same] injury," *Lincoln v. Detroit & Mackinac Ry.*, 179 Mich. 189, 196, 146 N.W. 405, 407 (1914), the legislature incorporated the two statutes into a single wrongful death law in 1939. The 1939 law enabled the injured person's representative to bring an action regardless of whether there was in-

mits an independent wrongful death action for pain and suffering and loss of companionship. Recovery for such injuries is in no way

stantaneous death or survival of the injured person, and specified to whom damages should be distributed. *Grimes v. King*, 311 Mich. 399, 414, 18 N.W.2d 870, 873 (1945). The current act provides an action for damages whenever, if death had not ensued, there would have been an action for damages by the person injured. MICH. COMP. LAWS ANN. § 600.2922(1) (Supp. 1977). See *O'Neil v. Morse*, 385 Mich. 130, 133, 188 N.W.2d 785, 786 (1971). The action arises solely on the date and because of the wrongfully injured decedent's death. See *Estate of Stewart v. Armstrong*, 384 Mich. 709, 714, 187 N.W.2d 223, 225 (1971). Since 1939 the Wrongful Death Act has stipulated that all actions for death, or actions pending at death, must be brought under that statute. See, e.g., MICH. COMP. LAWS ANN. § 600.2922(1) (Supp. 1977). See also MICH. COMP. LAWS ANN. § 600.2921.

It is the special duty of the personal representative to show that the deceased could have maintained an action in tort if death had not ensued. See *Maiuri v. Sinacola Const. Co.*, 382 Mich. 391, 396, 170 N.W.2d 27, 30 (1969); *Hoag v. Paul C. Chapman & Sons, Inc.*, 62 Mich. App. 290, 296, 233 N.W.2d 530, 533 (1975). At no time can surviving dependents bring an ancillary action to recover in an individual capacity. See *Burns v. VanLaan*, 367 Mich. 485, 116 N.W.2d 873 (1962); *Westfall v. Venton*, 1 Mich. App. 612, 137 N.W.2d 757, 762 (1965).

The Death Act provides that "the court or jury may give such damages as [they] shall deem fair and just, under all of the circumstances to those persons who may be entitled to such damages. . . ." MICH. COMP. LAWS ANN. § 600.2922(2) (Supp. 1977). Such damages include reasonable medical, hospital, funeral and burial expenses for which the estate is liable. Also included is compensation for loss of economic support and rendition of services to eligible survivors who were partially or wholly dependent upon the deceased. See *Mooney v. Hill*, 367 Mich. 138, 116 N.W.2d 231 (1962); *Rytkonen v. City of Wakefield*, 364 Mich. 86, 94-5, 111 N.W.2d 63, 67 (1961); *MacDonald v. Quimby*, 350 Mich. 21, 85 N.W.2d 157 (1957); *Judis v. Borg-Warner Corp.*, 339 Mich. 313, 326, 63 N.W.2d 647, 649-50 (1954); *Westfall v. Venton*, 1 Mich. App. 612, 621-22, 137 N.W.2d 757, 759 (1965). Loss of a deceased child's services is recoverable by the parents. *Rohm v. Stroud*, 386 Mich. 693, 194 N.W.2d 307 (1972); *Thompson v. Ogemaw County Bd. of Rd. Comm'rs.*, 357 Mich. 482, 98 N.W.2d 620 (1959). Conscious pain and suffering by the deceased before death is recoverable, *Baker v. Slack*, 319 Mich. 703, 707, 30 N.W.2d 403, 405 (1948); as is loss of his society and companionship to the survivors. MICH. COMP. LAWS ANN. § 600.2922(2) (Supp. 1977). Loss of companionship became a recoverable item only after considerable vacillation by the courts, and a specific amendment to that effect in 1971. *Id.* See *Smith v. City of Detroit*, 388 Mich. 637, 646 n.5, 202 N.W.2d 300, 305 n.5 (1972); *Bradfield v. Estate of Burgess*, 62 Mich. App. 345, 350-52, 233 N.W.2d 541, 543-44 (1975). See also *Breckon v. Franklin Fuel Co.*, 383 Mich. 251, 174 N.W.2d 836 (1970) (loss of companionship not recoverable), *overruled*, 388 Mich. 637, 202 N.W.2d 300 (1972); *Burns v. VanLaan*, 367 Mich. 485, 116 N.W.2d 873 (1962) (loss of companionship not recoverable); *Wycko v. Gnodtke*, 361 Mich. 331, 105 N.W.2d 118 (1960) (loss of companionship recoverable); *Swarthout v. Beard*, 33 Mich. App. 395, 190 N.W.2d 373 (1971) (loss of companionship not recoverable); *Westfall v. Venton*, 1 Mich. App. 612, 137 N.W.2d 757 (1965) (loss of companionship recoverable). If the tortfeasor should happen to die before the death of the injured victim, wrongful death liability will affix to the wrongdoer's estate. See *In Re Muller's Estate*, 28 Mich. 203, 211-15, 273 N.W. 448 (1937) (Butzel, J. dissenting). *But see In Re Onley's Estate*, 309 Mich. 65, 79-80, 14 N.W.2d 574, 581 (1974).

reduced by recovery pursuant to the no-fault act.³⁶ The no-fault statute does not permit wrongful death recovery for medical and funeral expenses, or for loss of support and services from the decedent, unless such recovery is for amounts over and above the \$36,000 maximum benefit paid pursuant to the no-fault personal protection insurance provisions.³⁷ Because of this limitation, it is common practice in Michigan, when negotiating a wrongful death settlement, to reduce the settlement by amounts received as survivors' loss benefits.

It is therefore apparent that survivors' loss is a partial substitute for recovery in wrongful death for the loss of economic support and services provided by the deceased to his next of kin. With the implementation of survivors' loss coverage, Michigan has swept away the necessity of pursuing the first \$36,000 of an automobile accident-wrongful death claim in court.

