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The Possession by a Trustee of the Power to Alter the Time and Manner of Enjoyment of Life Insurance Proceeds Held in Trust Requires That the Value of the Proceeds Be Included in the Decedent Trustee's Gross Estate.

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written agreement whereby the landlord has a contractual lien on the tenant's property and a contractual right of self-help seizure in the event of default. If the Constitution does not *per se* prohibit contractual liens and contractual self-help seizures in a written lease agreement, it seems unlikely that a statute can be unconstitutional when it only restricts and limits the landlord's right to contract for a lien and self-help remedy.

If the lien allowed by article 5236d is a purely contractual one, then a landlord, acting solely pursuant to such a lien, is not acting under the real or apparent authority of the state. However, even with the requirement that the landlord's right of self-help seizure be written into his apartment lease, article 5236d, just as article 5238a before it, still authorizes *summary* seizure by the landlord. Without the contractual lien provision in the statute, any seizure is unlawful; therefore the landlord's right to seize springs from the statute. Thus, as in article 5238a, the legislature has authorized summary seizure of a tenant's property without prior judicial hearing in article 5236d.

Betsy Hall

**ESTATE TAXATION—Trusts—The Possession by a Trustee of the
Power to Alter the Time and Manner of Enjoyment of Life
Insurance Proceeds Held in Trust Requires that the Value
of the Proceeds Be Included in the Decedent
Trustee's Gross Estate**

Rose v. United States,

511 F.2d 259 (5th Cir. 1975).

Catherine Myers Rose, as representative of her decedent husband's estate, brought suit seeking a refund of estate taxes which had been paid under protest. Her deceased husband had been appointed trustee of three separate irrevocable trusts created and initially funded by his brother. Each of the trusts had one of the decedent's three children as a sole beneficiary. Pursuant to his broad administrative powers as trustee, the decedent applied for three separate life insurance policies on his own life. As trustee, the decedent was made owner and beneficiary of the three policies, each of which was deposited among the assets of one of the trusts, and the premium for each policy was paid out of the corpus of its corresponding trust. The insurance contracts provided that the trustee had the power to convert the policies from

whole life insurance to either limited payment life insurance or endowment insurance. The decedent was also given control over the withdrawal of dividend accumulations, the surrender of dividend additions for their cash value, and the power to obtain loans on the policies. He was not prohibited by the trust instruments from exercising any of the powers granted by the insurance policies. The Commissioner of Internal Revenue included the value of the three life insurance policies in the decedent's gross estate for the purpose of assessing federal estate taxes. Mrs. Rose then filed suit for a refund of that portion of the estate taxes attributable to the inclusion of the insurance proceeds in her husband's gross estate. The district court entered summary judgment for the Government. On appeal, the Commissioner argued that the decedent possessed incidents of ownership in the policies at the time of his death, and therefore, the proceeds of the policies were properly included in the decedent's gross estate. Mrs. Rose contended that the decedent trustee possessed no incidents of ownership, and therefore, the policy proceeds were exempt from taxation. Held—*Affirmed*. Life insurance policies on a decedent trustee's life, which were held in trust, are includable in the decedent's gross estate for federal estate tax purposes where the decedent possessed the right to alter the time and manner of enjoyment of the proceeds.¹

The Internal Revenue Code specifically provides for the inclusion of life insurance proceeds in the value of a decedent's gross estate under certain conditions delineated in section 2042.² In addition to proceeds receivable by an executor under life insurance policies, the Code includes insurance proceeds receivable by "other beneficiaries."³ The Code provides that taxation of sums receivable by beneficiaries other than an executor is restricted to those situations where the decedent possessed "incidents of ownership" in the policy at his death.⁴ Precisely what constitutes an incident of ownership, however, is not expressly defined in the estate tax provisions of the Code.⁵ This lack of specificity requires reference to applicable Treasury Regulations and judicial decisions in order to ascertain whether a particular power is an "incident of ownership" within the meaning of the Code.

1. *Rose v. United States*, 511 F.2d 259 (5th Cir. 1975).

2. INT. REV. CODE OF 1954, § 2042.

3. *Id.* § 2042(2).

4. This subsection states that:

The value of the gross estate shall include the value of all property . . . [t]o 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.

Id. § 2042(2).

5. *Id.* § 2042(2). Subsection 2 of § 2042 states that the term "incidents of ownership," encompasses certain types of reversionary interests which are described and qualified, but no specific reference is made to any other type of interest.

