# NOTES

## DEMISE OF THE BEAMED TRANSFER THEORY—A RESULT OF LEGISLATIVE AMBIGUITY

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### I. INTRODUCTION

Under certain circumstances, the proceeds of a life insurance policy are included in the gross estate of an insured at his or her death and are subject to the federal estate tax. Section 2042 of the Internal Revenue Code ("Code") provides for the inclusion of life insurance proceeds in the decedent's gross estate.[1] The judicially created "beamed transfer theory," which has been incorporated into section 2035 of the Code, is yet another avenue of inclusion of life insurance proceeds.[2]

This Note outlines the development of the beamed transfer theory and discusses its viability in light of the amendments made to section 2035 by the Economic Recovery Tax Act ("ERTA") of 1981. The primary focus of this Note is on the legislative history of the changes made to section 2035 and the cases that have interpreted the amended section 2035. This Note con-

1. I.R.C. § 2042 (1988).
2. *Id.* § 2035; *see* text accompanying note 9.

cludes that, due to the ambiguity surrounding the legislative history of section 2035, courts have had no choice but to apply the "plain meaning" of the statute. The result has been the elimination of the beamed transfer theory from the arsenal of the Internal Revenue Service.[3]

## II. Estate Tax Treatment of Insurance Policies on the Life of a Decedent

The most common method of including the proceeds of an insurance policy on the life of a decedent in his or her gross estate is the use of section 2042 of the Code. Section 2042, which only applies to life insurance policies, provides in part:

> 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.[4]

The term "incidents of ownership," as it is used in section 2042, refers to "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."[5] In addition, the term has been held to include the power to prevent a change of beneficiary by withholding written consent,[6] and the power to select an optional mode of settlement and thus vary the time and manner in which policy proceeds will be paid.[7] It is important to note the term "incidents of ownership" does not apply to the situation in which a decedent,

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3. Estate of Headrick v. Commissioner, 93 T.C. 171 (1989), *aff'd* 918 F.2d 1263 (6th Cir. 1990), *action on decision*, 1991-012 (July 3, 1991). Internal Revenue Sevice announces it will no longer litigate the following issue:

> Whether the proceeds of a life insurance policy are includible in a decedent's gross estate where, even though the decedent was never listed as owner on the policy, the policy was procured at his instance, he paid the insurance premiums and he died within three years of taking out the policy.

This decision caused the demise of the beamed transfer theory.

4. I.R.C. § 2042 (1988). Section 2042 has remained essentially the same since it was originally enacted in 1954.

5. Treas. Reg. § 20.2042-1(c)(2) (1959).

6. Schwager v. Commissioner, 64 T.C. 781, 792 (1975).

7. Estate of Lumpkin v. Commissioner, 474 F.2d 1092, 1097 (5th Cir. 1973).

who possessed none of the above listed incidents of ownership, has paid some or all of the premiums of a policy of insurance on his or her life.[8]

Section 2042 is not the only provision that provides for the inclusion of life insurance proceeds in the gross estate of a decedent. Section 2035(a) provides a decedent's gross estate is to include "the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death."[9] Thus, if an insured has transferred a life insurance policy within three years preceding death, the value of the policy proceeds to the extent of the insured's interest is included in the insured's gross estate. Section 2035(a) does not apply to a transfer that constitutes a "bona fide sale for an adequate and full consideration in money or money's worth."[10]

Congress enacted section 2035(a) to prevent a decedent, whose gross estate would have included the value of his or her property pursuant to some other section of the Code, from escaping tax liability by transferring the property within three years of death.[11] It was initially assumed by many taxpayers and tax advisors that section 2035(a), as applied to life insurance policies, was meant to be read in *pari materia* with section 2042. The result would have provided for the inclusion of insurance proceeds in an insured's gross estate pursuant to section 2035(a) only if the insured had transferred a policy in which he or she had possessed an incident of ownership at any time within three years preceding death. The Internal Revenue Service, however, was able to broaden the application of section 2035(a) after it convinced courts to adopt the "beamed transfer theory."