It is logical that the no-fault law should fill such a role. The theory of no-fault is that the injured party looks to his own insurer for assistance and is thereby able to resolve the financial complications of his accident without protracted legal dispute.³⁸ If the insured is killed, his surviving dependents have an immediate need for replacement of his earning power. The survivors' loss provision provides such relief without substantial delay and therefore acts to defray the hardship of an unexpected death. Bolstered by a speedy survivors' loss award, the dependents of the deceased are in a better position financially to pursue lengthy wrongful death litigation for amounts in excess of the survivors' loss allowance. As a legislatively administered portion of wrongful death recovery, Michigan survivors' loss benefits should be excluded from the estate taxation under the *Connecticut Bank* rule.

Persons entitled to recover damages under the Wrongful Death Act must belong to the class of persons who, by law, would be entitled to inherit the personal property of the deceased had he died intestate. MICH. COMP. LAWS ANN. § 600.2922(2) (Supp. 1977). Within 30 days after judgment, the trial judge must certify to the probate court the amount of his judgment. *Id.* A written opinion must attach advising the probate court what proportion of the judgment goes to each eligible taker as shown by the evidence. *Id.* See also *Hix v. Besser Co.*, 386 Mich. 499, 194 N.W.2d 333 (1972). After providing for the payment of reasonable medical, hospital, funeral and burial expenses for which the estate is liable, the probate court determines and supervises the distribution of damages to eligible takers as provided for by the probate and intestate laws. *Id.*

36. See MICH. COMP. LAWS ANN. §§ 500.3135, .3116. (Supp. 1977). See also note 7 *supra*.

37. See MICH. COMP. LAWS ANN. § 500.3135(2)(c) (Supp. 1977).

38. See PROSSER, HANDBOOK OF THE LAW OF TORTS 568 (4th ed. 1971).

The IRS could argue that differences exist between survivors' loss and wrongful death which distinguish the application of *Connecticut Bank & Trust Co. v. United States*³⁹ to survivors' loss cases. Unlike an action for wrongful death, no showing of liability is needed to recover under the survivors' loss statute.⁴⁰ If the eligible survivors can show dependency as required by statute,⁴¹ they receive benefits. This is true even if the insured was partly responsible for the accident causing his death. In that regard survivors' loss benefits are a vested expectancy, resembling life insurance much more than they resemble potential recovery in tort. But if the Treasury takes the position that survivors' loss insurance is not a statutory embodiment of wrongful death recovery, the Department will probably run afoul of the same public indignation that encouraged the IRS to acquiesce to the *Connecticut Bank* rule originally. Survivors' loss benefits do not provide the recipient with a lucrative windfall, but only with a modest living allowance. However, even if the courts eventually determine that survivors' loss benefits are not deserving of wrongful death estate tax exclusion, the benefits would still fail to qualify as taxable life insurance proceeds under the tax code.

APPLICATION OF SECTION 2042 TO SURVIVORS' LOSS INSURANCE

If survivors' loss benefits were not viewed as a tax-exempt award under the rule of *Connecticut Bank & Trust*,⁴² the benefits would still qualify as nontaxable insurance proceeds under the criteria of § 2042.⁴³ An insured must possess powers of control over the policy on his life that vest him with economic benefits before the policy proceeds will be subject to estate taxation. A Michigan driver holds no economically beneficial powers of control—"incidents of ownership"—in the survivors' loss portion of his no-fault insurance contract. Therefore, survivors' loss benefits should not be subject to § 2042 taxation as proceeds from a policy on the life of the insured.

Survivors' Loss Coverage as Life Insurance

Generally, the layperson views life insurance as something purchased by the insured for the purpose of providing a fund of money to pass at his death to his favored dependents. Unfortunately, the

39. See notes 24-26 *supra* and accompanying text.

40. MICH. COMP. LAWS ANN. §§ 500.3105(2), .3121(2) (Supp. 1977).

41. MICH. COMP. LAWS ANN. § 500.3110 (Supp. 1977).

42. See notes 24-26 *supra* and accompanying text.

43. INT. REV. CODE OF 1954, § 2042.

tax authorities have not been overly zealous in their efforts to provide a more exact definition of life insurance for the purposes of section 2042.⁴⁴ The applicable regulation simply states: "The term 'insurance' refers to life insurance of every description, including death benefits paid by fraternal beneficial societies operating under the lodge system."⁴⁵ However, the substance of court *dicta* on the subject shows that for an insurance policy to exist for the purposes of § 2042, someone—usually the insured—is making payments in settlement of a contract that exposes the underwriters to a risk of financial loss if the insured dies. As Justice Murphy explained in *Helvering v. LeGierse*:⁴⁶

[For a life insurance policy to exist] amounts must be received as the result of a transaction which involved an actual "insurance risk" at the time the transaction was executed. Historically and commonly insurance involves risk-shifting and risk-distributing. . . . That these elements of risk-shifting and risk-distributing are essential to a life insurance contract is agreed by courts and commentators.⁴⁷

The severity of the "insurance risk" carried by the policy underwriter usually determines the cost of the insurance contract. The policy premiums are determined on the basis of the ratio of the premiums paid to the probability of the occurrence of the risk insured against—the death of the insured. But, for an insurance risk to exist, the insurer need not assume the full impact of the risk in a solitary calculated gamble. The insurer usually mitigates its potential loss by spreading the risk over a diverse number of policy holders.⁴⁸

The Treasury Regulations take the position that life insurance ceases to be a taxable item when the reserve value under the policy equals the death benefit, because there is no longer an insurance

44. Groll, *Some Federal Tax Aspects of Life Insurance*, 15 DEPAUL L. REV. 48, 72-74 (1965).

45. Treas. Reg. § 20.2042-1(a)(1) (1975).

46. 312 U.S. 531 (1941).

