Boston College Law Review

Volume 6 | Issue 3 Article 24

4-1-1965

Estate Taxation—Nature of Insurance Proceeds Includible in Decedent's Gross Estate.—In re Noel.

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Recommended Citation
Mark L. Cohen, *Estate Taxation—Nature of Insurance Proceeds Includible in Decedent's Gross Estate.—In re Noel.*, 6 B.C.L. Rev. 619 (1965), http://lawdigitalcommons.bc.edu/bclr/vol6/iss3/24

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In *Lincoln Mills*,[40] which involved labor legislation,[41] the Supreme Court said:

> [the lack of] express statutory sanction . . . will be solved by looking at the policy of the legislation and fashioning a remedy that will effectuate that policy. The range of judicial inventiveness will be determined by the nature of the problem. . . . [For] it is not uncommon for federal courts to fashion federal law where federal rights are concerned.[42]

Futhermore, in actions based on other federal statutes, federal courts, interpreting congressional intent, have created federal rules in furtherance of the intendment of the particular act.[43]

Further support for the creation of a "federal common law," if Massachusetts law is inapplicable, is found analogously in *J. I. Case Co. v. Borak*.[44] There, the state law was silent on any available relief to the plaintiff, a shareholder suing to void a merger obtained by misrepresentation in proxies in violation of the Securities Exchange Act of 1934.[45] Similarly, in the instant case, Massachusetts courts are silent on whether a large number of shareholders is an excuse. In *Borak*, the Supreme Court said:

> [I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose. . . . [W]e believe that the overriding federal law applicable here would, where the facts required, control the appropriateness of redress despite the provisions of state corporation law. . . . Moreover, if federal jurisdiction were limited . . . the hurdles that the victim might face . . . might well prove insuperable to effective relief.[46]

Thus, if the Massachusetts law were as stringent as the district court thought, its application in the instant case would inhibit the purposes of the act. In that event, the First Circuit intimates, the scope of federal common law should include federally created rules of decision governing legitimate excuses from making demand upon shareholders as a condition precedent to bringing a derivative action under the Investment Company Act.

JOHN M. MORAN

Estate Taxation—Nature of Insurance Proceeds Includible in Decedent's Gross Estate.—*In re Noel*.[1]—This action was brought to review a finding made by the Commissioner that proceeds paid under a flight insurance policy

40 Textile Workers v. Lincoln Mills, supra note 38.

41 Labor Management Relations Act of 1947, 61 Stat. 156, 29 U.S.C. § 185 (1958).

42 Textile Workers v. Lincoln Mills, supra note 38, at 457.

43 Rogers v. American Can Co., supra note 22; McClure v. Borne Chem. Co., 292 F.2d 824 (3d Cir. 1961); Fischbach & Moore, Inc. v. International Union of Operating Eng'rs, 198 F. Supp. 911 (S.D. Cal. 1961). See Notes, cited supra note 37.

44 377 U.S. 426 (1964).

45 48 Stat. 881 (1934), 15 U.S.C. § 78c (1958).

46 Supra note 44, at 433-35.

1 332 F.2d 950 (3d Cir. 1964).

were to be taxed as part of the decedent's gross estate. The decedent was issued two flight insurance policies prior to his departure for Venezuela, each valued at $62,500. The decedent's wife paid the premiums and was designated the beneficiary. The plane crashed, killing the decedent, and his wife recovered the full amount of the policies. The petitioners, executors of the decedent's estate, filed the required estate tax return after the decedent's death, but did not include the amount paid under the insurance policies in the assets of the gross estate. The Commissioner determined a deficiency in the tax paid, basing this ruling on Section 2042(2) of the 1954 Internal Revenue Code.[2] The Tax Court upheld the Commissioner's determination;[3] and on appeal the United States Court of Appeals for the Third Circuit HELD: The benefits received on the death of the insured from an accident insurance policy, as opposed to a life insurance policy, are not to be included in the gross estate of the decedent under section 2042(2).

In interpreting section 2042(2), the court first considered the ordinary and accepted meaning of "insurance . . . on the life of the decedent."[4] The court asserted that these words comtemplate a form of insurance, the nature of which is to insure against the death of the insured. Since the contingency or risk insured against determines the nature of an insurance policy, a policy primarily insuring against a contingency other than death is not insurance on life. In the case of life insurance, the inevitable death of the insured is the contingency insured against. Accident insurance, however, indemnifies the insured against the risk of accident. The mere fact that death may result from the accident does not change the "essential nature" of the policy to give it the character of insurance on life.