The beamed transfer theory refers to a situation in which an insured, who does not possess any incidents of ownership in the insurance policy, is deemed to have made an indirect or constructive transfer of the policy proceeds by the fact he or she paid the premiums on the policy and died within three years of the issuance of the policy. Under these circumstances, the insured is viewed as having "beamed" the policy to the beneficiaries, and thus causes the inclusion of the policy proceeds in the gross estate of the insured pursuant to section 2035(a). The beamed transfer theory should result in the same outcome whether the insured purchases the policy of insurance and

8. *See* First Nat'l Bank v. United States, 488 F.2d 575, 578 (9th Cir. 1973). The enactment of section 2042 was intended to eliminate the so called premium-payment test that had been used prior to 1954. *See* H.R. REP. NO. 1337, 83d Cong., 2d Sess. A316, *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4017, 4459; S. REP. NO. 1622, 83d Cong., 2d Sess. 472, *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4621, 5113. Under the premium-payment test, inclusion was based solely on whether a decedent had paid some or all of the premiums of an insurance policy on his or her life.

9. I.R.C. § 2035(a) (1988).

10. *Id.* § 2035(b)(1).

11. *See* United States v. Wells, 283 U.S. 102, 116-18 (1931).

later transfers it to the beneficiary, or the beneficiary purchases the policy at the urging of the insured and with the insured's funds.

## III. DEVELOPMENT OF THE BEAMED TRANSFER THEORY

### A. *Insured Pays the Policy Premiums*

The beamed transfer theory originated in *Bel v. United States*.[12] In *Bel*, the decedent, John Albert Bel, had purchased annual accidental death policies on his own life and had paid the premiums on the policies.[13] The last policy was purchased less than one year before his death and was owned solely by his three children.[14] At his death, his three children received the $250,000 proceeds of the policy.[15] The Commissioner of the Internal Revenue Service determined the policy had been transferred by the decedent to his children in contemplation of death[16] and included the proceeds in the decedent's gross estate.[17] The executors of the decedent's estate paid the resulting estate tax and then brought suit to obtain a refund.[18]

The Fifth Circuit Court of Appeals held the payment of the policy premiums by the decedent constituted a "transfer" of the accidental death policy within the meaning of section 2035(a) of the Internal Revenue Code, and the proceeds of the policy should be included in the gross estate of the decedent.[19] The court determined the policy proceeds could not be included in the decedent's gross estate pursuant to section 2042 because this section was effective only if the decedent had retained incidents of ownership in the policy.[20] Following *Estate of Coleman v. Commissioner*,[21] the court concluded section 2042 did not apply when, as here, a decedent had merely paid the policy premiums of a life insurance policy on his life but had not retained any incidents of ownership.[22]

The court, then, rejected the plaintiff's argument that if section 2042 did not apply when a decedent has only paid the policy premiums, then section 2035(a), likewise, should not apply.[23] The court pointed out sections 2042

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12. Bel v. United States, 452 F.2d 683 (5th Cir. 1971), *cert. denied*, 406 U.S. 919 (1972).

13. *Id.* at 686.

14. *Id.*

15. *Id.*

16. Prior to 1976, section 2035(a) contained the phrase "in contemplation of his death" rather than the current phrase "during the 3-year period ending on the date of the decedent's death." For the purposes of this article, this change is of little consequence.

17. *Id.* at 687.

18. *Id.*

19. *Id.* at 692.

20. *Id.* at 689.

21. Estate of Coleman v. Commissioner, 52 T.C. 921 (1969).

22. Bel v. United States, 452 F.2d 683, 689 (5th Cir. 1971), *cert. denied*, 406 U.S. 919 (1972).

23. *Id.* at 690.

and 2035 were not designed to be read in *pari materia*.[24] Section 2042 applies only to life insurance policies, but section 2035 applies to "all property which is transferred in contemplation of death."[25] The court stated the plaintiffs were attempting to "apply a section of the Code dealing with lemons (section 2042), to one pertaining to oranges (section 2035)."[26] Thus, the fact that payment of the policy premiums was insufficient to cause inclusion under section 2042 did not mean section 2035, also, did not apply when a decedent had only paid the premiums of a policy of insurance on his or her life.[27]

In concluding section 2035 applies when a decedent, although not the owner of the policy, has purchased the policy and paid the premiums, the court concentrated on the word "transfer" as it is used in section 2035(a). Looking to the definition of "transfer" as set out by the Supreme Court in *Chase National Bank v. United States*,[28] the court found "the word 'transfer' is not limited to the passing of property directly from the donor to the transferee, but encompasses a donation 'procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another.'"[29]

