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COMBINING LIFE INSURANCE PROCEEDS WITH OTHER ESTATE ASSETS

HENRY T. LOWE*

I. INTRODUCTION

Life insurance is often an important family asset, and the proceeds from that insurance may represent a significant part of an individual's estate after death. For reasons of control and convenience, the insured usually owns the policy on his own life at the time of his death, but the federal tax laws offer inducements to the insured while living to arrange for the ownership of the insurance by another, typically a family member or family trust. Regardless of the ownership, disposition of the insurance proceeds on the death of the insured becomes an important part of the family estate plan. Within broad

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limits, the policy owner may direct the disposition of the proceeds as he sees fit,[1] and the comments to follow address only one of the many available choices: how to combine life insurance proceeds with other property of the insured in a unified or integrated estate plan.

Recent developments in state and federal law make an examination of this topic timely. Missouri has adopted new probate legislation that authorizes independent administration of estates and modifies the marital property rights of surviving spouses.[2] The Missouri inheritance tax law has been repealed and a new estate tax law adopted.[3] Rulings and court decisions contain important interpretations of established principles relating to the transfer taxation of life insurance proceeds.[4] Significant amendments to the federal estate and gift tax laws were enacted in 1976,[5] 1978,[6] and 1981.[7] These developments may affect both the decision to combine insurance proceeds with other estate assets in a single estate plan and the choice of how to do it.

There are a number of possible objectives in combining life insurance proceeds with other property in one estate plan: (1) to provide funds to pay transfer costs, i.e., debts, taxes, and administration expenses at death; (2) to provide funds for cash distributions to estate beneficiaries; (3) to facilitate the insured's desire to defer disposition of estate property to estate beneficiaries through trust or other arrangements; (4) to protect estate beneficiaries from improvidence and the claims of creditors; and (5) to preserve the estate by transfers that minimize income and transfer taxes and estate transfer costs to the beneficiaries of the estate. It may be possible to accomplish one or more of these objectives without combining life insurance proceeds with other assets in a single estate plan, but it is often simpler and more effective when all of the property is combined in a single plan.

Typically, an insured will want to retain control over the disposition of his life insurance proceeds while living. Such control, if held directly, is an incident of policy ownership and may have unwanted transfer tax consequences.[8] These comments address the common situation where the insured will insist on control over the disposition of policy proceeds while living and hence will own the policy at death. An interesting development

1. Walker v. General Am. Life Ins. Co., 141 S.W.2d 785, 787 (Mo. 1940); Forester v. Bellville, 513 S.W.2d 726, 728 (Mo. App., St. L. 1974); Service Life Ins. Co. v. Davis, 466 S.W.2d 190, 194 (Mo. App., K.C. 1971).

2. MO. REV. STAT. §§ 473.780-.843 (Cum. Supp. 1981) (independent administration); *id.* §§ 452.330, 474.163-.235 (marital rights).

3. *Id.* §§ 145.009-.995.

4. *See* text accompanying notes 55-89 *infra*.

5. Tax Reform Act of 1976, Pub. L. No. 94-455, Title XX, 90 Stat. 1520, 1846-97.

6. Revenue Act of 1978, Pub. L. No. 95-600, Subtitle B, 92 Stat. 2763, 2881-84.

7. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Title IV, 95 Stat. 172, 299-323.

8. *See* Parts II.A. & B. *infra*.

to be discussed is the possibility that an insured who does not own the policy may have indirect, or de facto, control over the proceeds through the terms of a will or revocable trust.

There are two common methods for combining life insurance proceeds with other estate assets. By the first method the insured directs payment of the proceeds to the personal representative of his estate. The proceeds become probate property and the terms of the insured's will control their disposition in the same manner as other probate property.[9] This will be referred to as "payment to the estate."

By the second method the insured establishes a revocable trust while living and directs payment of the proceeds to the trustee of that trust. The revocable trust contains the estate plan of the insured and, in conjunction with the trust, he executes a will that "pours over" into the trust the probate property of the estate.[10] This is "payment to a revocable trust."

By a third, but less common, method the insured directs payment of the proceeds to the trustee of a trust established in the insured's will. Unlike the first method, this designation does not make the insurance proceeds probate property. This method has support in decisions of the Missouri Supreme Court,[11] even without the benefit of enabling legislation,[12] and is referred to as "payment to a testamentary trustee."

Application of state and federal law may differ depending on the method of combination selected. The rights of the insured's creditors to reach the insurance proceeds may be involved;[13] proceeds paid to the estate are more exposed than those paid to a revocable or testamentary trust. Similarly, exposure to administration expenses—particularly fees of personal representatives and attorneys—is greater for proceeds paid to the estate than those paid to a revocable or testamentary trust. Marital property rights of the insured's surviving spouse may differ under the various methods of combination. Exposure to federal and state transfer taxes may also differ under the various methods of combination, especially if the insured is not the owner of the policy at the time of his death. The willingness of an insurance company to accept a particular beneficiary designation is also important; there has been more reluctance on the part of some insurers to accept a direction to pay to a testamentary trustee than to the estate or a revocable trust.[14]

This Article will analyze the various methods of combining life insurance

9. *See* Part II.C.1. *infra.*

10. *See* Parts III.A. & B.2. *infra.*

11. *See* Prudential Ins. Co. v. Gatewood, 317 S.W.2d 382 (Mo. 1958); Tootle-Lacy National Bank v. Rollier, 340 Mo. 1027, 111 S.W.2d 12 (1937).

12. *See* G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 239, at 89-90 & n.55 (2d rev. ed. 1977).

13. *See* Riesenfeld, *Life Insurance and Creditors' Remedies in the United States*, 4 U.C.L.A. L. REV. 583 (1957); text accompanying notes 143-51 *infra.*

14. *See* Lawthers, *Testamentary Trusts as Beneficiaries Under Life Insurance Policies*, C.L.U. J., Fall 1955, at 307, 320-22. *See also* Part VI. *infra.*

proceeds with other estate property in light of these three considerations: (1) transfer taxes; (2) rights of creditors, beneficiaries, and others; and (3) rights of the surviving spouse.

II. TRANSFER TAXES

Life insurance proceeds may constitute the principal liquid asset of the estate, and the diminution of this asset by unnecessary transfer costs should be avoided. A principal concern for the policy owner in selecting a beneficiary designation may be to minimize transfer tax costs to the greatest extent possible.

Transfer taxes include federal gift[15] and estate[16] taxes, Missouri estate tax,[17] and the federal transfer tax on generation skipping transfers.[18] A discussion of the tax consequences of generation skipping transfers is beyond the scope of this Article, but it is clear that the disposition of life insurance proceeds through a trust or trust equivalent may involve application of this complicated legislation.[19]

Since January 1, 1981, the death tax in Missouri is equal to the maximum credit allowable under the federal estate tax law for state death taxes.[20] The Missouri estate tax is thus directly related to the federal estate tax; the same property that produces a federal estate tax produces a Missouri estate tax. To the extent that life insurance proceeds are subject to the federal estate tax, they are also subject to the Missouri tax. This contrasts with the inheritance tax in effect before January 1, 1981, where life insurance proceeds were exempt from Missouri death taxes unless payable to the estate of the insured.[21]

For an estate subject to the federal estate tax, transfer taxes are of primary importance in plans to minimize transfer costs. Because of this importance, the paragraphs that follow include a brief history of the rules applied to life insurance policies and their proceeds.

