Estate of Leder v. Commissioner: Laying to Rest the Three-Year Rule: The Impact of Section 2035(d) upon the Includibility of Life Insurance Proceeds

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NOTE

ESTATE OF LEDER V. COMMISSIONER: LAYING TO REST THE THREE-YEAR RULE; THE IMPACT OF SECTION 2035(d) UPON THE INCLUDIBILITY OF LIFE INSURANCE PROCEEDS

On January 28, 1981, TransAmerica Occidental Life Insurance Company issued a life insurance policy with a face value of $1,000,000 on the life of Joseph Leder.1 The policy application reflected Jeanne Leder, Joseph's wife, as owner of the policy and Joseph Leder as the insured. The insured's wholly owned corporation, Leder Enterprises, paid the premiums on the policy.2 The corporation treated these payments as loans to Joseph Leder. Neither Leder Enterprises nor Joseph Leder received any consideration from Jeanne Leder in return for paying the premiums on the policy.

About two years later, Jeanne Leder transferred the policy to herself as trustee of an inter vivos trust dated February 15, 1983. In the event of Joseph Leder's death, the trust agreement provided for Jeanne Leder, as trustee, to divide the trust corpus into four equal shares.3 Jeanne Leder made no further assignments of the policy.

Joseph Leder died on May 31, 1983. In her capacity as trustee, Jeanne Leder distributed the proceeds of the policy directly to each of the beneficiaries.4 The executor of Joseph Leder's estate, finding that the decedent possessed no ownership interest in the policy, excluded the entire distribution from Joseph Leder's gross estate for federal estate tax purposes. Applying the government's interpretation of Internal Revenue Code section 2035, the Commissioner of the Internal Revenue Service subsequently included the proceeds in Joseph Leder's gross estate and issued a notice of deficiency. The estate filed suit seeking the United States Tax Court's redetermination of the deficiency. Held, for the taxpayer: A decedent's estate does not in-

1. The parties submitted the case fully stipulated pursuant to rule 122 of the Tax Court Rules of Practice and Procedure.
2. The policy required premium payments of $3,879.08 per month.
3. The trust identified Jeanne Leder and the three children of Joseph and Jeanne Leder as the beneficiaries.
4. Each beneficiary received one-fourth of the total proceeds of $971,526.49.
clude the proceeds from an insurance policy if the decedent did not possess, at the time of his death, or at any time in the three years preceding his death, any of the incidents of ownership in the policy. Estate of Leder v. Commissioner, 89 T.C. 235 (1987).

I. THE DEVELOPMENT OF SECTIONS 2035 AND 2042

A. Section 2035

The Economic Recovery Tax Act of 1981 (ERTA)\(^5\) substantially altered the structure of Internal Revenue Code section 2035.\(^6\) Before 1981, section 2035(a), known as the three-year rule, included within a decedent's estate the value of all property in which the decedent had an interest during the three-year period preceding the decedent's death.\(^7\) As part of ERTA, Congress added subsection (d) to section 2035, limiting the three-year rule's applicability to estates of decedents dying prior to 1982, and to certain transfers of property interests under section 2035(d)(2).\(^8\)

The legislative history surrounding Congress's enactment of section 2035(d) offers the courts little guidance in construing the provision. In the original version of the bill, the Senate left the three-year rule intact, changing only the value of the gift included in the estate.\(^9\) The House of Representatives, however, provided an exemption to the three-year rule of section 2035(a) in its version of the bill.\(^10\) The House retained section 2035(a) with respect to gifts of life insurance and other specific property interests.\(^11\) The conference agreement adopted the House version.\(^12\) The version of the

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7. Id. § 2035(a) states:
   (a) INCLUSION OF GIFTS MADE BY DECEdent.—Except as provided in subsection (b), the value of the gross estate shall 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.
8. Id. § 2035(d)(1) & (2) (1982) states:
   (d) DECEidents 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 of such sections if such interest had been retained by the decedent.
11. House Report 97-201 explains:
   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).
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House bill that Congress enacted, however, omitted the exception with respect to gifts of life insurance.\textsuperscript{13}