The court completed its discussion by making the statement that has led to the use of the term "beamed transfer theory":

> We think our focus should be on the control beam of the word 'transfer.' The decedent, and the decedent alone, beamed the accidental death policy at his children, for by paying the premium he designated ownership of the policy and created in his children all of the contractual rights to the insurance benefits. These were acts of transfer.[30]

The beamed transfer theory, which subjects insurance proceeds to the federal estate tax when an insured has paid the premiums of an insurance policy and has died within three years of the issuance of the policy, was upheld in *First National Bank v. United States*.[31] The facts of *First National Bank* are slightly different from those of *Bel* because, although the decedent

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24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. Chase Nat'l Bank v. United States, 278 U.S. 327, 337 (1929). The Supreme Court stated:

> [T]he word 'transfer' . . . cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. It must, we think, at least include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another.

*Id.*

29. Bel v. United States, 452 F.2d 683, 691 (5th Cir. 1971), *cert. denied*, 406 U.S. 919 (1972).
30. *Id.*
31. First Nat'l Bank v. United States, 488 F.2d 575 (9th Cir. 1973).

in this case paid the premiums, he did not purchase the insurance policy on his life.[32] In *First National Bank*, the Ninth Circuit Court of Appeals held that "where life insurance policies are procured at the instance of the decedent within the presumptive period and where the premiums are paid by the deceased, the gross estate includes the proceeds of the policies" pursuant to section 2035 of the Code.[33]

The court stated section 2035 is intended "to reach substitutes for testamentary dispositions and thus to prevent evasion of the estate tax."[34] The court found the intention of the decedent in paying the premiums of the policies was to pass the proceeds at death.[35] According to the court, this "was . . . the equivalent of a testamentary disposition, and its taxation was precisely the object of section 2035."[36] Of importance to the court in reaching its decision was the fact that it was able to see only a "formal difference between a decedent first buying a policy, then transferring it to the beneficiary, and the beneficiary purchasing the policy at the urging of the decedent and with the decedent's funds."[37] The court decided that only a policy of tax evasion could support this formalistic distinction.[38]

*Bel* and *First National Bank* both support the application of the beamed transfer theory to the situation in which a decedent has directly paid the premiums of a policy on his or her life. The fact the policy was purchased by a beneficiary rather than by the decedent does not seem to make much difference. All that is important is the decedent has paid the premiums of a policy of insurance issued on his or her life and has died within three years of the issuance of the policy.

### B. *Agent of the Insured Pays the Policy Premiums*

The beamed transfer theory comes into play, not only when a decedent has directly paid the premiums of an insurance policy on his or her life, but also when an agent of the decedent pays the life insurance premiums. *Detroit Bank & Trust Co. v. United States*[39] was the first case to hold the beamed transfer theory is applicable even though a decedent has not directly paid the insurance premiums.[40]

In *Detroit Bank & Trust Co.*, the decedent had created a trust and had transferred some money to the trust so that he could acquire an insurance

32. *Id.* at 576. The decedent's wife was the purchaser of the insurance policy. *Id.*
33. *Id.*
34. *Id.* at 577 (quoting United States v. Wells, 283 U.S. 102 (1931)).
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. Detroit Bank & Trust Co. v. United States, 467 F.2d 964 (6th Cir. 1972), *cert. denied*, 410 U.S. 929 (1973).
40. *Id.* at 969.

policy on his life.[41] The trust was irrevocable, and the decedent lacked the power to control it.[42] The decedent was required to continue making contributions to the trust for the payment of life insurance premiums, and the trustees were required to use the contributed money to pay the premiums.[43] The decedent died within six months of the issuance of the life insurance policy.[44]

The Sixth Circuit Court of Appeals found the "trustee was in substance and reality acting as the decedent's agent in purchasing the policy" and in paying the premiums of the policy.[45] Based on this agency relationship, the court held the trust device was a substitute for a testamentary disposition; therefore, the proceeds of the life insurance policy were included in the decedent's gross estate pursuant to section 2035 of the Code.[46] Although the court did not refer to the term "beamed transfer theory" anywhere in its decision, it is evident from its discussion of *Bel*[47] that the court was in reality applying the theory.