Despite this apparent vagueness, the use in the Code of the “incidents of ownership” test for determining estate tax liability has been construed by the federal courts as inferring certain fundamental principles. Basically, it is a decedent’s ownership-related power with respect to a policy of insurance which is taxed by section 2042.⁶ The extent of the interest of the decedent is of no concern,⁷ nor is his ability to exercise his power at any particular time.⁸ One federal court of appeals has held that the power contemplated by use of the term “incidents of ownership” involves something less than complete legal and equitable title.⁹ For a specific power over an insurance policy to be considered an incident of ownership, it is required only that there exist a “possibility” that it will be exercised, and the “probability” that it will be exercised is irrelevant.¹⁰ For example, the mere necessity of a decedent’s consent in order to effect a change in a policy may be sufficient to vest in him an incident of ownership.¹¹

In determining whether a particular decedent possessed any incidents of ownership, “policy facts”—those actually contained in the insurance contract—prevail over “intent facts”—those revealed by external circumstances.¹² The Federal Treasury Regulations are helpful in determining whether powers granted to an insured by the terms of a life insurance policy are properly classified as incidents of ownership.¹³ Regulation 20.2042-1(c)(2) states that:

[T]he 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.¹⁴

The regulations also indicate that a decedent may possess incidents of ownership in a life insurance policy held in trust.¹⁵ This situation may exist, even though the decedent is not a beneficiary of the trust, if he has the

6. *Commissioner v. Estate of Noel*, 380 U.S. 678, 684 (1965); *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 10 (1st Cir. 1966).

7. *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 10 (1st Cir. 1966).

8. *Commissioner v. Estate of Noel*, 380 U.S. 678, 684 (1965).

9. *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 10 (1st Cir. 1966).

10. *Id.* at 10; *accord*, *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1096 (5th Cir. 1973).

11. *Commissioner v. Estate of Karagheusian*, 233 F.2d 197, 199 (2d Cir. 1956). This case was decided under § 811(g)(2) of the Int. Rev. Code of 1939, the predecessor to § 2042 of the Int. Rev. Code of 1954.

12. *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 12 (1st Cir. 1966); *accord*, *Kearns v. United States*, 399 F.2d 226, 230 (Ct. Cl. 1968).

13. *Treas. Reg. § 20.2042-1(c)* (1958).

14. *Id.* § 20.2042-1(c)(2). This part of the regulation further states that the term: [I]ncludes 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. . . .

Id. § 20.2042-1(c)(2).

15. *Id.* § 20.2042-1(c)(4).

power to change the policy's beneficiaries, or can affect the time and manner of the enjoyment of the policy or its proceeds.¹⁶ Despite this language in the regulations, recent decisions in the various federal circuit courts evince uncertainty regarding policies of life insurance held in trust for a beneficiary other than the decedent's estate.¹⁷

The issue confronted by the Fifth Circuit Court of Appeals in *Rose v. United States*¹⁸ was whether the gross estate of a decedent must include proceeds of life insurance policies held in trust even though the decedent was only a trustee and, as such, retained no beneficial interest in the policies.¹⁹ The court initially examined the effect of the decedent's trustee status on his ability to exercise control over the policies.²⁰ After concluding that a trustee was capable of possessing incidents of ownership,²¹ the court considered what the proper criteria should be for determining if a decedent possessed such incidents.²² The result was the adoption of a "substantial control" approach which had been used previously by the court.²³ Under this approach, the use of the term "incidents of ownership" is construed as an indication that Section 2042(2) of the Internal Revenue Code was intended to tax the value of life insurance proceeds over which the insured still possessed a "substantial degree of control" at his death.²⁴

It was argued in *Rose* that, since the decedent held his powers in a fiduciary capacity as trustee, his position of control was significantly different than that of an ordinary policy owner.²⁵ In *Rose*, the applicable state statutes governing trustees require that the trust be administered "solely in

16. *Id.* § 20.2042-1(c)(4).

17. Compare *Rose v. United States*, 511 F.2d 259 (5th Cir. 1975) (proceeds from life insurance policies on a decedent trustee's life were includable in his gross estate) with *Estate of Skifter v. Commissioner*, 468 F.2d 699 (2d Cir. 1972) (proceeds were not includable in a decedent's gross estate) and *Estate of Fruehauf v. Commissioner*, 427 F.2d 80 (6th Cir. 1970) (proceeds of policies on life of decedent were includable in his gross estate where policies were part of corpus of a trust of which he was both a trustee and a beneficiary).