47. *Id.* at 539. See also *Goldstone v. United States*, 325 U.S. 687, 690 (1945); *Keller v. Commissioner*, 312 U.S. 543 (1941); *Commissioner v. Treganowan*, 183 F.2d 288, 290 (2d Cir.), *cert. denied*, 340 U.S. 853 (1950); *Seward's Estate v. Commissioner*, 164 F.2d 434, 437 (4th Cir. 1947); *Helvering v. Tyler*, 111 F.2d 422, 426 (8th Cir. 1940), *aff'd*, 312 U.S. 651 (1941); *Old Colony Trust Co. v. Commissioner*, 102 F.2d 380, 382 (1st Cir. 1941).

48. See *Commissioner v. Treganowan*, 183 F.2d 288 (2d Cir.), *cert. denied*, 340 U.S. 853 (1950).

risk under the contract.⁴⁹ There is no proration under this rule; it is an all-or-nothing proposition. For example, imagine that the insured buys a \$36,000 endowment policy on his life. When the policy reserve reaches \$36,000 it ceases to be insurance for estate tax purposes. If, however, the reserve value amounted to only \$25,000, the entire policy would be regarded as taxable insurance, not merely 1/36 of the policy; the proportion by which the face value exceeded the reserve. As long as there is some risk of financial loss to the underwriter under the terms of the policy, no matter how small, the entire policy amount is regarded as life insurance for estate tax purposes.⁵⁰

The case of *Commissioner v. Noel's Estate*⁵¹ put to rest the idea that for the purposes of section 2042 "life insurance" status depends upon the technical label affixed to the policy by the insurer. In *Noel* the insured purchased a flight insurance policy shortly before boarding a flight which ultimately ended in a fatal crash. He named his wife as beneficiary and left the policy in her safekeeping. Relying on the earlier case of *Ackerman v. Commissioner*,⁵² the Supreme Court found no difference for estate tax purposes between life insurance and the flight insurance policy purchased by Noel. The fact that Noel's accidental death was an evitable event did not alter the fact that his insurer had assumed an insurance risk on his life, and therefore the proceeds of the policy were included in his gross estate for tax purposes.

The wording of section 2042 and its corresponding regulation,⁵³ together with the holding in *Noel*, indicate that the term "life insurance" should be interpreted to encompass flight insurance, accidental death insurance, double indemnity provisions and ordinary life policies, plus term insurance and all variations of those policies.⁵⁴ As will be shown, the term should include Michigan no-fault personal protection survivors' loss insurance.

49. Treas. Regs. §§ 20.2039-1(d), 20.2042-1(a)(2) (1975). Cf. *Provident Trust Co. v. United States*, 170 F. Supp. 74, 77 (E.D. Pa. 1959).

50. See *Altschuler v. United States*, 169 F. Supp. 456, 459-60 (W.D. Mo. 1958).

51. 380 U.S. 678 (1965).

52. 15 B.T.A. 635 (1929). In *Ackerman*, the Board of Tax Appeals considered whether amounts received under accident policies and life policies which provided for double indemnity in the case of death from accidental means should be included in the taxable estate of the insured. The board analyzed the distinction between life and accident insurance, and concluded that for purposes of the application of the federal estate tax, they were identical.

53. Treas. Regs. §§ 20.2039-1(d), 20.2042-1(a)(2) (1975); Rev. Rul. 62-222, 1965-2 CUM. BULL. 371.

54. See *Commissioner v. Noel's Estate*, 380 U.S. 678, 681-82 (1965).

One might be tempted to argue that survivors' loss protection does not constitute a "policy on the life of the decedent" for the purposes of § 2042 because it differs radically from the layperson's general concept of life insurance. A life insurance policy normally provides for the payment of a fixed amount, either in a lump sum or pursuant to certain annuity elections, contingent solely upon the death of the insured.⁵⁵ The policy usually represents an actuarial risk to the insurer as the policy premiums are based upon the life expectancy of the insured; therefore, the insurer will incur an economic loss if the insured suffers a "premature" death.⁵⁶ Obviously, these normal components of life insurance are not present in the Michigan personal protection survivors' loss plan. The survivors' loss benefit amount is not fixed, except in the maximum.⁵⁷ Payment of benefits is not solely contingent upon the death of the insured but is also contingent upon a surviving dependent incurring loss of economic support due to the insured's death.⁵⁸ Finally, the insurance premium is not based on an actuarial determination of the insured's life expectancy, but is roughly dependent upon the statistical probability that the insured will be survived by persons dependent upon him for support.

Notwithstanding its unusual characteristics, survivors' loss coverage still represents a contract that exposes the insurer to a risk of financial loss if the insured dies. The insurer mitigates this risk by spreading the cost among the class of similarly insured Michigan drivers.⁵⁹ This process of risk-shifting and risk-distributing draws survivors' loss protection within the *Helvering* definition of life insurance⁶⁰ and therefore constitutes a "policy on the life of the decedent" for the purposes of section 2042.⁶¹ However, it does not automatically follow that the insured Michigan driver holds any incidents of ownership in his survivors' loss coverage that would make benefits payable under that section taxable as life insurance proceeds.

55. See J. APPLEMAN, INSURANCE LAW AND PRACTICE §§ 2-3 (1965).

56. *Id.*

57. See note 21 *supra* and accompanying text.

58. See note 22 *supra* and accompanying text.

59. See notes 8 & 9 *supra* and accompanying text.

60. See pp. 486-87 and accompanying notes. See also *All v. McCobb*, 321 F.2d 633, 636-37 (1963).

As a final argument, survivors' loss benefits could be viewed as a liability payment by the insurer conditioned upon release of claims for damages by the surviving dependents to the extent of the payments. As a discharge of liability, the benefits would not be considered life insurance. See Rev. Rul. 57-54.

61. INT. REV. CODE OF 1954, § 2042.

Development of the Incidents of Ownership Test

If it is conceded that Michigan no-fault survivors' loss insurance represents an insurance policy upon the life of the insured, then the insured must hold some incidents of ownership in his survivors' loss coverage before the resulting benefits can be taxed. The incidents of ownership test for the taxation of life insurance proceeds is a product of many changes in the estate tax law. Tax experts agree that the estate taxation of life insurance "has been subject to more vacillation and variation by the Treasury Department and Congress than any other asset area."⁶² However, the evolution of the incidents of ownership test can be roughly arranged into three historical periods.