The United States Tax Court decision in *Estate of Kurihara v. Commissioner* reaffirmed the holding of *Detroit Bank & Trust Co.*[48] The facts of *Kurihara* are similar to those of *Detroit Bank & Trust Co.*, with the exceptions that the decedent, Tetsuo Kurihara, was not required to contribute money to the trust for payment of the policy premiums,[49] and the trustees were not required to pay the premiums of the life insurance policy.[50] The decedent, however, did, pay money into the trust for that purpose.[51] A notation on a check made out in the amount of the annual premium payment stated the funds were for the payment of the policy premiums.[52] The trustee endorsed this check to the order of the insurance company in payment of the initial premium.[53] The decedent died three months after the issuance of the policy.[54]

The court held the trustees had acted as the decedent's agent in paying the policy premium, and that, in reality, it was the decedent who had paid the initial premium.[55] Consequently, the court held the decedent had "created"

41. *Id.* at 965.
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.* at 966.
46. *Id.* at 969.
47. *Id.* at 967.
48. Estate of Kurihara v. Commissioner, 82 T.C. 51 (1984) (applying estate tax law as it existed prior to 1981).
49. *Id.* at 52.
50. *Id.* at 52-53 n.3.
51. *Id.* at 52.
52. *Id.*
53. *Id.*
54. *Id.* at 53.
55. *Id.* at 61.

the ownership rights in the trustees and had "transferred the policy to them within the meaning of section 2035."[56] Thus, the proceeds of the insurance policy were includable in the decedent's gross estate.[57]

It is evident that, prior to 1981, the beamed transfer theory was in full force. Section 2035(a) included the proceeds of a policy of insurance on the decedent's life in his or her gross estate if the decedent had paid the policy premiums and had died within three years of the issuance of the policy.[58] This was true even if the decedent had not purchased the life insurance policy.[59] The end result was not affected by the fact the decedent had not directly paid the policy premiums;[60] as long as the decedent's agent had paid them, the insurance proceeds were includable in the gross estate of the decedent. The addition of section 2035(d) to the Code in 1981, however, has cast doubt on the validity of the beamed transfer theory.[61]

## IV. IMPACT OF THE ECONOMIC RECOVERY TAX ACT OF 1981

### A. *Enactment of Internal Revenue Code Section 2035(d)*

Congress made substantial changes to the Internal Revenue Code when it passed the ERTA in 1981.[62] No changes were made to section 2042, but section 2035 was substantially changed by the addition of section 2035(d).[63] Section 2035(d) essentially abolished the three-year rule of section 2035(a),[64] with the exception that section 2035(a) continues to apply to transfers of property that would have been included in the gross estate by virtue of certain enumerated estate tax provisions.[65]

Prior to ERTA, the general effect of section 2035(a) was that the post gift appreciation of all gifts made by a decedent within three years of death was taxed. The gifts themselves were already subject to the gift tax provisions of the Code. However, if not for section 2035(a), the donor of a gift could escape tax liability on the post gift appreciation. Congress added section 2035(d)(1) because it believed taxation of appreciation that accrued after a gift had been made, merely because the donor had died within three years

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56. *Id.*
57. *Id.*
58. I.R.C. § 2035(a) (1988).
59. First Nat'l Bank v. United States, 488 F.2d 575 (9th Cir. 1973); *see supra* text accompanying notes 31-38.
60. Detroit Bank & Trust Co. v. United States, 467 F.2d 964 (6th Cir. 1972), *cert. denied* 410 U.S. 929 (1973); *see supra* notes 39-46 and accompanying text.
61. *See* I.R.C. § 2035(d) (1988).
62. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981).
63. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 424, 95 Stat. 172, 317 (1981).
64. *See supra* note 8 and accompanying text.
65. *See id.* See text of note 68 for list of estate tax provisions to which section 2035(a) still applies.

of the gift, was inappropriate.[66] Congress, however, decided to add section 2035(d)(2) because it believed that taxation of the post gift appreciation of certain gifts was necessary to preclude decedents from arranging their estates on their death bed to avoid taxation on this appreciation.[67] The legislative history does not reveal why Congress felt section 2035 should continue to apply to certain gifts, but it can be presumed that the exceptions contained in section 2035(d)(2) were considered to be more susceptible to abuse by taxpayers.