18. 511 F.2d 259 (5th Cir. 1975).

19. *Id.* at 260.

20. *Id.* at 262-63.

21. *Id.* at 263.

22. *Id.* at 263-65.

23. *Id.* at 262; see *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1097 (5th Cir. 1973).

24. *Rose v. United States*, 511 F.2d 259, 262 (5th Cir. 1975); accord, *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1097 (5th Cir. 1973); *United States v. Rhode Island Hosp. Trust Co.*, 355 F.2d 7, 11 (1st Cir. 1966). These cases seem to indicate that a decedent's control is "substantial" if it is evidenced by his possession of incidents of ownership. The relevant determination under this approach is simply whether or not the decedent possessed, at his death, any powers over the policy which could be classified as incidents of ownership. If it is determined that he did, then his control over the policy was substantial. See *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1095 (5th Cir. 1973) (right to elect optional modes of settlement gave insured decedent a degree of control over the policy which was held to be substantial).

25. *Rose v. United States*, 511 F.2d 259, 262 (5th Cir. 1975).

the interest of the beneficiary,"²⁶ and emphasize that a trustee has a duty to "take, keep control of, and preserve the trust property."²⁷ It is well established in the law of trusts that a fiduciary cannot use his position to benefit himself in his individual capacity.²⁸ As a result of this general rule, some courts have reasoned that a trustee does not automatically come within the operation of Section 2042(2) of the Code since he is incapable of benefiting himself through possession of incidents of ownership in insurance policies contained in a trust.²⁹

In *Estate of Fruehauf v. Commissioner*,³⁰ for example, the Sixth Circuit Court of Appeals concluded that a decedent's mere possession of incidents of ownership in a fiduciary capacity does not necessarily require that proceeds of insurance policies on his life be included in his gross estate for estate tax purposes.³¹ The court in *Rose*, however, rejected this argument against taxing proceeds of life insurance policies held in trust by a decedent who was also a trustee, and reasoned that a decedent's fiduciary status has no effect whatsoever on his liability for estate taxes.³²

One of the fundamental findings in *Rose* was that fiduciary restraints resulting from the decedent's trustee status did not deprive him of the "substantial control" over the life insurance policies required by Section 2042 of the Internal Revenue Code.³³ The powers held by the decedent in this case were analogous to those held by the decedent in *Estate of Lumpkin v. Commissioner*.³⁴ In *Lumpkin*, the decedent was an employee covered by a group term life insurance policy under which he could elect optional modes of settlement, giving him some control over when the proceeds of the policy could be enjoyed. The same section of the Code was the focal point of the dispute in the *Rose* and *Lumpkin* cases, and in both, the deciding circum-

26. LA. TRUST CODE ANN. ch. 1, § 2082 (1964).

27. *Id.* § 2091.

28. G. BOGERT, TRUSTS AND TRUSTEES § 543, at 473-74 (2d ed. 1965).

29. See *Estate of Fruehauf v. Commissioner*, 427 F.2d 80, 85 (6th Cir. 1970); *Estate of Fuchs v. Commissioner*, 47 T.C. 199, 204 (1966); *Estate of Carlton v. Commissioner*, 34 T.C. 988, 996 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).

30. 427 F.2d 80 (6th Cir. 1970).

31. *Id.* at 85. The court rejected the rule that incidents of ownership held in a fiduciary capacity must necessarily be included in a decedent's gross estate. The court found that, since the decedent trustee could surrender policies for their cash value and thereby enlarge the income producing ability of the corpus, the policy proceeds should be included in the decedent's gross estate. See, *Estate of Fuchs v. Commissioner*, 47 T.C. 199, 204 (1966) (giving further support to the theory expressed in *Fruehauf*).

32. *Rose v. United States*, 511 F.2d 259, 262-63 (5th Cir. 1975). The *Rose* and *Fruehauf* cases may be distinguished due to the fact that in *Fruehauf*, the decedent was both a trustee and an income beneficiary, while in *Rose*, the decedent was not a beneficiary of the trusts containing the policies on his life. Compare *id.* at 260 with *Estate of Fruehauf*, 427 F.2d 80, 82 (6th Cir. 1970).

33. *Rose v. United States*, 511 F.2d 259, 263 (5th Cir. 1975).

