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Estate Taxation--Constitutionality of the Premium Payment Test Applied to Life Insurance Policies When Gift Tax Has Been Paid on Inter Vivos Transfer

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It will be observed that the *holding* of the instant case avoids this problem. In this type of case, the defendant pays for his own defense. In requiring the government to release some of the defendant's money from its custody, the court is not requiring the government to actually hire the accountant. The government would merely released some of the security it was holding to guarantee that the defendant's taxes would be paid. At the worst, the government will be in exactly the same position it was in before it attached the defendant's property. Assuming that the defendant must "owe" either the government or an accountant, it seems preferable, in this case, that he owe the government since the opposite answer will virtually mean that the defendant won't be able to get the accounting assistance he requires to prepare his defense.[10]

It is therefore the writer's belief that in spite of the over-all tone of the opinion, the instant case should not be taken as a radical extension of the right to counsel as the concept has developed in this country. The writer, being in favor of the broadest possible extension of the right to counsel apparently guaranteed by the Sixth Amendment, is naturally in accord with the result reached in this case. Whenever at all feasible, the courts should see that the rights of a defendant are not unduly prejudiced because of his poverty. "Equal justice for rich and poor" is more than a Fourth of July platitude; it is one of the cornerstones of any democratic society.

TOM SOYARS

ESTATE TAXATION—CONSTITUTIONALITY OF THE PREMIUM PAYMENT TEST APPLIED TO LIFE INSURANCE POLICIES WHEN GIFT TAX HAS BEEN PAID ON INTER VIVOS TRANSFER—In 1921, the insured procured insurance policies upon his life and paid the annual premiums accruing thereon until 1941. Then he assigned all his rights in the policies to his three children, retaining to himself no title, interest, or possible right of reversion. He filed a gift tax return for that year, reported the transfer of the insurance policies, and paid the gift tax due thereon. All premiums on the policies accruing subsequent to the transfer were paid by the children. At the time of the insured's death, the Commissioner of Internal Revenue included in his gross taxable estate that portion of the value of the policies represented by the proportion that the premiums paid by the insured bore to the total amount of all the premiums. The children paid the tax on this amount, and then

[10] It must also be remembered that, because of the nature of a tax claim, the government is in an infinitely better position than the accountant, a mere creditor, to actually realize on its claim.

brought suit for refund, contending that the statutory "premium-payment" test was unconstitutional if applied in this manner. The statute provided that there should be included in the decedent's estate that portion of life insurance proceeds for which decedent had paid the premiums,[1] but plaintiffs contended that since the insured had transferred absolutely all his interest, and had paid a gift tax thereon, an additional tax would be direct and not levied by reason of a transfer at death. It would thus be unconstitutional because unapportioned. The District Court sustained this contention. *Held:* Affirmed. A tax imposed only by reason of the ownership of property is direct. Decedent had transferred all his property interest before death, and tax imposed upon proceeds of life insurance thus irrevocably assigned would be unconstitutional as imposing a direct tax without apportionment. This is not a case where the tax is constitutionally imposed because the transferor has retained incidents of ownership in the property transferred. Only when the gift is not complete until the assignor's death can the property be included in the decedent's estate. *Kohl* v. *U.S.*, 226 F. 2d 381 (7th Cir. 1955).

A direct tax is one that is imposed directly on property according to its value, while an indirect tax is a tax upon some right or privilege.[2] Thus, estate and inheritance taxes are generally held to be indirect, since they are imposed upon the privilege of transferring property at death.[3]

It is believed that an examination of the historical attempts of Congress and the Internal Revenue Service to tax the proceeds of life insurance policies payable to beneficiaries other than the insured will aid in a better understanding of the problem in the instant case. By the Revenue Act of 1918, proceeds in excess of $40,000 payable to beneficiaries other than the executor of the decedent's estate, were included in the gross taxable estate.[4] The constitutionality of this

[1] INT. REV. CODE of 1939, sec. 811 (g), as amended, 26 STAT. 332 (1942), provides that the taxable value of the gross estate of the decedent shall include ". . . the proceeds of life insurance . . . to the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance. . . ." This is the premium-payment test of taxability.

[2] Foster & Creighton Co. v. Graham, 154 Tenn. 412, 285 S.W. 570 (1926).

[3] Knowlton v. Moore, 178 U.S. 41 (1900). There it was said that it is the transmission of property from the dead to the living on which the taxes are imposed. For a text discussion of the indirect nature of inheritance and estate taxes, see 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION 5, 26, 27. (1942).