From 1918 to 1942 the role that incidents of ownership should play as a taxing criterion for life insurance was unsettled. In 1942 it was decided that if the insured paid his own life insurance premiums, he need not hold any incidents of ownership in the policy for it to be included in his gross estate for tax purposes. The modern rule, that life insurance proceeds will not be included in the gross estate of the insured unless he held incidents of ownership in the policy at death, was adopted by Congress in 1954. Under the 1954 incidents of ownership rule the survivors' loss benefits of a Michigan no-fault policy should be excluded from the estate of the deceased for estate tax purposes.

Life insurance proceeds were first subjected to federal estate taxation by the Revenue Act of 1918.⁶³ The two current provisions⁶⁴

62. Groll, *Some Federal Tax Aspects of Life Insurance*, 15 DEPAUL L. REV. 48 (1965). See also Eliasberg, *IRC Section 2042—The Estate Taxation of Life Insurance: What is an Incident of Ownership?*, 51 TAXES 91, 92 (1973). The tax court itself has labeled the historical metamorphosis of section 2042 "a long and tortuous path, often marked by confusion and contradiction." *Estate of Skifter v. Commissioner*, 56 T.C. 1190, 1196 (1971), *aff'd*, 468 F.2d 699 (2d Cir. 1972).

63. Pub. L. No. 65-244, § 402(f), 40 Stat. 1098 (1919).

64. The current estate tax section dealing with life insurance proceeds, § 2042, reads as follows:

The value of the gross estate shall include the value of all property—

(1) RECEIVABLE BY THE EXECUTOR.—To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

(2) RECEIVABLE BY OTHER BENEFICIARIES.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either along or in conjunction with any other person. For purposes of the preceding sentence, the term "incident of ownership" includes a rever-

that subject life insurance proceeds to estate taxation originated with the 1918 Act. The first provision required that insurance proceeds payable to the estate of the insured be taxed.⁶⁵ In the second provision, Congress required that proceeds payable to beneficiaries other than the estate of the insured, be taxed to the extent that such proceeds exceeded \$40,000.⁶⁶ An overriding requirement of both provisions was that the policy be "taken out by the decedent upon his own life."⁶⁷ Uncertainty arose as to the meaning of that phrase, and a great deal of tax litigation over its definition followed.⁶⁸

In hopes of ending the controversy over the phrase "taken out by the decedent upon his own life," the Treasury promulgated its first regulation under the 1918 life insurance provisions.⁶⁹ Under the regulation, policy proceeds payable to beneficiaries other than the estate of the insured were taxable only to the extent that premium payments had been made by the insured. Payment by the insured established the policy as insurance taken out by the insured upon his own life. However, following the Supreme Court decision in *Chase National Bank v. United States*,⁷⁰ the Treasury was forced to modify its position.

In *Chase* the Court held that the insured must possess some "incidents of ownership" in the policy at his death, in addition to

sonary 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 exceeds 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. . . .

INT. REV. CODE OF 1954, § 2042.

65. The estate tax treatment of proceeds payable to a decedent's executor has undergone only slight alteration over the years. LOWNDES, KRAMER & McCORD, FEDERAL ESTATE AND GIFT TAXES § 13.5 at 328 (3d ed. 1974). Courts have construed the phrase "receivable by the executor" to include proceeds which are paid to beneficiaries who are legally bound to use them to discharge obligations to the estate. BITTKER & STONE, FEDERAL INCOME, ESTATE AND GIFT TAXATION 1224 (4th ed. 1972).

66. This provision was the forerunner of § 2042(2), See note 64 *supra*.

67. See Pub. L. No. 65-244, § 402(f), 40 Stat. 1098 (1919).

68. Most of the confusion and subsequent litigation arose out of cases involving proceeds payable to other beneficiaries. BITTKER & STONE, FEDERAL INCOME, ESTATE AND GIFT TAXATION 1224 (4th ed. 1972). When the proceeds were payable to the estate of the insured, the requirement of "taken out by the insured" was usually ignored and the proceeds were taxed. LOWNDES, KRAMER & McCORD, FEDERAL ESTATE AND GIFT TAXES § 13.2 at 322 (3d ed. 1974).

69. Treas. Reg. 37, Art. 34 (1919).

70. 278 U.S. 327 (1929).

paying the policy premiums, for the proceeds to be taxable.⁷¹ Writing for the majority, Mr. Justice Stone explained that a decedent's possession at death of substantial control over his policy, such as the right to surrender or cancel the policy for his own benefit, was necessary for the inclusion of the proceeds in the gross estate.⁷²

In 1934 the Treasury Department modified its position on the "payment of premiums" and "incidents of ownership" tests as they applied to insurance proceeds payable to beneficiaries other than the insured's estate. The two tests were treated as alternatives. If the insured possessed any of the incidents of ownership under the policy, or if he had paid the policy premiums, the policy was considered to have been taken out by the decedent upon his own life.⁷³ Also, the Department decided that the entire amount of proceeds would be taxed instead of just a portion of the proceeds equal to the premium paid before death.⁷⁴ Eventually, the Treasury regressed and utilized the premium payments test exclusively in cases of proceeds paid to other beneficiaries.⁷⁵

Congress made a major revision of the tax code in 1942⁷⁶ to provide the public with more precise tax guidelines. The troublesome phrase "taken out by the decedent upon his own life" was dropped, and the alternative taxing criterion of 1934, "incidents of ownership" or "payment of premiums," was reinstated for proceeds payable to beneficiaries other than the estate of the insured. The \$40,000 exception was also deleted.⁷⁷ The new code also provided that if the insured had divested himself of all incidents of ownership in the policy, but continued to pay a percentage of the policy premiums, then a proportionate share of the policy premiums would be included in the insured's estate for tax purposes.⁷⁸

With its 1954 revision of the tax code⁷⁹ Congress eliminated the premiums payment test as a basis for inclusion of the proceeds of a

71. See Treas. Reg. 70, Arts. 25 & 27 (1929).

72. 278 U.S. 327, 335 (1929).