Sections 2035(d)(1) and (2) provide:

> (d) DECEDENTS DYING AFTER 1981.—
> (1) IN GENERAL.—Except as otherwise provided in this subsection, subsection (a) shall not apply to the estate of a decedent dying after December 31, 1981.
> (2) EXCEPTIONS FOR CERTAIN TRANSFERS.—Paragraph (1) of this subsection and paragraph (2) of subsection (b) shall not apply to a transfer of an interest in property which is included in the value of the gross estate under section 2036, 2037, 2038 or 2042 or would have been included under any such sections if such interest had been retained by the decedent.[68]

It would appear that section 2035(d) limits the application of the three-year rule to such life insurance proceeds as would have been includable under section 2042 if a decedent had retained incidents of ownership in the life insurance policy. Thus, the proceeds from a policy owned by a third party, on which the insured had merely paid the premiums, would not be includable in the insured's gross estate. To determine whether this is the case, it is necessary to examine the legislative history of section 2035(d).

### B. *Legislative History of Section 2035(d)*

The Senate's version of section 424 of ERTA provided that the three-year rule of section 2035(a) would continue to apply to all transfers made by a decedent for less than a full and adequate consideration.[69] The only proposed revision was to change the way in which an included transfer was valued for purposes of inclusion in the gross estate.[70] The Senate version of the bill is irrelevant for the purpose of ascertaining the intent of Congress in

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66. *See* S. REP. NO. 144, 97th Cong., 1st Sess. 22, *reprinted in* 1981 U.S. CODE CONG. & ADMIN. NEWS 105, 238-39; H.R. REP. NO. 201, 97th Cong., 1st Sess. 186 (1981).
67. *See* authorities cited *supra* note 66.
68. I.R.C. §2035(d)(1)-(2) (1988).
69. S. REP. NO. 144, 97th Cong., 1st Sess. 22, *reprinted in* 1981 U.S. CODE CONG. & ADMIN. NEWS 105, 239.
70. *Id.*

enacting section 424 of ERTA, because the conference agreement specifically stated it would follow the House bill.[71]

To discover the congressional intent of section 2035(d), it is necessary to examine the House bill. The House version of section 424 of ERTA specifically stated:

> The committee bill contains exceptions which continue the application of section 2035(a) to (1) *gifts of life insurance* and (2) interests in property otherwise included in the value of the gross estate pursuant to sections 2036, 2037, 2038, 2041, or 2042 (or those which would have been included under any of such sections if the interest had been retained by the decedent).[72]

It is apparent that the House bill, by providing a specific exception for gifts of life insurance, would preserve the validity of the beamed transfer theory. Although it is unclear what the House's intention was when it created this exception, it can reasonably be concluded the exception encompasses both direct and indirect transfers of insurance policies. The beamed transfer theory deals with indirect gifts or transfers of life insurance policies in that an insured is deemed to have made a transfer of an insurance policy merely by the fact that he or she has paid the policy premiums and has died within three years of the issuance of the policy. If the House bill had been enacted as written, clearly the beamed transfer theory would have continued in effect after ERTA just as it had prior to ERTA.

As previously mentioned, the conference agreement specifically stated it would follow the House bill.[73] Section 2035(d), however, did not follow the bill in all respects. For example, section 2035(d) does not contain the specific exception for gifts of life insurance. A detailed examination of the legislative debate of ERTA revealed no explanation for this omission.[74]

Apparently, the specific exception for gifts of life insurance was omitted because the legislators were under the impression it would be repetitious to include it because an exception for insurance policies had already been provided by the reference to section 2042. This impression would be true except that section 2042 does not apply when a decedent has merely paid the premiums of a policy of insurance on his or her life. The beamed transfer theory, however, does apply to this situation if the decedent has died within three years of the issuance of the policy.

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71. H.R. CONF. REP. NO. 215, 97th Cong., 1st Sess. 255, *reprinted in* 1981 U.S. CODE CONG. & ADMIN. NEWS 285, 343-44.

72. H.R. REP. NO. 201, 97th Cong., 1st Sess. 186, 187 (1981) (emphasis added).

73. *See supra* note 71.