A. *Federal Estate Tax*

Proceeds of life insurance policies first became subject to the federal estate tax in 1918. All amounts paid to the estate (receivable by the executor) were subject to the tax, while a total of $40,000 of proceeds paid to other beneficiaries was exempt.[22] It became necessary under this provision to decide if the $40,000 exemption was available when proceeds were payable to a

15. I.R.C. §§ 2501-2524 (1976 & Supp. V 1981).
16. *Id.* §§ 2001-2209.
17. MO. REV. STAT. §§ 145.009-.995 (Cum. Supp. 1981).
18. I.R.C. §§ 2601-2622 (1976 & Supp. V 1981).
19. *Id.* § 2611(d)(2); Prop. Treas. Reg. 26.2611-4 (1981).
20. MO. REV. STAT. § 145.011 (Cum. Supp. 1981).
21. *Id.* § 145.020.3(3) (1978) (repealed 1980).
22. Revenue Act of 1918, ch. 18, § 402, 40 Stat. 1057, 1097-98.

testamentary trust created by the insured rather than to his estate.[23] Amendments in 1942[24] retained the rule for proceeds paid to the estate, removed the $40,000 exemption, and added two new alternative tests for including life insurance proceeds in the insured's estate tax estate. Under the *premium payments* test, life insurance proceeds were included in the insured's estate tax estate in the proportion that the premiums paid directly or indirectly by the insured bore to the total premiums paid for the insurance.[25] If the decedent insured had paid all the premiums, all of the proceeds were included in his estate tax estate; if he paid half of the premiums, only half of the proceeds were included in the estate, provided he did not own the policy at his death. Under the alternative *ownership* test, the entire proceeds of a policy were included in the insured's estate tax estate if at death he possessed any of the incidents of ownership of the policy, exercisable alone or in conjunction with any other person.[26]

The Internal Revenue Code of 1954 included the estate tax provision for life insurance proceeds that is now in effect.[27] The premium payments test was deleted, but the ownership and payment to the estate tests were retained. Even though premium payments by the insured no longer create liability under the life insurance section of the estate tax law, the Internal Revenue Service has been successful in applying the premium payments test to transfers of life insurance policies and to premium payments by gift in contemplation of death or, after 1976, within three years of the insured's death. Although Congress repealed the three-year rule for most transfers of decedents who die after 1981, the rule for transfers with respect to life insurance policies was retained.[28] Thus, the proceeds of life insurance today can be exposed to federal estate taxes in three ways: (1) when the proceeds are payable to the estate; (2) when the insured possessed any of the incidents of ownership at the time of his death; and (3) when the insured makes a gift of the policy and premium payments within three years of his death. Ownership is the most significant of these three tests, and a large body of case law, Internal Revenue Service rulings, and commentary exists on the many questions involving incidents of ownership possessed by the insured at the time of death.[29]

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23. Generally, payment to a testamentary trustee was not payment to the decedent's estate. *See* cases cited note 123 *infra*.

24. Revenue Act of 1942, ch. 619, § 404(a), 56 Stat. 798, 944-45.

25. *Id.*

26. *Id.*

27. I.R.C. § 2042 (1976).

28. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 424(a), 95 Stat. 172, 317 (codified at I.R.C. § 2035(b)(2), (d)(1) (Supp. V 1981)). *See also* notes 53-54 and accompanying text *infra*.

29. For good discussions of the developments in this area, see D. KAHN & E. COLSON, FEDERAL TAXATION OF ESTATES, GIFTS, AND TRUSTS 102-111 (2d ed. 1975); C. LOWNDES, R. KRAMER & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES 330-35 (3d ed. 1974); R. STEPHENS, G. MAXFIELD, S. LIND & D. CALFEE,

Two other features of the federal estate tax important to planning the disposition of life insurance proceeds are the estate tax exemption level and the marital deduction for property passing to the surviving spouse in a qualified manner. Before 1977, the exemption in the estate tax estate was $60,000.[30] The Tax Reform Act of 1976 raised the exemption level in steps to a maximum of $175,625 for 1981 and future years.[31] Then, in one of the 1981 act's most significant changes, Congress further raised the exemption level in increments to $600,000 for 1987 and later years.[32]

Before 1977, the estate tax marital deduction for property passing in a qualified form to a surviving spouse was limited in the aggregate to fifty percent of the estate tax estate.[33] The Tax Reform Act of 1976 increased the maximum marital deduction to $250,000 for estates up to $500,000 but retained the fifty percent aggregate limitation for estates in excess of $500,000.[34] Another significant 1981 amendment authorized, for the first time, an unlimited gift and estate tax deduction for qualified transfers to a surviving spouse by individuals dying after 1981.[35] The newly revised marital deduction affords a complete exemption from the federal estate tax for life insurance proceeds passing to a surviving spouse in a qualified form.

If the estate tax estate is equal to or less than the exemption level, there can be no federal or Missouri estate tax liability.[36] Even if the estate tax estate exceeds the exemption level, the marital deduction for property passing to the surviving spouse may reduce the estate to an amount that does not exceed the maximum permissible exemption.

Family estate planning for a married couple seeking to minimize transfer tax costs will make effective use of the exemption levels available to both spouses and the marital deduction available to the estate of the first spouse to die. This planning process can be facilitated if life insurance proceeds are

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FEDERAL ESTATE AND GIFT TAXATION 4-293 to 4-302 (4th ed. 1978). *See also* Treas. Reg. § 20.2042-1(c) (1974), enumerating the common incidents of ownership which in a particular case will depend on the type of life insurance policy in question.

30. Internal Revenue Code of 1954, ch. 736, § 2052, 68A Stat. 1, 389 (codified at I.R.C. § 2052) (repealed 1976).

31. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001(a)(2), (b)(2), 90 Stat. 1520, 1848-49 (codified at I.R.C. §§ 2010, 2505 (1976)) (amended 1981).

32. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 401(a), (b), 95 Stat. 172, 299 (amending I.R.C. §§ 2010, 2505 (1976)).

33. Internal Revenue Code of 1954, ch. 736, § 2056(c), 68A Stat. 1, 394 (codified at I.R.C. § 2056(c)) (repealed 1981).

34. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2002(a), 90 Stat. 1520, 1854 (codified at I.R.C. § 2056(c) (1976)) (amended 1981).

35. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 403(a), (b), 95 Stat. 172, 301-04 (amending I.R.C. § 2056 (1976)).