Due to the paucity of legislative guidance regarding the proper interpretation of section 2035(d), planning or predicting its impact involves a degree of speculation.\textsuperscript{14} The uncertainty surrounding Congress's amendment of section 2035 centers on the structure of the analysis between paragraphs (1) and (2) of section 2035(d).\textsuperscript{15} Section 2035's plain meaning suggests that the three-year rule of section 2035(a) does not apply to insurance proceeds unless the proceeds fall within the exceptions of section 2035(d)(2).\textsuperscript{16} Consequently, in order to determine whether a particular insurance policy is subject to the three-year rule the executor must first ascertain whether the decedent's interest falls within the exceptions contained in section 2035(d)(2). Under paragraph (2), the executor would not include the proceeds from the policy in the decedent's estate unless, for example, the decedent possessed incidents of ownership in the life insurance policy under section 2042.\textsuperscript{17} Unfortunately, the simplicity of this analysis overlooks the position of the Internal Revenue Service (the Service) on the interpretation of section 2035(d) and the effect of case law interpreting pre-ERTA section 2035.\textsuperscript{18}

The Service clearly stated its position on the interpretation of section 2035(d) in Technical Advice Memorandum (Memorandum) 8509005.\textsuperscript{19} In the fact situation analyzed by the Service in Memorandum 8509005, the decedent signed an application for insurance as the insured, and $A$ signed as owner and beneficiary. The decedent's wholly owned corporation paid the premiums on the policy. $A$, as owner of the policy, later transferred the

\textsuperscript{13} The General Explanation of the Economic Recovery Tax Act of 1981, which the Staff of the Joint Committee on Taxation prepared, did not discuss the omitted exception for gifts of life insurance. STAFF OF JOINT COMM. ON TAXATION, 9TH CONG., 2D SESS., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY ACT OF 1981, at 261-63 (Comm. Print 1982), reprinted in P-H Federal Taxes, Report Bulletin v. LXII, § 2 (Jan. 14, 1982). Compare the enacted version of section 2035(d) in supra note 8 (no specific mention of life insurance), with the House version in supra note 11 (specific reference to life insurance).

\textsuperscript{14} See generally J. MUNCH, LIFE INSURANCE IN ESTATE PLANNING § 10.4.2 (Supp. 1987) (ERTA changed section 2035); Brody, Irrevocable Life Insurance Trusts, Problems in Transfers of Ownership, Three-Year Rule, Gift Tax Values, Transfers for Value, SOUTHERN METHODIST UNIVERSITY SCHOOL OF LAW EST. PLAN. INST. § 2 (1986) (assuming pre-ERTA law survived); Mohan, Life Insurance in Estate Planning—Taxation and Uses Today, 35 DRAKE L. REV. 773, 778 (1986-87) (assuming pre-ERTA law survived); Simmons, Life Insurance—The More the Rules Change, the More They Stay the Same, 20 UNIV. OF MIAMI PHILIP E. HECKERLING INST. ON EST. PLAN. § 602 (1986) (discussing ERTA's possible impact on section 2035(a)).

\textsuperscript{15} See supra note 8.

\textsuperscript{16} See MUNCH, supra note 14, § 10.4.2; Simmons, supra note 14, § 602.3.

\textsuperscript{17} I.R.C. § 2042 (1954). For a discussion of the incidents of ownership test, see infra notes 70-80 and accompanying text.

\textsuperscript{18} See Mohan, supra note 14, at 789-790.

policy to an irrevocable trust and served as sole trustee. The insured died within three years after the issuance of the policy. On the insured's death, A distributed the proceeds directly to himself and three other named beneficiaries.\(^{20}\)

In determining whether to include the proceeds of the policy in the decedent's estate, the Service began its analysis with a general discussion of sections 2035(a), 2035(d), 2042, and Treasury Regulation section 20.2042-1(a)(2).\(^{21}\) In its examination of the legislative history surrounding section 2035(d)(2), the Service emphasized the House bill that specifically continued to apply the three-year rule to gifts of life insurance.\(^{22}\) Next, the Service summarized the pre-1981 law concerning section 2035, and the application of the three-year transfer rule.\(^{23}\) The Service relied on First National Bank v. United States\(^{24}\) and other related cases.