74. *See* 127 CONG. REC. D488 (daily ed. July 20, 1981); 127 CONG. REC. D530 (daily ed. July 29, 1981); 127 CONG. REC. D545 (daily ed. July 30, 1981); 127 CONG. REC. D551 (daily ed. Aug. 3, 1981); 127 CONG. REC. D552 (daily ed. Aug. 4, 1981). ERTA was debated in the House on August 4th. The Senate debated ERTA on July 20th, July 29th, July 31st, and August 3rd.

Congress enacted section 2035(d)(2) because it believed continued taxation of the post gift appreciation of certain gifts was necessary to prevent donors from arranging their estates on their death bed to avoid estate taxes.[75] Because the beamed transfer theory reaches the same result by taxing the proceeds of an insurance policy that has appreciated in value because the insured has paid the insurance premiums, the omission of the reference to gifts of life insurance was probably just an oversight.

Congress' intent in enacting section 2035(d) is ambiguous. The language of section 2035(d), however, is not ambiguous. If the plain language of section 2035(d) controls, then Congress' unexplained and probably unintentional omission of the exception for gifts of life insurance may have served to abrogate the beamed transfer theory. However, if courts looked past the plain language of section 2035(d) and adopt the language used in the House bill, then the beamed transfer theory would be as viable after ERTA, as it was prior to ERTA.

### C. *The Internal Revenue Service's Position After ERTA*

Three years after the enactment of ERTA, the Internal Revenue Service ("Service") stated its position on the proper interpretation to be given section 2035(d) in its Technical Advice Memorandum 8509005 ("Memorandum").[76] The Memorandum was based on the following factual situation. The decedent, as insured, and A, both signed an application for insurance.[77] Afterwards, a policy of insurance on the decedent's life was issued to A as sole owner and beneficiary.[78] Later, A transferred the policy to an irrevocable trust that was to benefit A and three others designated by A.[79] The monthly premiums of the policy were paid by the decedent's wholly owned corporation.[80] These payments were treated as loans made by the corporation to the decedent.[81] The decedent died within three years of the issuance of the policy.[82]

The Service argued the proceeds of the life insurance policy should be included in the decedent's gross estate, based on the application of the beamed transfer theory.[83] It did not believe the enactment of section 2035(d) affected the validity of the beamed transfer theory.[84] The Service found

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75. SEN. REP. NO. 144, 97th Cong., 1st Sess. 138, *reprinted in* 1981 U.S. CODE CONG. & ADMIN. NEWS 105, 238.

76. Tech. Adv. Mem. 8509005 (Nov. 28, 1984).

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

support for its position in the House bill, which had provided a specific exception for gifts of insurance.[85] The Service concluded that:

> The legislative history underlying section 2035(d) states that section 2035(d)(2) was intended to *continue* the application of section 2035(a) to gifts of life insurance. Thus, it is clear that Congress in enacting section 2035(d)(2), intended that the gross estate continue to include the value of life insurance transferred within three years of the Decedent's death that would otherwise be subject to inclusion under section 2035(a) prior to the enactment of section 2035(d)(1).[86]

The enactment of section 2035(d), without an exception for gifts of insurance, did not cause the Internal Revenue Service to abandon the beamed transfer theory. Apparently, the Service was more than willing to look past the actual language of the statute and rely on the somewhat ambiguous legislative history underlying its enactment. The courts have not been so willing to ignore the plain language of section 2035(d).[87]

## V. REJECTION OF THE BEAMED TRANSFER THEORY

The judiciary's first opportunity to interpret section 2035(d) came in *Estate of Leder v. Commissioner*.[88] In *Leder*, the decedent's wife, Jeanne Leder, had purchased insurance on the decedent's life and had signed the original application as owner.[89] Jeanne Leder was initially the sole owner and beneficiary of the policy.[90] All of the premiums were paid by preauthorized withdrawals from the account of a corporation wholly owned by the decedent.[91] The premium payments were treated as loans made by the corporation to the decedent.[92] The decedent died less than five months after the issuance of the policy.[93]

The Commissioner of the Internal Revenue Service asserted the policy proceeds should be included in the decedent's gross estate pursuant to section 2035, while the executor of Leder's estate asserted section 2035 did not apply unless the insurance proceeds were includable in the gross estate pur-

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85. *See supra* note 72 and accompanying text.