36. I.R.C. § 2010 (1976 & Supp. V 1981) (federal estate tax); *id.* § 2011 (state estate taxes); MO. REV. STAT. § 145.011 (Cum. Supp. 1981) (Missouri estate tax). The federal estate tax credit for state death taxes cannot exceed the federal estate tax reduced by the amount of the unified transfer tax credit. I.R.C. § 2011(f) (1976).

combined with other property in a single estate plan. After the recent increases in exemption levels and the marital deduction, the techniques for making optimal use of these devices will change. A discussion of these techniques is beyond the scope of this Article.

B. *Federal Gift Tax*

The Tax Reform Act of 1976 unified the separate federal gift and estate taxes, making the same rates apply to both[37] and adopting one exemption level for both.[38] One purpose of this unification was to remove some of the transfer tax advantages available to those persons able to make substantial gifts while living.[39] Despite these changes, significant transfer tax advantages remain for lifetime gifts, and these advantages are magnified in the case of life insurance because of the large disparity that may exist between the gift tax value of the policy and its estate tax value (the policy proceeds). Frequently the gift tax value of the policy is so relatively small compared to its estate tax value that transfer tax consequences alone may dictate that the insured not own the insurance policy on his life.[40]

Generally, life insurance policies are assignable under state law, and case authority in Missouri confirms this view.[41] The validity of an assignment is measured not only by state law but by the terms of the particular policy. If the owner-insured makes a valid transfer of all incidents of ownership of a policy by gift, he has made a federal gift tax transfer.[42] That transfer will normally qualify for the present interest gift tax exclusion,[43] the split gift privilege for gifts by married persons to others,[44] and the gift tax marital deduction if the transfer is by the insured to his spouse.[45] If the insured continues to pay premiums on the policy, each premium payment is an additional gift tax transfer;[46] normally each payment also qualifies for the pre-

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37. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001(a)(1), (b)(1), 90 Stat. 1520, 1846-49 (codified at I.R.C. §§ 2001, 2502 (1976)).

38. *Id.* § 2001(a)(2), (b)(2), 90 Stat. at 1848-49 (codified at I.R.C. §§ 2010, 2505 (1976)).

39. U.S. CONGRESS, JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, at 566 (1976).

40. J. MUNCH, LIFE INSURANCE IN ESTATE PLANNING 243, 511 (1981).

41. *See, e.g.*, Smith v. Smith, 313 S.W.2d 753, 756 (Mo. App., K.C. 1958).

42. Treas. Reg. § 25.2511-1(h)(8) (1958).

43. Baer v. Commissioner, 2 T.C.M. (CCH) 285, 289, *aff'd*, 149 F.2d 638 (8th Cir. 1945); Treas. Reg. § 25.2503(a) (1958); Rev. Rul. 55-408, 1955-1 C.B. 113.

44. I.R.C. § 2513 (1976 & Supp. V 1981); I.R.S. Letter Ruling 8044080 (1980).

45. Kidd v. Patterson, 230 F. Supp. 769, 774 (N.D. Ala. 1964); I.R.C. § 2523 (1976 & Supp. V 1981).

46. Halsted v. Commissioner, 28 T.C. 1069, 1075 (1957) (power of withdrawal over trust corpus); Treas. Reg. § 25.2511-1(h)(8) (1958).

sent interest gift tax exclusion,[47] the split gift privilege for a gift to someone other than the donor's spouse,[48] and the gift tax marital deduction for a gift to a spouse.[49]

The gift tax value of a life insurance policy is generally its replacement value,[50] and regulations indicate that the gift tax value of a policy on which further premium payments are to be made may be approximated by adding to the interpolated terminal reserve at the date of the gift a proportionate part of the last premium that covers the period extending beyond the date of the gift.[51] The gift tax value of a premium payment is generally the amount of the premium, whether the insurance is term, whole life, or other.[52]

The transfer of a life insurance policy by the insured within three years of his death and the payment of premiums by the insured during that period on a policy on his life do not benefit from the estate tax exclusion available for certain present interest gift transfers made within three years of the donor's death.[53] Moreover, transfer of a life insurance policy by a donor within three years of his death or payment of premiums on such a policy is an estate, not a gift, transfer. The Internal Revenue Service asserts—and its position has been sustained in several court decisions—that a gift transfer of a life insurance policy by the insured within three years of his death is a transfer of the proceeds of the policy, not of the gift tax value of the policy adjusted to the date of death, and the 1981 amendments to the three-year rule reflect that view.[54]

Two recent developments respecting the transfer tax consequences of gifts of life insurance policies merit further comment. The first involves fiduciary ownership by the donor-insured of a life insurance policy previously

47. Baer v. Commissioner, 2 T.C.M. (CCH) 285, 289, *aff'd*, 149 F.2d 638 (8th Cir. 1945); Treas. Reg. § 25.2503-3(c) example 6 (1958); Rev. Rul. 76-490, 1976-2 C.B. 300 (group term policy); I.R.S. Letter Ruling 8006109 (1980) (same).

48. I.R.C. § 2513 (1976 & Supp. V 1981); I.R.S. Letter Ruling 8044080 (1980).

49. Kidd v. Patterson, 230 F. Supp. 769, 774 (N.D. Ala. 1964); I.R.C. § 2523 (1976 & Supp. V 1981).

50. Guggenheim v. Rasquin, 312 U.S. 254, 256 (1941).

51. Treas. Reg. § 25.2512-6 (1958).

52. Guggenheim v. Rasquin, 312 U.S. 254, 256 (1941) (by implication); Roberts v. Commissioner, 2 T.C. 679, 687 (1943), *aff'd*, 143 F.2d 657 (5th Cir. 1944), *cert. denied*, 324 U.S. 841 (1944); Lockhart v. Commissioner, 46 B.T.A. 426, 430 (1942); Phipps v. Commissioner, 43 B.T.A. 790, 792 (1941); Rev. Rul. 76-490, 1976-2 C.B. 300. *See also* Bolton v. Commissioner, 1 T.C. 717, 723 (1943); Rev. Rul. 71-497, 1971-2 C.B. 329 (payment of premium within three years of death is estate tax transfer of premium amount).

53. I.R.C. § 2035(b)(2), (d)(2) (1976 & Supp. V 1981).

54. Estate of Silverman v. Commissioner, 521 F.2d 574, 577 (2d Cir. 1975); First Nat'l Bank v. United States, 488 F.2d 575, 577-78 (9th Cir. 1973); Detroit Bank & Trust Co. v. United States, 467 F.2d 964, 969 (6th Cir. 1972); Bel v. United States, 452 F.2d 683, 690 (5th Cir.), *cert. denied*, 406 U.S. 919 (1972); Rev. Rul. 71-497, 1971-2 C.B. 329. *See also* text accompanying note 28 *supra*.

transferred to another; this fiduciary status may be either as personal representative or trustee for the donee-owner. The other development concerns the transfer tax consequences to the donor-insured and donee-owner of a life insurance policy on the death of the donor if by the beneficiary designation the insured is permitted to control disposition of the proceeds until his death.