In First National Bank\(^{25}\) the decedent and his wife signed an application for insurance designating the decedent as the insured. The couple purchased the policy at the insurance agent's urging, and the agent explained that the proceeds would be exempt from federal estate taxation.\(^{26}\) The decedent paid all the premiums on the policy. Less than three years after taking out the policy, the decedent died. The court, relying on the Fifth Circuit's analysis in Bel v. United States,\(^{27}\) concluded that the decedent made a transfer of property under section 2035.\(^{28}\)

In Bel the decedent annually purchased an accidental death policy on his own life. In his application, the decedent designated his children as owners of the policy. The decedent paid all premiums on the policy. Upon the decedent's death, the Bel court concluded that the decedent made a transfer of the policy under section 2035 in contemplation of death, and that the gross estate should therefore include the value of the proceeds.\(^{29}\) In reaching its conclusion, the court refused to apply the section 2042 incidents of ownership test\(^{30}\) to determine what the decedent transferred under section 2035.\(^{31}\) Rather, the court held that section 2035 was broader in scope than

\(^{20}\) A's corporation treated the payments as loans to the decedent. Memorandum 8509005, see id., contains exactly the same facts and dates as those of Estate of Leder v. Commissioner, 89 T.C. 235 (1987). See supra notes 1-4 and accompanying text.


\(^{23}\) Id.

\(^{24}\) 352 F. Supp. 1157, 1158 (D. Or. 1972), aff'd, 488 F.2d 575 (9th Cir. 1973); see also Detroit Bank & Trust Co. v. United States, 467 F.2d 964, 969 (6th Cir. 1972) (proceeds includible in gross estate where decedent transferred funds to trust for purchase of life insurance and paid policy premium; trustee held to be agent of decedent).

\(^{25}\) 488 F.2d at 575.

\(^{26}\) The Service's summary of First National Bank omitted this fact.

\(^{27}\) 452 F.2d 683 (5th Cir. 1971).

\(^{28}\) 488 F.2d at 576-78.

\(^{29}\) 452 F.2d at 692.

\(^{30}\) See infra note 70 and accompanying text.

\(^{31}\) 452 F.2d at 690. The Fifth Circuit distinguished the case that the district court relied upon, Estate of Coleman v. Commissioner, 52 T.C. 921 (1969), as only pertaining to payments made on a policy that came into existence more than three years prior to the decedent's death.
section 2042 because it included all property that the decedent transfers in contemplation of death and not just life insurance policies on which the decedent possessed an incident of ownership. The court in Bel also chose to adopt the broad interpretation of transfer, which the Supreme Court enunciated in Chase National Bank v. United States.

The Court in Chase National Bank interpreted a transfer to encompass not only the direct transfer of property from the donor to the transferee, but also the acquisition of property for the purpose of passing such property to another at the acquiror's death. Using this broad definition, the Bel court formulated the "beamed transfer" theory, holding that the decedent "beamed" the insurance policy at his children because, by paying the premiums, he designated ownership and created contractual rights in the policy for his children. The Bel court found that the decedent's acts constituted a transfer, legally indistinguishable from a direct assignment of the policy.

After examining the case authority on section 2035, the Service compared the facts in Memorandum 8509005 with those in First National Bank. The Service found no distinction between a decedent's purchase of an insurance policy in his wife's name and a decedent's purchase of a policy in his own name followed by the immediate transfer of his ownership rights to his wife. The taxpayer who requested the Letter Ruling, however, argued that section 2035(d)(2) now subjects the proceeds of life insurance policies to inclusion in the decedent's estate under the three-year rule only if the decedent possessed, at his death, an incident of ownership in the policy. Under the facts in Memorandum 8509005, the decedent possessed no incidents of ownership in the policy.

The Service disagreed with the estate and insisted that section 2035(a) controlled the analysis. Relying on First National Bank, Detroit Bank & Trust Co., and Bel, the Service found that the decedent transferred the policy under subsection 2035(a).

Reiterating the analysis of the court in First National Bank, the Service held that the incidents of ownership test

Under Coleman the court decided the amount of proceeds includible in the estate, not whether a transfer occurred under §2035(a). The Tax Court rejected the Service's position that the payment of premiums subjected the entire proceeds to inclusion under §2035(a), holding instead that only those payments made in contemplation of death could be includible in the decedent's estate. 52 T.C. at 922-24.

