IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

ESTATE OF JOEL LITMAN, Deceased; ARCHIE LITMAN, Executor, Plaintiff,	)	
v.	)	Civil Action No. 89-1302
UNITED STATES OF AMERICA, Defendant.	)	

R E P O R T

GARY L. LANCASTER,
United States Magistrate

This is an action to recover federal estate tax overpayments. Before the court are the parties cross motions for summary judgment. For the reasons set forth below, judgment should be entered in favor of plaintiff and against defendant.

A.

The facts relevant to this case are uncomplicated and have been stipulated to by the parties as follows:

On May 23, 1983, David S. Levy ("Levy"), applied for and purchased a $350,000 life insurance policy insuring the life of his stepfather, Joel Litman ("Litman"). Levy applied for the policy at the urging of Litman who apparently had received certain estate planning advice from an insurance consultant. Under the terms of the policy, Levy was the named owner and beneficiary, Litman was the insured. The monthly premiums on the policy were paid by S & S Distributing Co., Inc., ("S & S

Distributing") in which Litman owned 48.76% interest. The payments were reflected on the books of S & S Distributing as loans to Litman, portions of which were repaid every year. Joel Litman died on February 14, 1984.

Following Litman's death, the Executor of his estate filed a federal estate tax return (Form 706) which did not list in the gross estate the $350,000 proceeds of the life insurance policy. Following examination by the Internal Revenue Service ("IRS"), the gross estate was increased by the $350,000. In addition, the IRS disallowed certain deductions for debts and expenses.

On September 18, 1987, the Executor executed and filed with the IRS a Form 890, "Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment - Estate and Gift Tax." With the execution of the Form 890, the Estate paid federal estate tax on a gross estate which included the $350,000

On May 3, 1988, the Estate filed a timely refund claim with the IRS seeking a refund for the overpayment of federal estate taxes. In its claim, the Estate asserted that the gross estate should not have been increased by the $350,000 insurance policy proceeds. Further, the Estate claimed that the amount of interest paid in the settlement with the IRS should have been deducted from the gross estate thereby reducing the taxable estate. In light of the IRS's failure to rule on the refund claim, the Estate filed this Complaint.

B.

It is fundamental that the value of the taxable gross estate does not include property which the decedent did not own at the time of his death, with one caveat relevant to this proceeding. Under section 2035(a) of the Internal Revenue Code[1], the value of a gross estate does include the value of all property which the decedent transferred to another within the three years prior to his death. This is known as the Three Year Rule. The purpose of the Three Year Rule is to preclude one, in contemplation of death, from making an essentially testamentary gift of his property, yet avoid estate tax liability. Section 2035(a) creates a statutory presumption that a gift made within three years of death is testamentary in character and will act to bring the property back into the estate and, hence, taxable.

The Three Year Rule applies to the transfer of any property, including the transfer of the ownership interest in a life insurance policy. That is, under the Three Year Rule, if an individual purchases a policy insuring his own life, and thereafter

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1. Unless otherwise indicated, all statutory references are to the sections of the Internal Revenue Code of 1986, 26 U.S.C. § 1 et seq.

transfers ownership of that policy to another individual within three years prior to the original purchaser's death, the proceeds of that policy are brought back into the estate and are taxable under section 2035(a).

To effectuate the Three Year Rule further, the courts have created the legal fiction of a "constructive transfer." The concept of a "constructive transfer" of a life insurance policy was first recognized in Bel v. United States, 452 F.2d 683 (5th Cir. 1971), cert. denied, 406 U.S. 919 (1972), wherein the court held that if, within the three-year period prior to his death, a person purchased an insurance policy on his own life and paid the premiums, but designated a third party as the owner and beneficiary of the policy, such an arrangement would be treated as a "constructive transfer" of the policy. Accordingly, the proceeds would be included in the insured's gross estate under section 2035(a) even though the insured arguably never "owned" the policy. The court reasoned that the insured, by buying the policy on his life, naming the beneficiary, and having title placed in the latter's name, had directed or "beamed" the proceeds to the beneficiary in a way that was functionally the same as if the insured had bought the policy in his own name and then had given it away. E.g., Bel v. United States, 452 F.2d at 691-692.

In 1981, Congress generally eliminated the application of the Three Year Rule to estates where the decedent died after December 31, 1981. See 26 U.S.C. § 2035(d)(1). This might have been easy enough to understand except that contemporaneously, Congress adopted section 2035(d)(2). Section 2035(d)(2) provides that the Three Year Rule will be resurrected where we find:

> . . . a transfer of an interest in property which is included in the value of the gross estate under . . . § 2042 . . . or would have been included under [§2042] if such interest had been retained by the decedent.