1. Fiduciary Ownership

Frequently, the donor-insured who transfers a life insurance policy by gift to a donee is a husband (*H*) and the donee-owner is his wife (*W*). In this common situation the will or other estate plan for *W* may provide that if *H* survives her, he will serve as the executor and trustee of her estate. If *W* dies first, *H* will own the policy in a fiduciary capacity, and if he retains the policy until his death the estate tax problem for his estate may reappear.

Federal estate tax regulations provide that the term "incidents of ownership" refers generally to the right of the insured to the economic benefits of the policy.[55] But the regulations also state that an insured has estate tax ownership of a policy on his life if he "has 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.*"[56] Although the application of this regulation to the situation where *H*, the donor, is acting as testamentary trustee for *W* at the time of his death is uncertain, the Internal Revenue Service in 1976 ruled that the regulation applies even though *H* has no beneficial interest in the trust.[57] With the exception of the Fifth Circuit,[58] the federal courts of appeals have uniformly rejected the application of the regulation to this situation if the original donor-insured has no beneficial interest in the testamentary trust.[59] The result is different if the original donor-insured is not only the trustee but also has a beneficial interest in the trust; here the courts will impute estate tax ownership to the donor-insured on any policy held by the trust at the time of his death.[60]

In *Hunter v. United States*,[61] a case involving Missouri law, the United States Court of Appeals for the Eighth Circuit rejected the Internal Revenue Service position in the situation where *H*, the donor-insured, owns a policy

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55. Treas. Reg. § 20.2042-1(c)(2) (1958).
56. *Id.* § 20.2042-1(c)(4) (emphasis added).
57. Rev. Rul. 76-261, 1976-2 C.B. 276.
58. Terriberry v. United States, 517 F.2d 286, 294 (5th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976); Rose v. United States, 511 F.2d 259, 265 (5th Cir. 1975).
59. Hunter v. United States, 624 F.2d 833, 840 (8th Cir. 1980); Estate of Skifter v. Commissioner, 468 F.2d 699, 705 (2d Cir. 1972).
60. Gesner v. United States, 600 F.2d 1349, 1354 (Ct. Cl. 1979); Estate of Fruehauf v. Commissioner, 427 F.2d 80, 86 (6th Cir. 1970); Estate of Carlton v. Commissioner, 34 T.C. 988, 1000 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).
61. 624 F.2d 833 (8th Cir. 1980).

on his life as a fiduciary under the will of *W*, the donee. *H* had transferred ownership of eleven policies on his life to *W* over a twenty-two year period. *W* named *H* her sole executor and testamentary trustee. After *W*'s death in 1970, *H* served as her executor until his death in 1972. At the time of his death, *H* had made no distribution of assets to the testamentary trust, nor had he assumed any duties as testamentary trustee. Under *W*'s will, *H* had no beneficial interest in the income or corpus of the testamentary trust but did have authority as executor and trustee to sell estate property, including the life insurance policies, to any person, including himself in his individual capacity, in order to pay death taxes and court costs or for any other proper purpose.[62] The court concluded that *H* had no authority at the time of his death, either under the will or by state law, to sell the policies to himself and held that he did not possess incidents of ownership in the policies.[63] Although *H* had not yet begun to act as testamentary trustee at the time of his death, the court indicated its disapproval of the Internal Revenue Service approach adopted by the Fifth Circuit and its alignment with those courts that impute estate tax ownership to the donor-insured only if he has the right to the economic benefits of the policy at the time of his death.[64]

The United States Supreme Court has refused certiorari in a case involving fiduciary ownership[65] and the conflict between the circuits remains.

The issue of fiduciary ownership has arisen in several contexts: where the donor-insured is trustee of an irrevocable inter vivos trust he created during his lifetime;[66] where the donor-insured is trustee of an irrevocable inter vivos trust created by another;[67] and even where the donor-insured is trustee of a revocable inter vivos trust created by the donee.[68] Apparently, the Internal Revenue Service will assert its fiduciary ownership theory when the insured and the settlor are not husband and wife;[69] when the insured is acting as co-executor or co-trustee;[70] and when the settlor who was not the insured originally applied for and purchased the insurance.[71]

62. *Id.* at 835.
63. *Id.* at 840.
64. *Id.*
65. Terriberry v. United States, 517 F.2d 286 (5th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976).
66. Estate of Jordahl v. Commissioner, 65 T.C. 92, 93 (1975); Estate of Carlton v. Commissioner, 34 T.C. 988, 989 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).
67. Rose v. United States, 511 F.2d 259 (5th Cir. 1975).
68. Terriberry v. United States, 517 F.2d 286 (5th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976).
69. Rose v. United States, 511 F.2d 259, 260 (5th Cir. 1975).
70. Gesner v. United States, 600 F.2d 1349, 1350 (Ct. Cl. 1979); Terriberry v. United States, 517 F.2d 286, 287 (1975), *cert. denied*, 424 U.S. 977 (1976); Estate of Fruehauf v. Commissioner, 427 F.2d 80, 81 (6th Cir. 1980); Estate of Jordahl v. Commissioner, 65 T.C. 92, 96 (1975).
71. Rose v. United States, 511 F.2d 259, 260 (5th Cir. 1975); Estate of Fruehauf v. Commissioner, 427 F.2d 80, 81 (6th Cir. 1980).

2. Control By Insured Without Ownership

If a donor-insured transfers all incidents of ownership in a life insurance policy to a donee, or if a person acquires ownership of a policy of insurance on the life of another, the donee or other owner will have the right to designate the recipient of the proceeds of the policy on the insured's death.[72] Where the insured and the owner of the policy are related or have common interests, the owner of the policy may permit the insured to control the disposition of the proceeds, e.g., to combine those proceeds with other estate assets of the insured. Transfer tax problems to the insured and the owner of the policy in this situation are illustrated in the opinions in *Estate of Margrave*,[73] a Tax Court decision affirmed by the United States Court of Appeals for the Eighth Circuit.