32. 452 F.2d at 690.
33. 278 U.S. 327, 337 (1929) (upholding the constitutionality of §§ 401 and 402(f) of the Revenue Act of 1921, taxing the privilege of the decedent to transfer property at his death).
34. Id.
35. 452 F.2d at 691.
36. Id. at 692.
38. Id. Whether the Service's analysis of insurance policy transfers is an observation, conclusion, or continuation of the discussion of Bel and First National Bank is unclear.
39. Id.
40. Id.
42. 467 F.2d 964 (6th Cir. 1972).
43. 452 F.2d 683 (5th Cir. 1971).
under section 2042, and the related inquiry into the decedent's property interest, were not relevant to the proper application of section 2035. The Service cited the legislative history of section 2035(d)(2) as evidence of Congress's intent to continue the application of the three-year rule to gifts of life insurance. The Service then concluded that the decedent's gross estate should include the entire proceeds of the policy under section 2035(a).

In addition to the cases cited by the Service in Memorandum 8509005, several other cases bear directly on the issue of what constitutes a transfer under section 2035(a). In Hope v. United States the decedent, as the proposed insured, executed an application for a term life insurance policy. Three months later, she created a trust, appointed a trustee, and provided an initial funding of $100. The next day, the decedent designated the trustee as the proposed policy owner. The insurance company accepted the application subject to the payment of the premium. The decedent transferred the necessary funds to the trust, and the trustee paid the premium. The decedent died seven days later.

The Fifth Circuit found a practical difference between buying insurance for another, and giving that person money even if the recipient later used the money to purchase insurance. The court limited its prior holding in Bel to the simple proposition that purchasing a policy in one's own name and subsequently transferring it is the equivalent of purchasing the policy in someone else's name. The Hope court thus remanded the case for an inquiry into whether the trustee acted as the decedent's agent in purchasing the policies. Absent the trial court's finding that the trustee acted as the decedent's agent, the court concluded that the decedent's actions did not constitute a transfer under section 2035(a).

In Estate of Kurihara v. Commissioner the Tax Court, dealing with facts similar to Hope, held that the trustee did act as the decedent's agent in purchasing a policy. Using a two-part analysis, the court found first that the decedent's initial payment of the policy premium within the three-year period prior to his death established his ownership rights in the policy. Second, the court could see no difference between the action of a trustee in paying the first premium of the decedent's policy by endorsing the decedent's check and the decedent's paying the premium himself. The Tax Court took into account the fact that the decedent had written the
Court, however, reached a contrary conclusion in *Estate of Clay v. Commissioner.*

In *Clay* the decedent’s wife purchased insurance on the decedent’s life with funds from their joint account. The court, in applying the two-part analysis, rejected the Commissioner’s tracing analysis, by which the Commissioner attributed the spouse’s premium payments from the couple’s joint account to the decedent. The court distinguished *Kurihara,* and the cases on which it relied, as only applying to situations where the decedent initiated the purchase of the policy and physically paid or provided funds to an agent to pay the premiums on the policy. The court emphasized that the Service should focus its analysis on the decedent’s ability to control the entire transaction, as reflected by the decedent’s making the premium payments, and not on the source of the payments.

The taxpayer prevailed in *Clay* because the estate affirmatively presented evidence that the wife did not purchase the insurance at the direction of the decedent but rather acted on her own initiative. The *Clay* court concluded, after examining state law concerning the interest of a co-tenant in a joint account, that the wife’s payment of premiums from funds of a joint account does not constitute the nonwithdrawing tenant’s payment unless an agency relationship exists. Consequently, the *Clay* court held that proceeds of the policy were not includible in the gross estate as a transfer under section 2035(a).