The second major element in the court's reasoning is that Congress intended the predecessors of section 2042(2), as well as section 2042(2) itself, to apply exclusively to life insurance. Prior to 1918, a common method of avoiding the estate tax on the transfer of life insurance proceeds at the insured's death was to make them payable to a beneficiary rather than the executor of the estate. In this way the face amount of the policy passed outside of the estate and was therefore not subject to an estate tax. Section 402(f) of the Revenue Act of 1918[5] foreclosed this possibility of circumventing the estate tax for the first time by making all proceeds of insurance on life, whether payable to a beneficiary or the executor, includible in the decedent's gross estate.[6] This reason also underlies the passage of successors to section 402(f), the most recent of which is Section 2042(2) of the 1954 Internal Revenue Code. The conclusion that Congress intended these sections to apply to life insurance is drawn from the fact that only *life* insurance could be used effectively as a method of avoiding estate taxation in this way. This scheme can be operative in planning an estate only when the insurance provides the policyholder with investment features and an inevitable payment of the face value of the policy. Life insurance is shown by the court to have such

[2] Int. Rev. Code of 1954, § 2042(2).
[3] Estate of Noel, 39 T.C. 466 (1962).
[4] Int. Rev. Code of 1954, § 2042(2).
[5] Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098.
[6] See H.R. Rep. No. 767, 65th Cong., 2d Sess. 22 (1918).

characteristics. On the other hand, because accident insurance has no investment features and insures against an event which may never occur, it cannot be used as a projected plan to avoid estate taxation at the death of the insured. Therefore, the court concluded, accident insurance cannot be included within the purpose of the statutes.

Each of the two major arguments of the court has an inherent weakness which renders it of questionable support for a decision which breaks with strong precedent. Regarding the first premise outlined above, although the occurrence of the accident is one necessary factor in making the insurance company liable, the accident must be coupled with injurious consequences before the company will actually become obligated to make payment. It is, therefore, the consequence of the accident, rather than the accident itself, which is the contingency that triggers payment of the proceeds. If in this case the plane had crashed but Noel had escaped injury, there would have been no payment of proceeds. The accident, however, did result in death, and it was actually the *death* of Noel which triggered the payment of the insurance money. The terms of the policy taken out by Noel provided for specified amounts to be paid for certain kinds of injury, but it was stipulated that the principal sum of the policy was only to be paid in the event of death. Therefore, since death is, in reality, a contingency insured against, the accident policy is, among other things, insurance on life. Clearly, to include this type of accident insurance within the statutory phrase, "insurance . . . on the life of the decedent," comports with the "ordinary, plain and generally accepted meaning"[7] of the words.

Secondly, the conclusion drawn by the court that Congress intended section 2042(2) to include only life insurance overlooks the context and repeated usage of the words "insurance . . . on . . . life."[8] The fact that this identical phrase is used in both subsection (1) and subsection (2) of the section indicates that Congress intended the meaning of the phrase to remain consistent throughout the section. The Congressional history of the section indicates that "insurance . . . on . . . life" in subsection (1) was intended to encompass death benefits from accident insurance as well as proceeds from life insurance. In the report of the Ways and Means Committee cited by the court,[9] the phrase, "insurance . . . on . . . life," used in subsection (1) was said to fall within the scheme of Section 202(a) of the Revenue Act of 1916.[10]

[7] This was the test applied by the court. In re Noel, supra note 1, at 952.

[8] Int. Rev. Code of 1954, § 2042 provides:

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 alone or in conjunction with any other person. . . . (Emphasis added.)

[9] H.R. Rep. No. 767, 65th Cong., 2d Sess. 22 (1918). The Ways and Means Committee Report actually explained § 402(f) of the Revenue Act of 1918, but since reasons underlying both § 402(f) of that Act and § 2042(2) of the Internal Revenue Code of 1954 are the same it refers equally to § 2042(2). See In re Noel, supra note 1, at 954.

[10] Revenue Act of 1916, ch. 463, § 202(a), 39 Stat. 777.