73. Treas. Reg. 80, Art. 25 (1934). The relevant text may be found in Schlesinger, *Taxes and Insurance: A Suggested Solution to the Uncertain Cost of Dying*, 55 HARV. L. REV. 226, 234 (1941).

74. Treas. Reg. 80, Art. 25 (1929).

75. Treas. Reg. 80, as amended, T.D. 5032, 1941-1 CUM. BULL. 427.

76. INT. REV. CODE OF 1939, § 811(g), as amended by the Revenue Act of 1942, Pub. L. No. 77-753, ch. 619, § 404(a), 56 Stat. 798.

77. *Id.*

78. *Id.*

79. INT. REV. CODE OF 1954, § 2042. See note 64 *supra*.

life insurance policy in the estate of the insured.⁸⁰ Under the 1954 code, insurance proceeds payable to the estate of the insured are fully taxable.⁸¹ However, for life insurance proceeds payable to beneficiaries other than the estate of the insured, the sole test for estate tax includability is whether or not the insured possessed at his death, exercisable alone or in conjunction with another,⁸² any of the incidents of ownership under the policy.⁸³ If the insured possesses such incidents, the policy proceeds are includable in his estate regardless of who paid the policy premiums. Conversely, the insured may maintain the premium payments and not be subject to the estate tax if he divests himself of all incidents of ownership under the policy.⁸⁴ Questions surrounding proceeds payable to the insured's estate are straightforward and have given estate planners few problems.⁸⁵ In contrast, the estate tax status of insurance proceeds payable to beneficiaries other than the estate hinges upon the phrase "incidents of ownership."⁸⁶ The meaning of "incidents of ownership" is therefore determinative of whether or not Michigan

80. The rationale for abolishing the premiums payment test was outlined in the Congressional Committee Reports:

No other property is subject to estate tax where the decedent initially purchased it and then long before his death gave away all rights to the property, and to discriminate against life insurance in this regard is not justified.

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

81. INT. REV. CODE OF 1954, § 2042(1).

82. Originally the 1942 tax code specified that incidents of ownership could be exercised alone or in conjunction with another person. That change from previous law caused an expansion of the taxation of life insurance proceeds. Today, taxation occurs when the insured can change the beneficiary of his policy only upon securing the approval of the present beneficiary, or when the insured's approval is required before a change of beneficiary can take place. See *Nance v. United States*, 430 F.2d 662, 663 (9th Cir. 1970); *Commissioner v. Estate of Karaghousian*, 233 F.2d 197, 199 (2d Cir. 1956).

83. INT. REV. CODE OF 1954, § 2042(2).

84. Estate planning advisors are quick to point out that life insurance proceeds which are not taxable under section 2042 may be taxed under some other estate tax provision. See Berall, *Use of Life Insurance in Estate Planning*, 31 N.Y.U. INST. FED. TAX. 1053, 1064 (1973). For example, a transfer of incidents of ownership by the insured within three years of death will cause the policy proceeds to be included in the insured's gross estate under section 2035. INT. REV. CODE OF 1954, § 2035. See also *Treas. Reg. § 20.2042-1(a)(2)*. The same is true for policy premiums paid in contemplation of death. See *Rev. Rul. 71-497*, 1971-2 CUM. BULL. 300; *First Nat'l Bank of Midland v. United States*, 423 F.2d 1286 (5th Cir. 1970).

85. See Eliasberg, *IRC Section 2042—The Estate Taxation of Life Insurance: What is an Incident of Ownership?*, 51 TAXES 91, 92 n.5 (1973).

86. See Groll, *Some Federal Tax Aspects of Life Insurance*, 15 DEPAUL L. REV. 48, 52 (1965).

no-fault survivors' loss coverage should be subject to the federal estate tax. As will be shown, a Michigan driver holds no incidents of ownership in the personal protection survivors' loss portion of his no-fault policy. Hence, the benefits therefrom should be excluded from his gross estate for tax purposes.

Application of the Incidents of Ownership Test

Identification of the incidents of ownership in any insurance arrangement, including no-fault survivors' loss coverage, is a complicated task. This is because the tax code does not define "incidents of ownership" other than to make it clear that it includes a reversionary interest in the policy if the value of the reversionary interest exceeds 5% of the value of the policy before the death of the insured.⁸⁷ However, the accompanying regulation⁸⁸ indicates that the term is not limited in application to ownership in the technical property law sense,⁸⁹ but includes rights held by the insured that entitle him to the *economic benefits* of the policy. Because the regulation is

87. INT. REV. CODE OF 1954, § 2042(2). See *Goldstone v. United States*, 325 U.S. 687 (1945); *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85 (1935); *Liebman v. Hassett*, 50 F. Supp. 537 (D. Mass. 1943); *Bailey v. United States*, 27 F. Supp. 617 (Ct. Cl. 1939).

Community property states may raise interesting reversionary interest problems in §2042(2) situations. See, e.g., *Bintliff v. United States*, 462 F.2d 403 (5th Cir. 1972) (72-2 USTC 12,858), *rev'g in part*, 329 F. Supp. 1356 (E.D. Tex. 1971) (71-2 USTC 12,800). Cf. *Corman v. United States*, 238 F. Supp. 225, 230 (E.D. Mich. 1968). See generally *Thurman, Federal Estate and Gift Taxation of Community Property Life Insurance*, 9 STAN. L. REV. 239 (1957); Note, *Federal Estate Taxation of Community Property Life Insurance*, 64 MICH. L. REV. 1150 (1966).

88. The regulation reads as follows:

(2) 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 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. See subparagraph (6) of this paragraph for rules relating to the circumstances under which incidents of ownership held by a corporation are attributable to a decedent through his stock ownership.