In *Margrave*, *W* applied for and received a decreasing term life insurance policy on the life of her husband, *H*. At all times before *H*'s death, *W* owned the policy and paid the premiums with her funds. She designated as beneficiary the trustee of a revocable trust created by *H*. After *H*'s death, the trustee collected the proceeds and administered them as a part of *H*'s trust.[74] The Internal Revenue Service asserted that the proceeds were a part of *H*'s estate tax estate either because *H* held incidents of ownership in the policy at the time of his death, or because he held a general power of appointment with respect to the proceeds of the policy.[75] Even though this arrangement permitted *H* to control the disposition of the proceeds at his death and to combine the life insurance proceeds with other assets of his estate, both the Tax Court,[76] in a reviewed opinion, and the Eighth Circuit[77] concluded that the proceeds were not a part of *H*'s estate tax estate on either theory advanced by the Internal Revenue Service. *H* was not an owner of the policy by virtue of his control over the trust because *W* at all times could change the beneficiary designation.[78] *H* did not have a general power of appointment at death because his power over disposition of the proceeds of the policy was merely an expectancy. In the Eighth Circuit's view, the existence of a property interest in the policy in *H* at his death was a condition to his having a power of appointment.[79] Seven members of the Tax Court dissented from the majority view in three opinions. Six judges expressed the opinion that *H* did have a general power of appointment over the proceeds at the time of his death.[80]

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72. Smith v. Smith, 313 S.W.2d 753, 756 (Mo. App., K.C. 1958).
73. 71 T.C. 13 (1978), *aff'd*, 618 F.2d 34 (8th Cir. 1980).
74. *Id.* at 15.
75. *Id.* at 16.
76. *Id.* at 20.
77. Estate of Margrave v. Commissioner, 618 F.2d 34, 39 (8th Cir. 1980).
78. *Id.* at 37.
79. *Id.* at 38.
80. Judges Fay, Dawson, Simpson, Irwin, and Wilbur, 71 T.C. at 22-26, and Judges Quealy and Simpson, 71 T.C. at 26-28, concluded that the decedent had a general power of appointment at his death. In a separate dissent, Judge Chabot

The Internal Revenue Service has announced that in similar cases it will no longer assert either theory advanced in *Margrave*. Rather, it will insist that *W* has made a completed transfer when *H* dies and the proceeds are payable to *H*'s trustee.[81] Further, if *W* has an income or other interest in the trust created by *H*, the transfer by *W* will be an estate tax transfer at her death.[82] Thus, under this ruling, transfer tax consequences are shifted from the insured to the owner of the policy who makes the beneficiary designation. For tax purposes, the transfer of the proceeds by the owner of the policy is complete when the insured dies.

When the objective of the family is to combine the insurance proceeds on the insured's life with other estate assets of the insured, and when, as in *Margrave*, one spouse is the insured and the other is the owner of the insurance policy, the Internal Revenue Service position in the ruling may favor taxpayers more than its position in *Margrave* by allowing deferral of transfer taxes on the insurance proceeds. If the insurance proceeds are a part of *H*'s estate tax estate as the Internal Revenue Service asserted in *Margrave*, the proceeds are exposed to estate taxes on his death. If, however, the insurance proceeds are not a part of *H*'s estate tax estate but *W* makes a gift or estate tax transfer on *H*'s death, transfer taxes may be deferred in whole or in part until *W* dies.[83]

Will the Internal Revenue Service position in the ruling receive judicial support? The ruling holds that when *H* dies the amount of the transfer is measured by the policy proceeds, not by the lower gift tax value of the policy determined at a time just prior to *H*'s death. In a 1946 decision involving similar facts, the United States Court of Appeals for the Second Circuit held that the amount of the transfer was the face value of the policy, not the gift tax value of the policy at *H*'s death;[84] in that case the taxpayer conceded that a gift tax transfer occurred at *H*'s death. Another case supporting the Internal Revenue Service position, from the Third Circuit, held that *W*, the owner of the policy, made a completed transfer on the death of *H*, the insured, under a beneficiary designation that created vested future interests in the proceeds in her children.[85] Although some support is found for fixing the amount of the transfer at the lower gift tax value of the policy,[86] the

asserted that the proceeds were payable to the decedent's estate under I.R.C. § 2042 (1976). 71 T.C. at 28-32.

81. Rev. Rul. 81-166, 1981-1 C.B. 477.

82. *Id.*

83. *W* will offset any federal gift tax liability on the transfer by the transfer tax credit available to her at that time. *See* I.R.C. § 2505 (1976 & Supp. V 1981).

84. Goodman v. Commissioner, 156 F.2d 218, 220 (2d Cir. 1946).

85. Estate of Pyle v. Commissioner, 313 F.2d 328, 330 (3d Cir. 1963).

86. In Estate of Chown v. Commissioner, 428 F.2d 1395 (9th Cir. 1970), husband and wife died together in an air crash. Wife owned a policy on husband's life. The court held that the gift tax value of the policy, not the proceeds, should be reflected in the wife's estate tax estate. *Id.* at 1400-01. That decision, however, was based on a state law presumption that a husband survived his wife. The court

better view appears to be that the transfer is complete on *H*'s death and the amount of the transfer is the face value of the policy.[87]

The ruling and the cases that support it involve situations where *W*, the owner of a policy on *H*'s life, exercises her right to designate a beneficiary under the policy. May one avoid the ruling by having *H*, the owner-insured, make the beneficiary designation *before* he makes the gift, and then transfer ownership of the policy to *W* who does not change the beneficiary designation, although as owner she has the legal right and power to do so? In this situation, the Sixth Circuit has held that *W* made no transfer, noting that inaction, acquiescence, or acceptance of *H*'s prior designation is not a transfer for tax purposes.[88]

There is no assurance that other courts will follow that decision. Even if they do, the Internal Revenue Service will likely assert that if *W* owns the policy with the legal right or power to change the beneficiary designation, she has a general power of appointment for transfer tax purposes, and her failure to exercise that power is a gift tax transfer at the time of *H*'s death. The assertion that the owner of the policy has a general power of appointment over the proceeds of the policy has judicial support.[89] Unless the courts adopt that view, life insurance proceeds might escape transfer taxes in both *H*'s and *W*'s estates, a result the Internal Revenue Service will strongly resist and the courts will be reluctant to adopt.

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discussed the question of when the transfer occurs in such a case—just before, at the instant of, or just after the husband's death. *Id.* at 1398. In Estate of Goldstone, 78 T.C. 80 (1982), the Tax Court in a reviewed opinion considered a case where *H* and *W*, residents of Indiana, died in a common disaster with no evidence of survivorship. At the time of her death, *W* owned a policy on *H*'s life and had directed that the proceeds be paid to an insurance trust created by *H*, in which *W* had a beneficial interest, in the event she survived *H*. The court held that transfer tax consequences should flow from the presumption under state law that *W* was the survivor spouse. Accordingly, *W* made a gift of the matured policy—the face value plus post-mortem dividends. *Id.* at 84. In dictum, the court referred to the question whether *W* made a gift or an estate tax transfer: "Under the unified transfer tax there will be one transfer tax imposed at the unified rates, whether the transfer is viewed as occurring inter vivos or at death." *Id.* at 85.

87. *See* Estate of Pyle v. Commissioner, 313 F.2d 328, 330 (3d Cir. 1963); Goodman v. Commissioner, 156 F.2d 218, 220 (2d Cir. 1946). *See also* Kasishke v. United States, 426 F.2d 429, 433 (10th Cir. 1970) (proceeds of endowment policy held by insurer with interest paid to purchaser during life, remainder to son, and no right of withdrawal properly included in estate of purchaser); Streck v. Commissioner, 1982 T.C.M. (CCH) 391 (July 13, 1982) (*H* was settlor of insurance trust which owned policy on *W*'s life; held that *H* made completed gift of policy proceeds when *W* died); Rev. Rul. 77-48, 1977-1 C.B. 292; Rev. Rul. 73-207, 1973-1 C.B. 409.