Under the pre-ERTA case law a decedent’s estate included insurance proceeds under section 2035 if, within three years of death, the decedent purchased the policy and assigned it to another, or purchased the policy in the name of another. Likewise, if the owner purchased the policy under the decedent’s direction, and the decedent paid the first premium on the policy, section 2035 governed the transfer. The courts held that the owner purchased the policy at the decedent’s initiative if an agency relationship existed between the decedent and the owner of the policy. The section 2035 analysis becomes more complex, however, when the court must inter-

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57. 86 T.C. 1266 (1986).
58. Id. at 1272.
59. 82 T.C. 51 (1984).
60. Id.; see First Nat’l Bank v. United States, 488 F.2d 575 (9th Cir. 1973); Detroit Bank & Trust Co. v. United States, 467 F.2d 964 (6th Cir. 1972); Bel v. United States, 452 F.2d 683 (5th Cir. 1971).
61. 86 T.C. at 1273.
62. Id. The court found the Commissioner’s position reminiscent of the premium payment test abandoned under § 2042. See infra notes 74-76 and accompanying text.
63. 86 T.C. at 1271.
64. Id. at 1274.
65. Id. at 1266.
68. Detroit Bank & Trust Co. v. United States, 467 F.2d 964, 969 (6th Cir. 1972); Estate of Kurihara, 82 T.C. 51, 61 (1984).
pret both sections 2035 and 2042.  #69

B. Section 2042

In its enactment of section 2042 in the 1954 Code, Congress legislated the application of the "incidents of ownership" test to determine the inclusion of insurance proceeds in a decedent's estate.  #70 Under section 2042, a decedent's estate includes all insurance proceeds on which the decedent possessed an incident of ownership at his death.  #71 The statute describes an incident of ownership as including a reversionary interest, arising under the terms of the policy or state law, which exceeds five percent of the policy value.  #72

Prior to Congress's enactment of section 2042, the courts created two different tests to help determine the estate tax status of life insurance proceeds: the "premium payment" test and the "incidents of ownership" test.  #73 The premium test treated the decedent's payment of any premium payment as evidence of the decedent's property interest in the policy, hence automatically dictating inclusion of the proceeds in the decedent's gross estate.  #74 Congress attempted to provide guidance in this area by adopting both judicial tests in the Revenue Act of 1942 along with committee reports explaining the criteria used to determine the inclusion of insurance proceeds.  #75 By enacting section 2042, Congress eliminated the "premium payment" test as an independent criterion for the includibility of life insurance proceeds, and shifted the focus to the broader issue of the decedent's ownership interests in the policy.

The Estate Tax Treasury Regulations list various proprietary attributes that the courts should consider incidents of ownership.  #77 Section 20.2042-1(c)(2) refers to an incident of ownership as the right of the insured, or his estate, to the policy's economic benefits.  #78 The regulation includes as exam-

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#70 I.R.C. § 2042 (1954) specifies:

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

(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.

#71 Id.

#72 Id.

#73 Estate of Lumpkin v. Commissioner, 56 T.C. 815, 822 (1971), vacated and remanded, 474 F.2d 1092 (5th Cir. 1973).

#74 56 T.C. at 822.


#78 Id. § 20.2042-1(c)(2).
pies of incidents of ownership, the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to pledge the policy for a loan, or to borrow against the surrender value.\textsuperscript{79} The sole and controlling stockholder of a corporation also possesses the corporation’s incidents of ownership in a policy that the Service attributes to him by virtue of his interest in the corporation.\textsuperscript{80}

The regulations have provided the courts with guidelines for drawing conclusions concerning incidents of ownership in complicated fact situations.\textsuperscript{81} Neither the regulations nor the cases, however, provide clear legal guidance in all situations, as when sections 2035 and 2042 overlap. Prior to 1981, section 2035(a) included within a decedent’s estate any property he transferred within three years of his death.\textsuperscript{82} Section 2042 included all insurance proceeds in which the decedent had an incident of ownership, regardless of when he acquired the interest.\textsuperscript{83} Neither section, however, resolved the situation in which a third party acquired an insurance policy on the decedent’s life within three years of the decedent’s death. In such a case the taxpayer advocated the position that only if the decedent possessed an incident of ownership under section 2042 would the proceeds be includible. The Service’s argument, on the other hand, centered on the premise that section 2035 controlled and thus favored factual interpretations that led to an indirect theory of transfer. If the decedent paid some or all of the premiums, the court faced the dichotomy of applying the “premium payment” test in the context of section 2035 even though the “premium payment” test no longer applied in the context of section 2042. In this arena of inconsistent and confusing case law, Congress’s 1981 addition of section 2035(d) provides a much simpler alternative. Depending upon the courts’ interpretation of the new section 2035 provisions, the difficulty that estate planners previously encountered in accurately predicting the inclusion of life insurance proceeds in a decedent’s estate may be at an end.