86. Tech. Adv. Mem. 8509005 (Nov. 28, 1984) (emphasis in original).

87. *See infra* text accompanying notes 88-114.

88. Estate of Leder v. Commissioner, 89 T.C. 235 (1987), *aff'd*, 893 F.2d 237 (10th Cir. 1989). The facts in *Leder* are so similar to those in Technical Advice Memorandum 8509005 that it is very likely the Memorandum was written in response to an inquiry by Leder's estate. *See supra* notes 76-86 and accompanying text.

89. Estate of Leder v. Commissioner, 89 T.C. at 236.

90. *Id.* Later, Jeanne Leder transferred the policy to an irrevocable trust that had been created for the benefit of her and her children. *Id.* at 237.

91. *Id.* at 236.

92. *Id.* at 237.

93. *Id.* at 236.

suant to section 2042.[94] The executor of Leder's estate went on to claim that, because the decedent had never possessed any of the incidents of ownership in the policy, the policy proceeds were not includable in the gross estate pursuant to section 2042.[95]

The United States Tax Court held the insurance proceeds were not includable in the decedent's gross estate, because (1) section 2042 was not applicable due to the fact the decedent had never possessed any of the incidents of ownership in the policy; (2) the section 2035(d)(2) exception to section 2035(d)(1) was not applicable because the conditions of section 2042 had not been met; and (3) section 2035(d)(1) overrides section 2035(a).[96] The court did not find it necessary to discuss whether there had been a "transfer" within the meaning of section 2035(a).[97]

The court found the plain language of section 2035(d) required that it be an "added sieve through which transactions must pass before the transfer may even be tested under the 3-year rule."[98] In response to the Commissioner's argument that the Senate and House bills were evidence that Congress "clearly" intended for the three-year rule to continue to apply to gifts of life insurance regardless of section 2035(d)(1),[99] the court stated that, although resort may be made in some circumstances to legislative history to find Congress' intent, it was "hesitant to rely on inconclusive legislative history to supply a provision *not enacted* by Congress."[100]

On appeal, the Tenth Circuit Court of Appeals affirmed the Tax Court's holding that the proceeds from the insurance policy were not includable in Leder's gross estate under section 2035(d) because Leder had never possessed any of the incidents of ownership in the policy under section 2042.[101] In reaching its decision, the court did not refer to the legislative history of section 2035(d), but instead, limited its discussion to the express language of the statute.[102]

The court expressly declined to create "a judicial gloss on the express language of section 2035(d)" by incorporating into the section the beamed transfer theory.[103] The court stated:

> [T]he Commissioner's interpretation of section 2035—that the constructive transfer doctrine [also known as the beamed transfer theory] of section 2035(a) applies to 2035(d), and specifically section 2035(d)(2)—

94. *Id.* at 237-38.
95. *Id.* at 238.
96. *Id.*
97. *Id.*
98. *Id.* at 239.
99. *Id.* at 240-41.
100. *Id.* at 242.
101. Estate of Leder v. Commissioner, 893 F.2d 237, 238 (10th Cir. 1990).
102. *See generally id.*
103. *Id.* at 240.

> would have us mixing lemons and oranges [refering to the quote from *Bel*[104]]. Section 2035(d)(2) specifically cross references section 2042. The only inference we can draw from this express cross reference is that Congress, in enacting subsection (d), meant to construe sections 2035(d)(2) and 2042 in *pari materia*.[105] 'It is a well established law of statutory construction that, absent ambiguity or irrational result, the literal language of a statute controls.'[106]

The court then concluded the application of the beamed transfer theory to section 2042 (by way of section 2035(d)(2)) "would contravene Congress' intent in enacting section 2042 by effectively resurrecting the premium payment test."[107]