88. National City Bank v. United States, 371 F.2d 13, 16 (6th Cir. 1966).

89. Keeter v. United States, 461 F.2d 714, 716 (5th Cir. 1972); United States v. Turner, 287 F.2d 821, 824 (8th Cir. 1961); Rev. Rul. 55-277, 1955-1 C.B. 456. *Contra* Second Nat'l Bank v. Dallman, 209 F.2d 321, 324 (7th Cir. 1954).

C. *Alternative Dispositions Compared*

The impact of transfer taxes will influence decisions on the ownership of life insurance policies and the selection of a method of combining the proceeds with the insured's other property. Legislation in 1981 increasing the transfer tax exemption level[90] and marital deductions[91] on qualified transfers between spouses will have an important bearing on both ownership and disposition of proceeds.

After 1981, transfer of ownership of a policy from an owner-insured to someone other than his spouse still has the transfer tax advantage of reducing the estate tax estate of the insured by the difference between the amount of the policy's proceeds and its gift tax value.[92] For most policies, this difference is large and the ownership transfer permits deferral or avoidance of transfer taxes on part or all of the proceeds.

The unlimited marital deduction for qualified interspousal transfers permits tax free transfer of policy ownership to a spouse while the insured is living or of the policy proceeds on the insured's death if the insured owns the policy. Even with an unlimited marital deduction, married persons will continue to seek optimal use of the transfer tax exemptions available to each of them. Property transfers between spouses, including life insurance policies, may be necessary to do this. The unlimited marital deduction greatly facilitates these benefits.

The fiduciary ownership problem is present if the donee of a life insurance policy dies before the donor-insured and names the donor as his executor or testamentary trustee. When the donee-owner outlives the donor-insured, the donee may want to combine the insurance proceeds with the donor's other estate property. The method chosen will have transfer tax consequences for both the donor-insured and the donee.

The comments to follow consider those beneficiary designations which (1) combine life insurance proceeds with other estate assets of the insured and (2) permit the insured to retain control, directly or indirectly, over disposition of the proceeds until his death.

1. Payment to the Estate

A, the owner-insured of a life insurance policy, may designate his estate as beneficiary of the proceeds and thus combine the proceeds with his other estate property. This designation exposes the proceeds to federal and Missouri estate taxes in *A*'s estate,[93] but the estate tax marital deduction[94]

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90. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 401, 95 Stat. 172, 299 (codified at I.R.C. §§ 2010, 2505 (Supp. V 1981)).

91. *Id.* § 403, 95 Stat. at 301-04 (codified at I.R.C. § 2056 (Supp. V 1981)).

92. For transfers of policies by gift within three years of the donor's death or the payment of premiums by the donor on such a policy, see notes 53-54 and accompanying text *supra*.

93. *See* notes 27-29 and accompanying text *supra*.

94. I.R.C. § 2056 (1976 & Supp. V 1981).

may shelter that part of the proceeds which passes to *A*'s spouse in a qualified form. This designation also exposes the proceeds to the claims of *A*'s creditors[95] and adds the proceeds to the statutory base for determining the fees of *A*'s executor and the executor's attorney.[96]

If *A* is the insured and *B* is the owner of the policy, *B* may designate *A*'s estate as beneficiary of the proceeds and thus combine the proceeds with *A*'s other estate property. This designation exposes the life insurance proceeds to federal and Missouri estate taxes in *A*'s estate,[97] but the estate[98] and gift tax[99] marital deductions may alleviate the transfer tax cost if *B* is a spouse and beneficiary of *A*'s estate. This designation also exposes the proceeds to the claims of *A*'s creditors[100] and augments the statutory base for fixing the fees of *A*'s executor and the executor's attorney.[101] Does *B* make a gift if he owns a policy on *A*'s life, payable to *A*'s estate, and the proceeds pass on *A*'s death to someone other than *B*? There is no indication now that the Internal Revenue Service will assert a gift tax transfer in this situation, but under the recent ruling[102] that possibility exists.

2. Payment to Revocable Trust

A popular method of combining life insurance proceeds with other estate assets is for the owner-insured to create a revocable inter vivos trust and to designate the trustee of that trust the beneficiary of the proceeds. After his death, estate assets may pass by will to the trust, and the trustee of that trust can then administer the combined property in a unified plan. Under this method the life insurance proceeds are a part of the insured's estate tax estate since he owns the policy at death,[103] but the estate tax marital deduction[104] may shelter the proceeds from tax costs in whole or in part if the beneficiary is his spouse. This disposition involves the expense of a separate trust but protects the proceeds from the claims of the insured's creditors[105] and keeps the proceeds out of the statutory base used for determining the fees for the insured's executor and the executor's attorney.[106]

B may own a policy on *A*'s life and designate the trustee of *A*'s revocable trust as beneficiary of the proceeds, combining the proceeds with *A*'s other

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95. *See* notes 165-67 and accompanying text *infra*.
96. *See* notes 172-75 and accompanying text *infra*.
97. *See* notes 27-29 and accompanying text *supra*.
98. I.R.C. § 2056 (1976 & Supp. V 1981).
99. *Id.* § 2523.
100. *See* notes 165-67 and accompanying text *infra*.
101. *See* notes 172-75 and accompanying text *infra*.
102. Rev. Rul. 81-166, 1981-1 C.B. 477. *See* text accompanying notes 81-82 *supra*.
103. *See* notes 27-29 and accompanying text *supra*.
104. I.R.C. § 2056 (1976 & Supp. V 1981).
105. *See* notes 124-42 and accompanying text *infra*.
106. *See* notes 172-75 and accompanying text *infra*.

estate property. This is the situation involved in *Margrave* and the recent Revenue Ruling.[107] The Eighth Circuit held,[108] and the Internal Revenue Service now concurs,[109] that the proceeds are not a part of *A*'s estate tax estate. But the Internal Revenue Service will assert that *B* makes a gift and, perhaps, an estate tax transfer on *A*'s death if the trust property passes in whole or in part to someone other than *B*.[110]

As indicated above, the ruling shifts transfer tax consequences on the proceeds from *A* to *B* and may permit some deferral of transfer taxes on the proceeds until *B*'s death. The deferral feature will be important where the amounts involved are relatively large, the period between the death of the donor and the donee is relatively long, and *A* and *B* are not married. This designation has the same advantage regarding *A*'s creditors[111] and the computation of executors' and attorneys' fees[112] as when *A* owns the policy and designates the trustee of his revocable trust the beneficiary.