34. 474 F.2d 1092, 1095 (5th Cir. 1973).

stance was the fact that the decedent could exercise control over the time and manner of enjoyment of the policies.³⁵ An examination of cases dealing with related Code sections led the court in *Lumpkin* to the conclusion that this form of control provided the appropriate standard for applying the provisions of section 2042(2) to any given fact situation.³⁶ By applying this standard to the facts in the *Rose* case, it was determined that life insurance proceeds can be included in a decedent's gross estate under section 2042(2) even though the decedent could not benefit himself or his estate on account of his fiduciary status.³⁷ This conclusion is supported by Treasury Regulation 20.2042-1(c)(4) which reveals that a decedent trustee need not have a beneficial interest in the trust in order to have an incident of ownership in an insurance policy on his life held in the trust.³⁸ The regulation requires only that he have the power to alter the time and manner of enjoyment of the policy or its proceeds.³⁹

The court in *Rose* was then confronted with the problem of how to evaluate the powers held by a decedent to determine whether they amounted to incidents of ownership.⁴⁰ Two approaches, the "substantial control" approach and the "retained interests" approach were considered to be potentially applicable.⁴¹

The "retained interests" approach was applied in the Second Circuit Court of Appeals case of *Estate of Skifter v. Commissioner*,⁴² a case which is in

35. Compare *Rose v. United States*, 511 F.2d 259, 265 (5th Cir. 1975) with *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1097 (5th Cir. 1973).

36. *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1096-97 (5th Cir. 1973). See *United States v. O'Malley*, 383 U.S. 627, 631 (1966) (dealing with the effect of a trustee's fiduciary status on the operation of the predecessor to Int. Rev. Code of 1954, § 2036, concerning transfers with a retained life estate); *Lober v. United States*, 346 U.S. 335, 337 (1953) (dealing with the effect of a trustee's fiduciary status on the operation of the predecessor to Int. Rev. Code of 1954, § 2038, concerning revocable transfers).

37. *Rose v. United States*, 511 F.2d 259, 263 (5th Cir. 1975), citing *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1095 (5th Cir. 1973).

38. Treas. Reg. § 20.2042-1(c)(4) (1958) states:

A decedent is considered to have an 'incident of ownership' in an insurance policy on his life held in trust if, under the terms of the policy, the decedent (either alone or in conjunction with another person or persons) as [sic] the power (as trustee or otherwise) to change the beneficial ownership in the policy or its proceeds, or the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust.

39. *Id.*

40. *Rose v. United States*, 511 F.2d 259, 263-64 (5th Cir. 1975).

41. *Id.* at 263-64.

42. 468 F.2d 699 (2d Cir. 1972). In *Skifter*, the decedent had assigned to his wife all of his interest in insurance policies on his life. By her will, the wife placed the policies in trust with the decedent as trustee. As trustee, the decedent had managerial control over the assets of the trust which included the policies. The court determined that since the decedent could not exercise his powers to gain any economic benefit for himself from the property, these powers were not incidents of ownership. Compare *id.* at 704 with *Estate of Lumpkin v. Commissioner*, 474 F.2d 1092, 1095 (5th Cir. 1973). It is significant to note that, in *Rose*, the court considered a decedent's ability to derive

point with *Rose*. The court concluded that Section 2042 of the Internal Revenue Code was intended to apply only to interests retained by the decedent.⁴³ The rationale for this conclusion was that section 2042 was part of a congressional scheme to tax only interests which amounted to reservations of powers by a transferor as trustee, and that a transferee of rights in a policy was not to be taxed where his powers could not be exercised for his own benefit.⁴⁴

The *Rose* opinion expressly rejected the interpretation of the Internal Revenue Code relied on in *Skifter*, choosing instead to follow the "substantial control" approach adopted in *Lumpkin*.⁴⁵ The mere fact that a decedent "possessed" an incident of ownership is sufficient to satisfy section 2042 and the means by which he acquired it is irrelevant according to *Lumpkin*.⁴⁶ If, at his death, the decedent had substantial control over a life insurance policy on his life due to his right to alter the time and manner of its enjoyment, then he possessed an incident of ownership under section 2042(2).⁴⁷ In *Rose*, the decedent was found to possess substantial control over the time and manner of enjoyment of the proceeds of the insurance policies which he had obtained as a trustee.⁴⁸ On the basis of *Lumpkin* and Treasury Regulation 20.2042-1(c)(4), the court decided that the value of the insurance proceeds was properly included in the decedent trustee's gross estate under section 2042(2) of the Code.⁴⁹

The *Rose* decision is obviously significant in the use of the life insurance trust as a method of estate planning. It demonstrates that tax liability under Section 2042(2) of the Internal Revenue Code cannot be avoided by placing life insurance policies in a trust where the insured is the trustee unless he completely divests himself of all control over the time and manner of enjoyment of the proceeds,⁵⁰ or resigns his position as trustee. Whenever

economic benefit from his control over a policy to be irrelevant in view of the *Lumpkin* holding.