The Internal Revenue Service attempted to use the beamed transfer theory in three cases decided after *Leder*. In *Estate of Headrick v. Commissioner*,[108] *Estate of Chapman v. Commissioner*,[109] and *Estate of Perry v. Commissioner*,[110] the United States Tax Court adhered to its interpretation that section 2035(d) includes in a decedent's gross estate only those insurance proceeds that would have been included under section 2042 if the decedent had retained incidents of ownership in the life insurance policy.[111] With the addition of *Headrick*, *Chapman*, and *Perry*, a total of four cases have dealt with section 2035(d) since its enactment in 1981.[112] All four have rejected any application of the beamed transfer theory to the statute as it currently reads.[113] The courts, in all four cases, were unwilling to rely on an ambiguous legislative history to ascertain Congress' intent in enacting section 2035(d).[114] The "plain language" of this statute was deemed sufficient to cause the demise of the beamed transfer theory.[115]

In 1991, the Internal Revenue Service reluctantly announced it would no longer litigate cases involving the beamed transfer theory.[116] This

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104. *See supra* text accompanying note 25.

105. Estate of Leder v. Commissioner, 893 F.2d at 241.

106. *Id.* (quoting Edwards v. Valdez, 789 F.2d 1477, 1481 (10th Cir. 1986)).

107. *Id.* at 242. *See supra* note 5.

108. Estate of Headrick v. Commissioner, 93 T.C. 171 (1989), *aff'd*, 918 F.2d 1263 (6th Cir. 1990).

109. Estate of Chapman v. Commissioner, 56 T.C.M. (CCH) 1451 (1989).

110. Estate of Perry v. Commissioner, 59 T.C.M. (CCH) 65 (1990), *aff'd*, 927 F.2d 209 (5th Cir. 1991).

111. *See* Estate of Perry v. Commissioner, 59 T.C.M. (CCH) 65 (1990), *aff'd*, 927 F.2d 209 (5th Cir. 1991); Estate of Chapman v. Commissioner, 56 T.C.M. (CCH) 1451 (1989); Estate of Headrick v. Commissioner, 93 T.C. 171 (1989), *aff'd*, 918 F.2d 1263 (6th Cir. 1990); Estate of Leder v. Commissioner, 89 T.C. 235 (1987), *aff'd*, 893 F.2d 237 (10th Cir. 1989).

112. *See* cases cited *supra* note 111.

113. *See id.*

114. *See id.*

115. *See id.*

116. Action on Decision, 1991-012 (July 3, 1991) (regarding Estate of Headrick v. Commissioner, 93 T.C. 171 (1989), *aff'd*, 918 F.2d 1263 (6th Cir. 1990)).

announcement can be attributed to the fact that the Internal Revenue Service's position was unanimously rejected by the appellate courts for the Fifth, Sixth, and Tenth Circuits.[117] The Internal Revenue Service's aquiescence means the beamed transfer theory can no longer be considered viable.

## VI. CONSEQUENCES OF THE REJECTION OF THE BEAMED TRANSFER THEORY

The uniform rejection of the beamed transfer theory since the enactment of ERTA has created a loophole for taxpayers that did not exist for a period of about ten years. The loophole provides a taxpayer with several options by which to make insurance funds available to beneficiaries without fear the proceeds will be included in his or her gross estate.

A taxpayer can purchase an insurance policy on his or her life and pay its premiums and, as long as no incidents of ownership are retained, the insurance proceeds will not be subject to the estate tax. Alternatively, a taxpayer could create an irrevocable trust and direct the trustee to purchase an insurance policy on the life of the taxpayer. The taxpayer could, then, periodically transfer a sufficient sum of money to the trust to enable the trustee to pay the policy premiums. When the taxpayer has not retained any incidents of ownership in the policy, the insurance proceeds cannot be included in the taxpayer's gross estate at death. This is true even if the taxpayer has died within three years of the issuance of the policy. Under these circumstances, neither section 2042 nor section 2035 applies, and a taxpayer will be able to avoid having the insurance proceeds included in his or her gross estate.

## VII. CONCLUSION

The enactment of Internal Revenue Code Section 2035(d) has substantially impacted on the viability of the beamed transfer theory. Although the Internal Revenue Service has argued the legislative history of the statute supports the idea that Congress intended to provide an exception for gifts of life insurance, this legislative history is just too ambiguous for the judiciary to find that Congress actually intended to create such an exception. This leaves courts with no choice but to apply the "plain language" of the statute, with the result that the beamed transfer theory must be rejected.

*Keith Buck*

117. *See* cases cited *supra* note 111.