\textsuperscript{79} Id.; see United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7, 13 (1st Cir. 1966) (decedent’s power to change beneficiary on policy controlled by father held to be incident of ownership); St. Louis Union Trust Co. v. United States, 262 F. Supp. 27, 29 (E.D. Mo. 1966) (retention of right to receive cash surrender value after assignment of policies to trust held to be incident of ownership); see also Rev. Rul. 83-147, 1983-2 C.B. 158, 158 (proceeds includible where partnership owns policy and proceeds payable to third party); Rev. Rul. 79-129, 1979-1 C.B. 306, 307 (power to borrow against cash surrender value is an incident of ownership and thus entire proceeds includible in decedent’s estate). \textit{But see} Estate of Rockwall v. Commissioner, 779 F.2d 931, 937 (3d Cir. 1985) (decedent’s power to veto assignment of policies to person without an insurable interest on his life held not incident of ownership); Estate of Smead v. Commissioner, 78 T.C. 43, 52 (1982) (conversion privilege on group term life insurance only exercisable if employment terminated held not incident of ownership); Estate of Bloch v. Commissioner, 78 T.C. 850, 856 (1982) (trustee has no incidents of ownership in individual capacity); Estate of Smith v. Commissioner, 73 T.C. 307, 309 (1979) (where employer, owner, and beneficiary paid premiums on policy, decedent had no incident of ownership even though had option to buy policy if employer wanted to sell).


\textsuperscript{81} Id.

\textsuperscript{82} I.R.C. § 2035 (1954); see supra notes 7-8.

\textsuperscript{83} I.R.C. § 2042 (1954); see supra note 70.
When Congress enacted section 2035(d)(2) as an amendment to the three-year rule, it did not indicate whether the provision would change the analysis required under prior law. In Leder the Tax Court first faced the issue of whether to interpret section 2035(d)(2) as altering the pre-1981 law so as to require the decedent to possess an incident of ownership in a life insurance policy for the policy's proceeds to be included in the gross estate under section 2035(a). The court approached the issue as one of first impression, relying on the plain meaning of the statute for its conclusion.

The Tax Court first considered the merits of the Commissioner's contention that the insurance proceeds were includible in the decedent's gross estate pursuant to section 2035. Characterizing the addition of section 2035(d) as merely "an added sieve through which transactions must pass before the transfer may even be tested under the 3-year rule," the court interpreted section 2035(d)(1) to exclude section 2035(a)'s application to the proceeds unless the proceeds fall within the provisions of section 2035(d)(2). Relying upon the plain meaning of section 2035(d)'s language, the court determined that the section directed courts to examine its provisions prior to consulting section 2035(a). The threshold issue of section 2035(d)(2) requires the existence of an interest in property for the decedent to transfer prior to any analysis of section 2035(a).

The court examined the sparse legislative history accompanying section 2035(d), and found no indication that Congress intended the three-year rule to continue to apply to gifts of life insurance regardless of section 2035(d)(1). The court discounted the Senate Finance Committee Report, which the Commissioner relied on for his position, since the Conference Committee chose to follow the House bill. The Commissioner also cited the House Report as support for retaining life insurance as an exception to the three-year rule exclusion. After examining the incon-
clusive legislative history of section 2035(d), the court declined to attribute to congressional intent a provision that Congress had not enacted.\textsuperscript{99}

In concluding its discussion, the court reiterated that courts and the Service should interpret section 2035(d) according to the plain meaning of its language.\textsuperscript{100} In order to determine if the three-year rule applies under section 2035(d)(2), a court must first ascertain the existence of the decedent's interest under the terms of section 2042.\textsuperscript{101} The court declined to determine whether the proceeds would be includible under section 2035(a) since section 2035(d)(1) applied and precluded consideration of the three-year rule.\textsuperscript{102} The court, therefore, omitted any discussion of the beamed transfer theory and the cases applying it.\textsuperscript{103}