Treas. Reg. § 20.2042-1(c)(2) (1975) (emphasis added).

89. Several factors often considered essential for ownership are not necessary for section 2042 to apply. For example, the insured need not possess legal and equitable title in the policy. *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 10 (1st Cir. 1966). The insured need not keep possession of the policy either. *Fried v. Granger*, 105 F. Supp. 564, 566 (W.D. Pa. 1952), *aff'd per curiam*, 202 F.2d 150 (3d Cir. 1953).

modeled after the Congressional reports which describe the intended scope of section 2042,⁹⁰ it has been persuasively argued by tax authorities that those reports indicate that *economic benefit* was to be a key ingredient of any incident of ownership:

[T]he very thrust of the Regulation and the Congressional Reports indicate[s] that an attempt was made to place the taxation of life insurance proceeds on a par with the taxation of other assets; the special provision was tailored to take cognizance of the difference in the nature of the life insurance contract only to the extent of including proceeds where the insured, though not the legal owner of the policy, did possess the economic benefit of ownership. Where economic benefit is missing, the proceeds should go untaxed.⁹¹

If a power of control held by the insured over a policy on his own life does not confer some economic benefit upon him, it is not an incident of ownership for the purposes of the code.⁹² It follows that if the insured can realize no economic benefit from an insurance policy on his own life that will pay proceeds to beneficiaries other than his estate, then the policy proceeds will not be included in his gross estate for tax purposes.

A solitary reported case, *United States v. Rhode Island Hosp. Trust Co.*,⁹³ suggested that incidents of ownership may include powers of control by the insured which do not provide him with economic benefit. However, subsequent cases and authorities have not given determinative weight to that position, and economic benefit stands strong as a main requisite of the incidents of ownership test.⁹⁴ For example, in *Estate of Lumpkin v. Commissioner*⁹⁵ the Tax Court held that an employee's power to affect the cancellation

90. See S. REP. NO. 1622, 83d Cong., 2d Sess. 472 (1954). See also H.R. REP. NO. 2333, 77th Cong., 2d Sess. 163 (1942); S. REP. NO. 1631, 77th Cong., 2d Sess. 235 (1942). These reports indicate Congressional intent that economic benefit be a primary taxing criterion of the incidents.

91. Groll, *Life Insurance: Incidents of Ownership and Economic Benefit*, 16 DEPAUL L. REV. 339, 351 (1967). See also *Estate of Fuchs v. Commissioner*, 47 T.C. 199, 206 (1966); *Wilson Equal Treatment for Life Insurance*, 112 TRUSTS AND ESTATES 270 (1973).

92. Groll, *Life Insurance: Incidents of Ownership and Economic Benefit*, 16 DEPAUL L. REV. 339, 351 (1967).

93. 355 F.2d 7 (1st Cir. 1966).

94. See Groll, *supra* note 92. See also *Estate of Fuchs v. Commissioner*, 47 T.C. 199, 204-06 (1966).

95. 56 T.C. 815 (1971), *rev'd on other grounds*, 474 F.2d 1092 (5th Cir. 1973).

of an employer-owned policy of insurance on the employee's life by quitting his job was not an incident of ownership, since such power of cancellation, if it could realistically be considered as such, did not comprehend an economic interest of the employee. Neither the employee nor his estate could gain any economic benefit from cancellation of his policy.

If a life insurance policy does bestow incidents of ownership on the insured, he will be deemed to possess them at death regardless of his intent not to possess or exercise such rights.⁹⁶ Also, his physical inability to exercise such authority will not prevent taxability.⁹⁷ It is the *power* to exercise incidents of ownership, and not the *willingness* to exercise them nor physical possession of the policy, that is determinative of the includability question.

The present regulation gives an illustrative list of rights held by the insured that should be considered incidents of ownership.⁹⁸ The rights mentioned—the power to change the beneficiary, surrender, cancel, or assign the policy, revoke an assignment, pledge the policy for a loan, or obtain from the insurer a loan against the surrender value of the policy—have uniformly resulted in inclusion if possessed by the insured at death.⁹⁹ Possession of any one of the

96. In other words, the policy facts will always predominate over the intent of the parties, see *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 8, 13 (1st Cir. 1966), unless the policy facts are the product of an insurance company error. See *Lamade v. Brownell*, 245 F. Supp. 691, 696-97 (M.D. Pa. 1965) (65-2 USTC 12,353); *National Metropolitan Bank v. United States*, 87 F. Supp. 773 (Ct. Cl. 1950 (50-1 USTC 10,747)); *Estate of Fuchs v. Commissioner*, 47 T.C. 199 (1966); *Estate of Infante*, 29 T.C. Memo. 903 (1970). See generally *Yohlin, Ownership and Transfer of Life Insurance*, 28 N.Y.U. INST. FED. TAX. 765, 767-69 (1970). In determining exactly what the policy facts are, reference to state law is essential. In *Estate of Barlett v. Commissioner*, 54 T.C. 1590 (1970), the Tax Court outlined the role of state law in this regard:

[The Treasury Department's] own regulation requires us to look to the terms of the policy and to the effect of local law upon the provisions of the policy. Sec. 20.2042-1(c)(5), Estate Tax Regs. Local Law . . . is commonly omitted from the face of the policy. And local law may require that external provisions be added to the policy . . . even though it does not appear on the face of the policy.

54 T.C. 1590, 1598-99 (1970). Cf. *Keefe v. Broderick*, 25 F. Supp. 957 (D.R.I. 1939); *Columbian Nat'l Life Ins. Co. v. Welch*, 15 F. Supp. 777 (D. Mass. 1936). The federal tax courts have not always been as diligent as they could be in divining the applicable state laws. See *Mistereck, A Role for State Court Adjudication in Federal Tax Cases—A Proposal*, 3 VAL. U.L. REV. 1 (1968).