Section 202(a) provided that all "real, personal, tangible or intangible" property which is owned by a decedent at his death is to be subject to an estate tax. Because accident insurance is intangible personal property and is capable of ownership by a decedent at his death,[11] as was the case in *Noel*, it is within the scheme of section 202(a). Since subsection (1) of section 2042 is only a more specific re-enactment of section 202(a),[12] it must also include accident insurance within its meaning. The conclusion then follows that if the phrase, "insurance . . . on . . . life," includes accident insurance in subsection (1), the identical phrase must be given the same meaning in subsection (2) of section 2042. This result is not inconsistent with the portion of the Committee report concerning tax avoidance, because, although Congress showed an intent to include life insurance for particular reasons, it never indicated that it intended to exclude other forms of insurance.[13]

There is a further aspect, which was not considered by the court. If the court's reasoning is followed to its logical extremity, the proceeds of a term insurance policy would have to be excluded from estate taxation. Term insurance resembles accident insurance more than it resembles ordinary life insurance as these forms of insurance are defined by the court, for term insurance has no investment features and does not subject the insurance company to an absolute risk of payment of the value of the policy. Term insurance, therefore, would not be used as a tax avoidance device and does not fall within the court's understanding of the purpose of section 2042(2). If, in order to include term insurance, the court were to differentiate term insurance from accident insurance on the grounds that term insurance falls more easily within the words "insurance . . . on . . . life," a strong argument could be made that the flight insurance policy taken out by Noel was actually a term policy. The flight policy comes within the definition of a term policy because it insures the insured's life for a fixed term (the time the plane is in the air). Furthermore, a life policy was said by the court to insure against death from any cause, unless the cause is excepted in the terms of the policy.[14] It could be argued that the flight policy insures the decedent against death from any cause, except death from natural causes and death resulting from disease.[15]

In holding as it does, the court in the instant case comes into conflict with well-reasoned precedent. The leading case, *Leopold Ackerman v. Com-*

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[11] Insurance contracts are generally held to be personal property or choses in action. 12 Appleman, Insurance Law & Practice § 7007 (1943).

[12] H.R. Rep. No. 767, 65th Cong., 2d Sess. 22 (1918) stated that the construction of § 202(a) of the Revenue Act of 1916 was written into this subsequent section, "for the sake of clearness."

[13] It is interesting to note that in the Ways and Means Committee Report the word "life" neither appears alone nor in conjunction with insurance. The Committee spoke only of insurance, never using the terms "insurance . . . on . . . life." It can be presumed that "on life" was used in the statute to differentiate other forms of insurance, i.e., home insurance, automobile insurance, etc., from insurance which is payable because of the death of the insured.

[14] In re Noel, supra note 1, at 952.

[15] These exceptions are not as all-encompassing as they might otherwise be, because in the course of a flight, if death is to occur at all, the great likelihood is that it will be by accident.

missioner,[16] decided that proceeds received from the double indemnity clause of an insurance contract should be taxed as part of the decedent's gross estate. In arriving at this determination, the court asserted that Congress must have intended both accident and life insurance to be grouped within the meaning of Section 302(g) of the 1924 Revenue Act,[17] the predecessor of section 2042. The *Ackerman* court noted that Congress expressly distinguished between life and casualty insurance in section 503 of the Revenue Act of 1918, and merely used the words "insurance . . . on . . . life" in section 402(f) of that act.[18] The conclusion thus followed that Congress must have intended to separate the two in the former and group the two together in the latter section.[19]

The weight of precedent is clearly on the side of assessment of estate taxes where insurance contracts have insured against avoidable events and involved no investment features. For example, the proceeds of war risk insurance, where the policy is effective for only a limited amount of time and minimum premiums are paid, have been held subject to an estate tax by way of Section 811(g) of the Revenue Act of 1939,[20] a predecessor of section 2042(2).[21] The courts have so held[22] even in the light of federal legislation making the proceeds of these policies exempt from estate taxation.[23] The effect of this legislation was circumvented by deeming the proceeds themselves exempt from the tax, while levying the tax on the privilege of transferring the benefits. In still another case,[24] death benefits, payable as a result of a fund set up by the New York Stock Exchange, were held taxable under section 2042. Members of the Exchange contributed fifteen dollars upon admittance to the Exchange and fifteen dollars upon the death of any member. This "gratuity fund" thereby entitled the widows of the deceased member to receive $20,000, or something less if that amount could not be collected. In deciding that these benefits were to be taxed as insurance on life, Judge Learned Hand provided an interesting interpretation of section 811(g):

> The respondent's argument, as I understand it, is that in the tax statute [811(g)], the word should be limited to conventional life insurance, based upon adequate actuarial bases, and perhaps limited by the exclusion of bad risks. That appears to me [much] too circumscribed a reading of the phrase: "Insurance of every description." Back of the statute lies the purpose, I think, to include in a

16 15 B.T.A. 635 (1929).