\section*{B. Section 2042}

After noting that the Commissioner based his case solely upon the application of section 2035,\textsuperscript{104} the court began its examination of the includibility of life insurance proceeds under section 2042 by determining if the decedent possessed any incidents of ownership in the policy.\textsuperscript{105} The court discussed \textit{Carlstrom v. Commissioner},\textsuperscript{106} where, as in \textit{Leder}, the wife owned the policy and the decedent's corporation paid the premiums. In \textit{Carlstrom} the court concluded that the proceeds were not includible in the estate because under the applicable state law the decedent possessed no incidents of ownership.\textsuperscript{107} The \textit{Leder} court then turned to Oklahoma law to decide if the decedent had any legal interests in the policy that could be considered an incident of ownership.\textsuperscript{108} Under Oklahoma law, the court found that the decedent never possessed any incidents of ownership in the policy.\textsuperscript{109} Without the requisite interest in property under section 2042, the court found section 2035(d)(2) inapplicable.\textsuperscript{110} Having eliminated the threat of section 2035(d)(2), the

\begin{thebibliography}{10}
\bibitem{99} Id.
\bibitem{100} Id.
\bibitem{101} Id.
\bibitem{102} Id. at 244 n.12.
\bibitem{103} Id.
\bibitem{104} Id. at 242.
\bibitem{105} Id. at 243.
\bibitem{106} 76 T.C. 142 (1981).
\bibitem{107} Id. at 147-49.
\bibitem{109} 89 T.C. at 244. Under Oklahoma law, an insured cannot change the beneficiary on the policy by deed of assignment, will, or any other act unless an express right to change the policy exists in the policy. \textit{Brown v. Home Life Ins. Co.}, 3 F.2d 661, 662-63 (E.D. Okla. 1925). Additionally, an assignment cannot be made without such a provision in the policy itself. \textit{City Nat'l Bank v. Lewis}, 73 Okla. 329, 176 P. 237, 239 (1918). Oklahoma law also prohibits the exercise of a power of disposition by an insured when the policy is for the benefit of the insured's spouse or children. \textit{OKLA. STAT. ANN. tit. 36, § 3631} (West 1976). The Oklahoma Supreme Court interpreted the predecessor to this statute to mean that the insured had no interest in the policy, and that upon his death neither his personal representatives nor his creditors had an interest in the proceeds. \textit{Johnson v. Roberts}, 124 Okla. 68, 254 P. 88, 90 (1926). Furthermore, the decedent does not acquire any interest in the insurance policy by the payment of premiums. \textit{Clark v. Clark}, 460 P.2d 936, 941 (Okla. 1969); \textit{Johnson}, 254 P. at 90.
\bibitem{110} 89 T.C. at 244.
\end{thebibliography}
court held that section 2035(d)(1) rendered the proceeds excludible from the gross estate because section 2035(d)(1) cancels the application of section 2035(a) for decedents dying after December 31, 1981.111

III. CONCLUSION

As the first case interpreting the impact of section 2035(d) upon the includibility of life insurance proceeds in a decedent’s estate, Leder decided that section 2035(d)(2) required a decedent to possess incidents of ownership in the policy under section 2042 before the Service could require the estate to include the proceeds pursuant to section 2035(a). Finding an absence of legislative guidance on the subject, the Tax Court relied on the plain meaning of the statute to decide the issue. The court found no ambiguity in the statute, firmly holding that under its terms section 2035(d)(2) required an interest in property to exist prior to inclusion under section 2035(a).

The court’s decision contradicted the position advanced by the Service that ERTA did not alter the treatment of transfers of life insurance under section 2035(a). The holding also refuted implicitly the Service’s indirect transfer argument, with the court deciding that analysis unnecessary in light of the new statute. Whether Congress deliberately or inadvertently changed the law regarding section 2035, the plain meaning of section 2035(d)(2) offers both the courts and estate planners an opportunity to determine clearly when insurance proceeds are includible in a decedent’s gross estate.

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111. Id.