97. See *Commissioner v. Estate of Noel*, 380 U.S. 678, 683-84 (1965).

98. *Treas. Reg. § 20.2042-1(c)(2)* (1975).

99. *Chase Nat'l Bank v. United States*, 278 U.S. 327, 333-35 (1929); *Nance v. United States*, 430 F.2d 662, 663 (9th Cir. 1970); *Estate of Piggott v. Commissioner*, 340 F.2d 829, 833-34 (6th Cir. 1965) (65-1 USTC 12,290); *Farwell v. United States*, 243 F.2d

enumerated rights will cause the proceeds to be subject to the estate tax.¹⁰⁰

Other less significant powers held by the insured over a life insurance policy on his own life may also pull the proceeds into the gross estate of the insured. For example, possession of the power to borrow on the policy only to pay the premiums¹⁰¹ or the right to elect a settlement option¹⁰² have resulted in inclusion. In the case of a policy held in trust, the insured's power to change beneficial ownership of the policy or the time or manner of enjoyment thereof is considered an incident of ownership, even though the insured has no beneficial interest in the trust.¹⁰³ As in other possessory

373 (7th Cir. 1957); Commissioner v. Estate of Karagheusian, 233 F.2d 197, 199 (2d Cir. 1956); Singer v. Shaughnessy, 198 F.2d 178, 181 (2d Cir. 1952); Rhodes v. Commissioner, 174 F.2d 584, 586 (3d Cir. 1949); Commissioner v. Washer, 127 F.2d 446 (6th Cir.) (42-1 USTC 10, 168), *cert. denied*, 317 U.S. 653 (1942); Helvering v. Reybaine, 83 F.2d 215 (2d Cir. 1936); Goldstein's Est. v. United States, 122 F. Supp. 677 (Ct. Cl. 1954), *cert. denied*, 348 U.S. 942 (1955); Bank of New York v. United States, 115 F. Supp. 375, 384-85 (S.D.N.Y. 1953); Fried v. Granger, 105 F. Supp. 564 (W.D. Pa. 1952), *aff'd per curiam*, 202 F.2d 150 (3d Cir. 1953); Godfrey v. Smyth, 87 F. Supp. 982 (N.D. Cal. 1949), *aff'd per curiam*, 180 F.2d 220 (9th Cir. 1950); Estate of Collins v. Commissioner, 25 T.C. 1026, 1033 (1956); Estate of Welliver v. Commissioner, 8 T.C. 165, 168-69 (1947); Estate of Elizabeth A. Wilson, ¶ 51,247 P-H T.C. Memo 728-29 (1951); (power to change or designate the beneficiaries, or change their respective shares of recovery); Commissioner v. Treganowan, 183 F.2d 288, 292 (2d Cir.), *cert. denied*, 340 U.S. 853 (1970); Kearns v. United States, 399 F.2d 226 (Ct. Cl. 1968); Liebmann v. Hasset, 148 F.2d 247, 249 (1st Cir. 1945); Ballard v. Helburn, 9 F. Supp. 812, 814 (W.D. Ky. 1933), *aff'd*, 85 F.2d 613 (6th Cir. 1936) (36-1 USTC 9250); (right to surrender the policy for cash); Commissioner v. Noel's Est., 380 U.S. 678, 684 (1965); Helvering v. Reybaine, 83 F.2d 215 (2d Cir. 1936); (right to assign the policy); Prichard v. United States, 397 F.2d 60, 64 (5th Cir. 1968); Fried v. Granger, *supra* at 566-68; (right to pledge the policy as collateral for a loan); Ballard v. Helburn, *supra*; Samson v. United States, 1 F. Supp. 95 (D. Mass. 1932); (right to borrow against the surrender value of the policy); Landorf v. United States, 408 F.2d 467, 461-69 (Ct. Cl. 1969); Estate of Selznick v. Commissioner, 15 T.C. 716 (1950), *aff'd per curiam*, 195 F.2d 735 (9th Cir. 1952); (right to cancel the policy).

100. Cf. Commissioner v. Chase Manhattan Bank, 259 F.2d 231, 245-46 (5th Cir. 1958).

101. Estate of Bryan S. McCoy, ¶ 61,039 P-H T.C. Memo. 243 (1961).

102. Estate of Lumpkin v. Commissioner, 474 F.2d 1092, 1087 (5th Cir. 1973).

103. Treas. Reg. § 20.2402-1(c)(4). But, retention of purely administrative powers by the insured will not cause the trust corpus to be included in his estate. Old Colony Trust v. United States, 423 F.2d 601 (1st Cir. 1970).

The application of the incidents of ownership test to policies held by the insured in a fiduciary capacity presents a host of interesting problems outside the scope of this note. For a good discussion of the topic, see Note, *Federal Estate Tax: Application of the Section 2042 Incidents of Ownership Concept to the Insured Fiduciary's Estate*, 60 IOWA L. REV. 1319, 1327-64 (1975). See also Note, *Estate Taxation of Life Insurance Under § 2042: Recent Decisions Defining Incidents of Ownership*, 33 WASH. & LEE REV. 776 (1976).

capacities, it is divestment of the incidents of ownership, not the irrevocability of the trust, that is necessary to produce estate tax excludability.¹⁰⁴ The regulations also attribute incidents of ownership to an insured if he is the sole or controlling stockholder of a corporation which owns a policy on his life, as long as the proceeds are neither payable to the corporation nor to a third party for business purposes.¹⁰⁵

Courts prefer to examine the issue of inclusion in terms of the Treasury's illustrative list of incidents of ownership,¹⁰⁶ and perhaps that is why the Department has not fared well in taxing life insurance proceeds where the insured possessed somewhat more peripheral powers under the policy on his life.¹⁰⁷ For example, it has been held that the mere receipt of policy dividends is not an incident of ownership.¹⁰⁸ Also, in a case where the insured had irrevocably assigned away all of his incidents of ownership, and then subsequently lent his signature to convert the policy from term insurance to modified whole life, the court held that the insured had not exercised a new incident of ownership.¹⁰⁹ Finally, by way of example, it has been held that ownership of 50% of a partnership by the insured does not constitute an incident of ownership over policies owned by the partnership entity.¹¹⁰

No Incidents of Ownership in Survivors' Loss Coverage

Even though Michigan personal protection survivors' loss insurance represents a policy on the life of the insured, the benefits therefrom should not be included in the insured's gross estate for

104. See Eliasberg, *IRC Section 2042—The Estate Taxation of Life Insurance: What is an Incident of Ownership?*, 51 TAXES 91, 102-05, 109-12 (1973). See also *Estate of Fruehauf v. Commissioner*, 50 T.C. 915 (1968), *aff'd*, 427 F.2d 80, 83-6 (6th Cir. 1970).