A disadvantage of the *Margrave* designation is that *B* makes a gift tax transfer on *A*'s death if someone other than *B* is the beneficiary of *A*'s trust. This is avoided if *B*, the owner of the policy on *A*'s life, creates a separate revocable trust and designates that trust as beneficiary of the proceeds on *A*'s death. If *B* may revoke that trust while living, he has made no gift tax transfer of the proceeds if he is still living when *A* dies.[113] *B*'s revocable trust may provide for distribution of the trust property in the manner provided for in *A*'s estate plan, and when *B* dies the property in his revocable trust may be combined with that of *A*.[114] The creation of a separate revocable trust by *B* will involve some additional expense.

3. Payment to Testamentary Trustee

The insured may want to combine the insurance proceeds with his other estate property by designating his testamentary trustee the beneficiary of the proceeds. This designation protects the proceeds from the claims of the creditors of his estate[115] and from the fees of the executor and the executor's

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107. *See* notes 73-83 and accompanying text *supra*.
108. Estate of Margrave v. Commissioner, 618 F.2d 34, 39 (8th Cir. 1980).
109. Rev. Rul. 81-166, 1981-1 C.B. 477.
110. *Id.*
111. *See* notes 124-42 and accompanying text *infra*.
112. *See* notes 172-75 and accompanying text *infra*.
113. Treas. Reg. § 25.2511-2(c) (1958).
114. If the terms for distribution and administration of a trust created by *A* are substantially the same as those of a trust created by *B*, and if both trusts authorize the mingling of the two funds, there should be no objection to combining them. 1 A. SCOTT, THE LAW OF TRUSTS 417 n.22 (2d ed. 1956); 2 *id.* at 1434; Note, *Trusts: Additions: Augmentation by Persons Other Than Settlor*, 48 CORNELL L.Q. 585 (1963). *See also* Bemis v. Fletcher, 251 Mass. 178, 146 N.E. 277 (1925).
146 N.E. 277 (1925).
115. *See* notes 124-42 and accompanying text *infra*.

attorney,[116] and saves him the expense of creating a separate revocable trust during his lifetime. This has been and remains a somewhat controversial designation for reasons referenced elsewhere in these comments.[117]

If *A* owns the policy at the time of his death, the insurance proceeds are a part of his estate tax estate if paid to his testamentary trustee,[118] but the estate tax marital deduction may negate all or part of any transfer tax cost if *B*, the beneficiary, is *A*'s spouse.[119] If *B* owns a policy on *A*'s life and designates *A*'s testamentary trustee the beneficiary of the proceeds, the transfer tax consequences should parallel those in *Margrave* and the Revenue Ruling that followed that decision.[120] Transfer taxes on the proceeds are shifted from *A* to *B*, and *B* makes a gift, and possibly an estate tax transfer, on *A*'s death.

Payment to *A*'s testamentary trustee is the substantial equivalent of payment to a trustee of *A*'s revocable trust since *A* can control the terms of his will during his lifetime and retains control over the disposition of the insurance proceeds at his death so long as *B* does not change the beneficiary designation in the policy. Although there are apparently no decisions or rulings on this point, the reasoning in *Margrave* should apply since payment of proceeds to a testamentary trustee is not equivalent to payment to the estate under Missouri law.[121] Internal Revenue Service rulings[122] and federal court decisions[123] involving life insurance proceeds hold that payment to *A*'s testamentary trustee is not a payment to *A*'s estate under federal estate tax law.

Payment to *A*'s testamentary trustee when *B* owns the policy suggests some possible advantages: (1) the transfer tax consequences of *Margrave* and the later Revenue Ruling; (2) protection of the proceeds from the claims of creditors; and (3) insulation of the proceeds from the statutory base used to determine fees for executors and attorneys.

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116. *See* notes 172-75 and accompanying text *infra*.
117. *See* Part VI. *infra*. *See also* Lawthers, *supra* note 14, at 320-22.
118. *See* notes 27-29 and accompanying text *supra*.
119. I.R.C. § 2056 (1976 & Supp. V 1981).
120. *See* notes 73-83 and accompanying text *supra*.
121. *See* notes 124-42 and accompanying text *infra*.
122. Rev. Rul. 77-157, 1977-1 C.B. 279 (trustee permitted but not directed to pay estate obligations); Rev. Rul. 73-404, 1973-2 C.B. 319 (trustee prohibited from paying estate obligations); I.R.S. Letter Ruling 8133094 (1981) (inter vivos trust). *Contra* I.R.S. Letter Ruling 7905008 (1979) (trustee directed to use trust assets to pay estate obligations).
123. United States v. First Nat'l Bank & Trust Co., 133 F.2d 886, 888 (8th Cir. 1943); Proutt's Estate v. Commissioner, 125 F.2d 591, 593-94 (5th Cir. 1942); Webster v. Commissioner, 120 F.2d 514, 515 (5th Cir. 1941); Boston Safe Deposit & Trust Co. v. Commissioner, 100 F.2d 266, 268 (1st Cir. 1938); Commissioner v. Jones, 62 F.2d 496, 497-98 (6th Cir. 1932).

III. CLAIMS OF CREDITORS, BENEFICIARIES, AND OTHERS

When an insured seeks to combine proceeds of insurance on his life with his other estate property, the method he selects to accomplish this objective can affect several interests: estate beneficiaries, including heirs at law in the case of intestacy and legatees named in the will; his creditors and those of his estate; fees for his personal representative and the representative's attorney; and his surviving spouse's marital property rights.

A. Tootle-Lacy *and* Prudential

Two decisions of the Missouri Supreme Court have an important bearing on the rights of creditors and others when life insurance proceeds are combined with other estate property of the insured in the manner discussed in these comments.

In 1937 the court decided *Tootle-Lacy National Bank v. Rollier.*[124] The insured in *Tootle-Lacy* owned eight policies of insurance on his life and had designated his wife beneficiary under each. Following his wife's incapacity, the insured changed the beneficiary on each of the policies to the trustee of a trust established in his will.[125] After the change in beneficiary designation, the insured executed a will leaving $6,000 and his jewelry and personal effects to another woman, with a residuary bequest in trust for the benefit of his wife during her lifetime, remainder to his son. The insured died three months later. When his executor lacked sufficient property to pay the other woman's bequest, she sought satisfaction from the insurance proceeds, asserting that they were estate property.[126]

The supreme court affirmed the trial court's decree denying that claim and upholding the validity of a trust of the insurance proceeds for the exclusive benefit of the insured's wife and son.[127] The court concluded that the insured had created two trusts—one an express inter vivos trust in the proceeds of the policy, the other a testamentary trust of the residuary estate, if any.[128] Except for the trust property, the two trusts were identical as to their nature, character, conditions, beneficiaries, and trustee.