43. Estate of *Skifter v. Commissioner*, 468 F.2d 699, 704 (2d Cir. 1972).

44. *Id.* at 704-705. Sections of the Code which deal with property interests by a decedent prior to his death were analyzed. INT. REV. CODE OF 1954, §§ 2036, 2038. The court stated that they were of the "view that Congress did not intend section 2042 to produce divergent estate tax treatment between life insurance and other types of property." Estate of *Skifter v. Commissioner*, 468 F.2d 699, 705 (1972).

45. 511 F.2d 259, 264-65 (5th Cir. 1975).

46. Estate of *Lumpkin v. Commissioner*, 474 F.2d 1092, 1097 (5th Cir. 1973); *accord*, *Rose v. United States*, 511 F.2d 259, 264 (5th Cir. 1975). In *Lumpkin* it is implied and in *Rose* it is affirmatively stated that the fact that the language in § 2042 of the Code employed the word "possessed" rather than "retained" indicates that the section applies to any form of substantial control over a policy, and not exclusively to control which was retained.

47. Estate of *Lumpkin v. Commissioner*, 474 F.2d 1092, 1097 (5th Cir. 1973); *accord*, *Rose v. United States*, 511 F.2d 259, 265 (5th Cir. 1975).

48. *Rose v. United States*, 511 F.2d 259, 265 (5th Cir. 1975).

49. *Id.* at 265.

50. See *Commissioner v. Estate of Noel*, 380 U.S. 678, 684 (1965).

drafting a trust instrument to accommodate this type of situation, a provision should be inserted which specifically excludes the insured trustee from participation in managerial decisions concerning the policies.⁵¹ Such a provision would at least preclude a finding, based on the trust instrument, that the trustee possessed incidents of ownership in such policies. The facts that a decedent exercised control in a fiduciary capacity and that he was unable to exercise any incidents of ownership for his own benefit have become irrelevant considerations in light of this decision. The only material determination to be made in a given case dealing with section 2042(2) is whether the insured had substantial control over the time and manner of enjoyment of the policy or its proceeds. If it is found that he did, then it follows that he possessed incidents of ownership in the policies, and the value of the proceeds must be included in his gross estate.

The *Rose* and *Skifter* decisions are clearly in conflict regarding the application of section 2042(2) to life insurance trusts. The approach followed in the *Rose* decision seems to be based on stronger reasoning and authority, and the less restrictive application of section 2042 appears to be more consistent with a common sense interpretation of the statute. It seems likely that courts faced with fact situations similar to those in *Rose* and *Skifter* in the future will find the *Rose* opinion to be more persuasive, and its doctrine should eventually prevail.⁵² If the conflict persists, however, the United States Supreme Court should permanently resolve it so that uniformity in the assessment of federal estate taxes can be established and maintained.

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51. See *Terriberry v. United States*, 517 F.2d 286, 288-89 (5th Cir. 1975). In this case, the decedent husband, whose life was insured, was empowered as trustee to elect a settlement option which allowed the policies' value to be paid out as annuities. The opinion discusses a provision in a trust instrument which was aimed at avoiding the operation of § 2042(2), but which the court found to be ineffective to accomplish that purpose. *Id.* at 289.

52. *Id.* at 287. The Fifth Circuit Court of Appeals relied on the precedent established in *Rose* to reach its conclusion in this subsequent case. The court found that the decedent possessed sufficient incidents of ownership in the policies at his death to require that the proceeds be included in his gross estate under § 2042(2) of the Int. Rev. Code of 1954. The court reached this conclusion despite the fact that the trust agreement expressly prohibited the decedent "from exercising any of the incidents of ownership" of the policies and the fact that his wife could revoke the trust or remove her husband as trustee. The court refused to allow the provision prohibiting the decedent from exercising incidents of ownership to nullify the provision which had expressly empowered the decedent to elect the settlement option. *Id.* at 289.