105. *Treas. Reg. § 20.2042-1(c)(6)* (1975). See *Cockrill v. O'Hara*, 302 F. Supp. 1365 (M.D. Tenn. 1969) (69-1 USTC 12,610). See generally Gordon, *Life Insurance as a Planning Tool*, 33 N.Y.U. INST. FED. TAX. 793 (1975 Part 1).

106. LOWNDES, KRAMER & MCCORD, *FEDERAL ESTATE AND GIFT TAXES § 13.7* at 331 n.38 (3d ed. 1974).

107. *Id.* at 330-31.

108. See *Keefe v. Broderick*, 25 F. Supp. 957 (D.R.I. 1939), *rev'd on other grounds*, 112 F.2d 293 (1st Cir. 1940), *cert. dismissed*, 311 U.S. 721 (1940); *Newcomb v. Commissioner*, 34 T.C. 958, *rev'd on other grounds*, 298 F.2d (2d Cir. 1960); *Estate of Bowers v. Commissioner*, 23 T.C. 911 (1955); *Estate of Dorson v. Commissioner*, 4 T.C. 463 (1944).

109. *LaMade v. Brownell*, 245 F. Supp. 691 (M.D. Pa. 1965). The insured's signature was not necessary for the conversion to take place.

110. *Estate of Knipp v. Commissioner*, 244 F.2d 436 (4th Cir. 1957), *cert. denied*, 355 U.S. 827 (1957).

federal estate tax purposes. A driver insured under the Michigan no-fault law holds no rights in the survivors' loss portion of his total policy that provide him with economic benefit. For example, the insured has no power to designate or change beneficiaries under the provision, or to change their respective shares of recovery. Instead, the beneficiaries are designated by statute and the amount of recovery, if any, is determined after the death of the insured.¹¹¹ The statute expressly prohibits any attempt to assign the benefits.¹¹² The insured builds no equity in his survivors' loss coverage and the policy cannot be surrendered for cash. Also, as in the case of standard term insurance, survivors' loss benefits do not represent a policy reserve against which the insured may draw a loan, or which the insured may use as collateral for some other business transaction. Finally, the insured has no power to alter the time of enjoyment of the benefits.

Obviously, the no-fault insured retains the power to cancel his survivors' loss coverage by cancelling his entire insurance policy. However, that power to cancel should not be treated as an incident of ownership for the purposes of § 2042. By definition an incident of ownership must bring some economic benefit to the insured.¹¹³ In past cases the power to cancel a policy has been considered an incident of ownership when cancellation would provide the insured with some form of cash return.¹¹⁴ In contrast, cancellation of survivors' loss insurance results in an *economic detriment* to the insured. Without proper auto coverage the insured forfeits his right to drive legally in Michigan.¹¹⁵ Loss of that privilege is hardly an economic benefit in today's mobile society.

Since the insured holds no economically beneficial power of control over the survivors' loss portion of his policy, it should be concluded that he possesses no incidents of ownership in his survivors' loss coverage. Accordingly, amounts receivable by the insured's dependents as survivors' loss benefits should not be included in the gross estate of the insured.

111. See notes 22 & 23 *supra* and accompanying text.

112. See note 21 *supra*.

113.

It is clear that Congress intended the term "incidents of ownership" to mean more than mere possession or ownership in the technical-legal sense. Rather the test was intended to be—does the insured have the right to the economic benefits of the policy, regardless of his rights to the proceeds themselves?

Wilson, *Equal Treatment for Life Insurance*, 112 TRUSTS & ESTATES 270 (1973).

114. See, e.g., *Estate of Selznick v. Commissioner*, 15 T.C. 716, 729 (1950).

115. See MICH. COMP. LAWS ANN. § 500.2101 (Supp. 1977).

CONCLUSION

Michigan survivors' loss benefits should be excluded from the taxable gross estate of the insured for two reasons. First of all, the benefits represent a portion of wrongful death recovery in Michigan, and therefore are exempt from taxation under the holding in *Connecticut Bank & Trust Co. v. United States*.¹¹⁶ Secondly, the benefits do not qualify as taxable life insurance proceeds under § 2042. The insured holds no economically beneficial powers of control—"incidents of ownership"—over the survivors' loss portion of his policy. Therefore, according to the tax code, the benefits paid for survivors' loss should not be included in the gross estate of the insured for estate tax purposes.

If a tax break should arise in Michigan due to strict enforcement of the incidents of ownership test, it is proper that the benefits therefrom should inure to the taxpayers.¹¹⁷ Only Congress has the broad power to tax life insurance proceeds,¹¹⁸ and the IRS may not legislate, through administrative tactics, so as to defy the taxing criteria established by law.¹¹⁹ If correct application of the tax laws to survivors' loss benefits causes a reduction in the total revenues collected by the Treasury, it is the role of the Congress, and not of the IRS, to make up the difference.

116. See notes 24-27 and accompanying text.

117. See *Gorman v. United States*, 288 F. Supp. 225, 230 (E.D. Mich. 1968).

118. *Id. Cf. Fernandez v. Weiner*, 326 U.S. 340 (1945).

119. See *Gorman v. United States*, 288 F. Supp. 225, 230 (E.D. Mich. 1968).

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