Thus, under the literal terms of the 1981 amendment, in order to include the proceeds of the Levy insurance policy as a part of the Litman estate via the resurrection of the Three Year Rule, we must first find that there has been a transfer of the type of property that would be includable as part of the estate under section 2042. Section 2042 provides in pertinent part:

> Section 2042. **Proceeds of life insurance.**
>
> 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.[2] (Emphasis added.)

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2. The term "incidence of ownership" includes "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. Treasury Reg. § 20.2042-1(c)(2).

Whether the decedent possessed "incidents of ownership" for federal tax purposes must be determined in accordance with the applicable state law. Estate of Rockwell v. CIR, 779 F.2d 931 (3d Cir. 1985). We need not dwell on this issue, however, because the parties have stipulated that under the terms of the policy, Litman possessed no incidents of ownership in the policy. Stipulation No. 11. Because Litman possessed no incidents of ownership in the policy, the proceeds of the policy are not includable in his gross estate under the literal terms of section 2042. Since the proceeds are not includable under section 2042, the provisions of section 2035(d)(2) resurrecting the Three Year Rule are inapplicable. Accordingly, there is no statutory basis to include these insurance proceeds in the estate.

This same result was reached in Estate of Leder v. Commission, 893 F.2d 237 (10th Cir. 1990). Although we recognize that decisions of other circuits are not binding precedent for this court, Bonham v. Dresser Industries, Inc., 424 F. Supp. 891, 896 (W.D. Pa. 1976), reversed in part on other grounds, 569 F.2d 187 (3d Cir. 1977), cert. denied, 439 U.S. 821 (1979), such decisions, especially in areas of the law where there is a strong interest in uniformity, should be accorded due consideration. Butler County Memorial Hospital v. Heckler, 780 F.2d 352, 357 (3d Cir. 1985); Colby v. J. C. Penney Co., Inc., 811 F.2d 1119, 1123-24 (7th Cir. 1987).

Furthermore, although the Court of Appeals for the Third Circuit has not addressed the issue, there is no reason to suspect that it would reach a different result on similar facts.

The government urges a contrary result. It argues that Congress did not intend by the enactment of section 2035(d)(2), to eliminate the concept of a constructive transfer of a life insurance policy. In advancing this argument, the government devotes a great deal of attention to the legislative history of the various amendments to the Internal Revenue Code applicable to this issue.

In our review of the government's argument, "[w]e begin with a familiar canon of statutory construction that the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." <u>Consumer Products Safety Commission v. GTE Sylvania, Inc.</u>, 447 U.S. 102, 108 (1980). Thus, although the legislative history may in certain instances provide some guidance, "[t]here is, of course, no more persuasive evidence of the purpose of the statute than the words by which the legislature undertook to give expression to its wishes." <u>Griffin v. Oceanic Contractors, Inc.</u>, 458 U.S. 564, 570 (1982) (quoting <u>United States v. American Trucking Ass'n, Inc.</u>, 310 U.S. 534, 543 (1940)).

In the instant case, there is nothing ambiguous about the language Congress used. The Three Year Rule, as delineated in section 2035(a), has been abrogated and will be resurrected only if the transferred property is the type that is includable in the gross estate under the provisions of section 4020. The fiction of constructive transfer was never applicable to determining whether insurance policy proceeds are includable in the estate under section 4020. The benchmark case upon which defendant relies, Bel v. United States, clearly points this out:

> We recognize, of course, that John Bel never formally possessed any of the incidents of ownership in the accidental death policy. As noted above, however, we conclude that section 2042 and the incidents-of-ownership test are totally irrelevant to a proper application of section 2035.

452 F.2d at 691. The only analysis relevant to section 4020 is whether the decedent possessed the incidents of ownership in the policy as determined under state law. As stated infra, the parties have stipulated that the decedent here did not.

Finally, the government correctly states that had Litman himself purchased the insurance policy, in his own name, and simply named Levy as beneficiary, the policy proceeds would be clearly includable in the gross estate under section 2042. Thus, the government asserts, there is no practical distinction between an insured buying the policy himself and naming his stepson as beneficiary on the one hand, or the insured buying the policy in the name of the stepson, with the stepson named as the beneficiary. Therefore, the two situations should be treated the same for tax purposes.

Although we might agree there is no practical difference between the two scenarios, Congress has determined that there is a difference in the tax consequences. The former being taxable, the latter not. If this results in an unintended loop-hole created by Congress, then it is up to Congress to remedy it, not the courts.

Summary judgment should be entered in favor of plaintiff and against defendant.[3]

United States Magistrate

Dated: April 23, 1990

cc: All Counsel of Record

3. The parties have agreed that if it is determined that the taxable estate must be reduced by the amount of the $350,000 insurance policy proceeds, the federal estate tax liability will be reduced to an amount to be determined at a later date. Moreover, the issue of whether the interest payment should have been deducted from the gross estate will also be determined at a later date and in another forum.

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