17 Revenue Act of 1924, ch. 234, § 302(g), 43 Stat. 305.

18 Revenue Act of 1918, ch. 18, § 503, 40 Stat. 1104.

19 This reasoning was held significant with regard to the Revenue Act of 1924, since § 302(g) of that Act is a re-enactment of § 402(f) of the Revenue Act of 1918. The wording of § 2042(2) of the Internal Revenue Code of 1954 is substantially the same as that of both § 402(f) of the Revenue Act of 1918 and § 302(g) of the Revenue Act of 1924.

20 Revenue Act of 1939, ch. 3, § 811(g), 53 Stat. 122. This section in part provided that the gross estate included proceeds "under policies upon the life of the decedent."

21 United States Trust Co. of N.Y. v. Commissioner, 98 F.2d 734 (2d Cir. 1938).

22 United States Trust Co. of N.Y. v. Helvering, 307 U.S. 57 (1939).

23 World War Veterans Act of 1924, ch. 320, § 22, 43 Stat. 613.

24 Commissioner v. Treganowan, 183 F.2d 288 (2d Cir. 1950).

man's estate whatever provision he may have made for his successors, which depends upon his death, and which he has secured by means of "premiums" or "other considerations," paid during his life.[25]

This weight of precedent in opposition to the court's holding takes on a particular importance in view of the fact that the section of the Code dealing with estate taxation of insurance has been re-enacted many times, and Congress obviously saw no need to change or clarify the meaning given to this section by court holdings. Apparently, some stamp of approval was given by Congress to the interpretation which the courts and regulations had given this section. Repeated re-enactment of a statute, in the light of judicial and administrative interpretation of that statute, usually gives the interpretation the force of law.[26]

Another important aspect of *Noel*, which warrants consideration, is the possible repercussions which might arise as a result of its holding. Proceeds from an insurance policy were exempted from income taxation by Section 101(a) of the Code.[27] The rationale for this exemption is that it would be unfair to subject insurance proceeds to an income tax, since they are already subject to estate taxation.[28] Because *Noel* has made the determination that proceeds from certain types of insurance policies are to be excluded from a decedent's gross estate and therefore are to be immune from estate taxation, the reason for excluding these proceeds from income taxation no longer exists. The result of *Noel*, therefore, is either to create a tax "loophole," whereby these proceeds would pass with no tax being assessed on the transfer, or to subject accident and possibly forms of term insurance proceeds to income taxation.

The court, in the instant case, is on questionable ground in excluding death benefits of accident insurance from estate taxation. In the absence of a meaningful argument to the contrary, death benefits resulting from many forms of insurance fall within the clear and ordinary meaning of the words "insurance . . . on . . . life." Also, a long standing determination of an issue should not be overruled without meeting head-on the decisions of precedent cases in the area and without consideration of the serious repercussions which are likely to arise as a result of such reversal.[29]

MARK L. COHEN

Labor Law—Section 504 LMRDA—Communist Labor Officials—Constitutionality.—*Brown v. United States*.[1]—The defendant, Archie Brown, had been a member of the Communist Party since at least 1935. From 1959

[25] Id. at 293. The words "insurance of every description" used by Learned Hand were taken from the regulation which is found in Treas. Reg. 20.2042-1.

[26] United States Trust Co. of N.Y. v. Commissioner, supra note 21, at 735.

[27] Int. Rev. Code of 1954, § 101(a).

[28] 1 Bowe, Estate Planning & Taxation 437 (1957).

[29] Certiorari has been granted. Commissioner v. Estate of Noel, appeal docketed, No. 503, 2d Cir., June 17, 1964; cert. granted, 33 U.S.L. Week 3208 (U.S. Dec. 8, 1964).

[1] 334 F.2d 488 (9th Cir. 1964), cert. granted, 33 U.S.L. Week 3169 (U.S. Nov. 9, 1964) (No. 399).