[4] REVENUE ACT of 1918, sec. 402, COMP. ST. ANN. SUPP. 1919, sec. 6336 ¾ c, provides; "That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal,

provision was challenged in the case of *Frick* v. *Lewellyn.*[5] There the decedent made irrevocable assignments of life insurance policies to his wife and daughter, without reserving the power to change the beneficiaries. These assignments were not made in contemplation of death. Pursuant to statute, all proceeds in excess of $40,000 were included in his taxable estate, but the court held that taxation of the proceeds of life insurance policies thus irrevocably assigned would be unconstitutional as providing for the taking of property without due process of law, and for the levy of a direct tax without apportionment. The court reasoned that there was no transfer at the time of the insured's death. Subsequent to this case, a treasury decision interpreted this statute so as to make taxable the proceeds of policies irrevocably assigned by an insured, *if* he continued to pay the premiums.[6] This "premium-payment" test of taxability was upheld in *Colonial Trust Co.* v. *Kraemer,*[7] where the court said:

> . . . [T]he test of constitutional taxability is not whether there has been in the strict sense a "transfer" but "whether the death has brought into being *or ripened* for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result. . . .[8]

The government apparently adopted this reasoning in the instant case, since it was contended that the value of the insurance policies was substantially enlarged after the time that the gifts were completed, and thus should be taxable as part of the estate.

It is believed, however, that the court was undoubtedly right in holding the tax unconstitutional as applied to the proceeds of these insurance policies. It has been held that where the transferor of a policy could surrender the policy for actual cash value, or borrow upon it, such reservations constituted incidents of ownership making it taxable to his estate.[9] This is analogous to the retention of incidents

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tangible or intangible, wherever situated—

"(f) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

[5] 298 Fed. 803 (W. D. Penn. 1924).

[6] T. D. 5032, 1941–1 CUM. BULL. 427. The decision is worded as follows: "Where a portion of the premiums or other consideration was actually paid by another and the remaining portion by the decedent, either directly or indirectly, such insurance is considered to have been taken out by the latter in the proportion that the payments therefor made by him bear to the total amount paid for the insurance." P. 428.

[7] 63 F. Supp. 866 (D. C. Conn. 1945).

[8] *Id.* at 873. See also Helvering v. Reybine, 83 F. 2d 215 (2d Cir. 1936); Levy's Estate v. Comm'r of Internal Revenue, 65 F. 2d 412 (2d Cir. 1933).

[9] Walker v. U.S., 83 F. 2d 103 (8th Cir. 1936); Sampson v. U.S., 1 F. Supp. 95 (D.C. Mass 1932).

of ownership over an inter vivos trust; where the settlor retains the power to revest in himself title to any part of the trust, or to change the beneficiary, the corpus of the trust may be included in his gross taxable estate.[10] But in the instant case, the policies were irrevocably assigned, and no incidents of ownership were retained by the donor. In this situation, courts have held that proceeds of such policies are not taxable to the decedent's estate, since he has retained no interest in, or control over, the policies and since there is no transfer of property at the time of his death. The transferee acquires a vested interest at the time of the assignment.[11]

The premium-payment test may nevertheless make taxable to the donor that portion of the proceeds for which he has paid the premiums, *if* he has not paid a tax *at the time of the transfer.* But in the instant case, the insured paid a gift tax when he made the irrevocable assignment to the plaintiffs, and since the transfer had previously been completed, an additional tax would be direct and imposed by reason of the ownership of the property. As one court expressed this view:

> . . . Gifts inter vivos . . . may be an appropriate subject of taxation by the federal government.
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> But it is doubtful whether such gifts, completed during the life of the donor, could be lawfully brought into the gross estate of a decedent for the purpose of measuring a tax upon his estate. I should expect such an attempt to fail for the reason that the transfer would have no reasonable relation to the event of death.[12]

It is believed that the instant case reached an equitable result, and that the owners of insurance policies should be allowed to assign them absolutely, inter vivos, paying a gift tax thereon, without the proceeds of these policies being taxed again at the assignor's death.

ROBERT A. PALMER

SEDUCTION—PROMISE TO MARRY—REFUSAL OF PARENTAL CONSENT—Appellant, a boy under twenty-one years of age, was tried and convicted of the statutory crime of seduction.[1] Both during and before the trial

[10] White v. Erskine, 47 F. 2d 1014 (1st Cir. 1931).

[11] Pennsylvania Co. for Insurances on Lives and Granting Annuities v. Commissioner of Internal Revenue, 79 F. 2d 295 (3rd Cir. 1935). See also Helvering v. Parker, 84 F. 2d 838 (8th Cir. 1936).

[12] Sampson v. U.S., *supra* note 9 at 98.

[1] KY. REV. STAT. sec. 436.010 (1955) provides: "(1) Any person who, under promise of marriage, seduces and has carnal knowledge of any female under twenty-one years of age, shall be confined in the penitentiary for not less than one nor more than five years.

(2) No prosecution under subsection (1) of this section shall be instituted where the person charged *has married the girl seduced or offers and is willing to marry her. . . .*" (Italics supplied.)