In upholding the trust created by the beneficiary designation, the court could not rely on the doctrine of incorporation by reference[129] since the in-

124. 340 Mo. 1027, 111 S.W.2d 12 (1937).
125. *Id.* at 1028, 111 S.W.2d at 13.
126. *Id.* at 1029, 111 S.W.2d at 14.
127. *Id.* at 1032, 111 S.W.2d at 17.
128. *Id.*
129. In order to be "incorporated by reference" into a will, a document (including a trust) must meet three requirements: (1) the will must refer to the document with reasonable certainty; (2) the will must refer to the document as presently existing; and (3) the testator must have intended to incorporate the document. T. ATKINSON, HANDBOOK OF THE LAW OF WILLS 387-90 (2d ed. 1953). The intent to incorporate "must clearly appear, either by direct reference . . . or from un-

sured had executed his will *after* naming his testamentary trustee the beneficiary of the proceeds. The court instead indicated that an express inter vivos trust may be derived from "several instruments executed at other times than that of the transfer of title."[130] Of critical importance was the insured's intention that the proceeds should not pass under his will as a part of his estate. Had he intended to have them pass under his will, said the court, "would he not have made them payable directly to the personal representative or his estate?"[131]

In 1958, the court decided *Prudential Insurance Company v. Gatewood*,[132] and reaffirmed its holding in *Tootle-Lacy*. In *Prudential*, the insured owned accidental death policies which paid $20,000 to beneficiaries following his accidental death in September, 1956. The insured had divorced his first wife in February, 1956, and married his second wife two months later. After the divorce but before the second marriage, the insured executed a will which provided for a trust of the residue of the estate for the benefit of his minor children. After executing the will, the insured asked the insurer to change the beneficiary on the policies to "Citizen's Bank, Trustee of the Estate of John J. Gatewood."[133] In July, he executed forms furnished by the insurer containing the same beneficiary designation. The assets of the probate estate were not sufficient to pay claims and administration expenses. The first wife (in her own behalf), the second wife (as personal representative of the estate), and the testamentary trustee each asserted rights to the proceeds.[134]

The court followed *Tootle-Lacy* and upheld the claim of the testamentary trustee.[135] Since the will was in existence at the time of the beneficiary designation, the court concluded that the insured's purpose was "to incorporate by reference the terms and provisions of the trust created by the will as the terms and provisions by which the trust created in the proceeds of the policy was to be administered for the exclusive benefit of the children."[136] As in its earlier opinion, the court respected the insured's intentions to have the proceeds administered apart from his estate. "Had he desired that the proceeds of the policy be first administered as part of his estate, such desire could easily have been effected by making the proceeds payable to his estate."[137]

Although some commentators have not endorsed *Tootle-Lacy* with enthusiasm,[138] it remains the primary precedent in Missouri for a distinc-

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equivocal facts and circumstances surrounding the transaction." St. Louis Union Trust Co. v. Blue, 353 S.W.2d 770, 777 (Mo. 1962).

130. 340 Mo. at 1031, 111 S.W.2d at 16.
131. *Id.* at 1032, 111 S.W.2d at 17.
132. 317 S.W.2d 382 (Mo. 1958).
133. *Id.* at 385.
134. *Id.* at 384.
135. *Id.* at 390.
136. *Id.*
137. *Id.* at 387.
138. *See* Haskell, *Testamentary Trustee as Insurance Beneficiary: An Estate Planning*

tion between payment of proceeds to the insured's estate and payment of proceeds to a testamentary trustee named by the insured. In holding that the insured created two trusts, the court implicitly approved the payment of proceeds to the trustee of a revocable trust created by the insured while living. For if a beneficiary designation and a later executed will establish a valid inter vivos trust of the proceeds, then a beneficiary designation and an existing revocable trust document will also establish a valid inter vivos trust for disposition of the proceeds. The two-trust theory of *Tootle-Lacy* is a clear indication that in Missouri there are two, not three, separate theories for combining insurance proceeds with other estate property in the manner indicated in these comments: payment to the estate, and payment to a trust established by the insured while living. Payment to a revocable trust and payment to a testamentary trust are, in substance and effect, the same thing.

Neither *Tootle-Lacy* nor *Prudential* involved a beneficiary designation by the owner of a policy who is not the insured. Someone other than the insured may own a policy on the life of the insured and designate a trust created by the insured as beneficiary of the proceeds. Unless the purported trust is too indefinite, there is no apparent reason why the courts in Missouri should not reach the same result as when the insured owns the policy and makes the beneficiary designation. A trust of the proceeds created by a policy owner who is not the insured is neither more nor less indefinite than that created by an insured policy owner, since in each case reference must be made to another document to determine the terms of the trust.[139]

If the revocable trust or will is in existence at the time of the beneficiary designation, the doctrine of incorporation by reference[140] may be used to fix the terms of the trust. But if the insured were later to change his will or revocable trust without the knowledge or consent of the policy owner, a more serious question is involved than if the policy owner and the insured were the same person.[141] If the insured's will or revocable trust has not been executed when the policy owner makes the beneficiary designation, the later executed document also may not accurately reflect the intentions of the policy owner.[142] These considerations might cause a court to be more reluctant to find a valid trust of the proceeds since a necessary step in establishing or

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Gimmick, 41 N.Y.U. L. REV. 566, 578 (1966); Lawthers, *supra* note 14, at 316; Schipper, *Designating Trustee Under Will As Beneficiary of Insurance Policy*, 1955 A.B.A. SEC. REAL PROP. PROB. TR. L. REP. 57, 60. For a more sympathetic view, see Note, *The Testamentary Life Insurance Trust*, 51 MINN. L. REV. 1118 (1967).

139. *See* First Trust Co. v. Northwestern Mutual Life Ins. Co., 204 Minn. 244, 283 N.W. 236 (1930); RESTATEMENT (SECOND) OF TRUSTS § 57 (1972).

140. *See* note 129 *supra*.

141. This is not a serious problem in situations like that in Estate of Margrave v. Commissioner, 618 F.2d 34 (8th Cir. 1980), where the insured husband and owner wife are of one mind as to disposition of proceeds.

142. *See* text accompanying notes 124-28 *supra*.

maintaining a trust for disposition of the insurance proceeds depends on the actions of another individual—the execution by the insured of a revocable trust or a will, or the modification of those documents.

B. *Creditors, Administration Expenses, Heirs, and Legatees*

The scope of creditors' remedies with respect to life insurance policies and the proceeds of those policies is beyond the focus of these comments. Interested creditors include those of the owner-insured, the policy owner who is not the insured, the beneficiary of the proceeds, and their respective estates. The transfer of a life insurance policy by gift or other assignment and payment of premiums on such a policy may be fraudulent as to creditors,[143] and the trustee in bankruptcy of an insured or beneficiary may assert claims with respect to a policy or the proceeds of a policy.[144]

Generally, life insurance policies and the proceeds of those policies receive favored treatment under the state law of creditors' remedies.[145] Missouri is no exception. Since 1866, Missouri has had liberal insurance exemption statutes to protect women.[146] A married woman may insure the life of her husband and on his death receive the proceeds free from the claims of her husband's creditors; if she dies before her husband the proceeds are payable to her heirs and are not subject to the claims of her creditors.[147] An unmarried woman may insure the life of her father or brother and on the death of the insured receive the proceeds free from the claims of the insured's creditors.[148] If a husband provides life insurance "for the benefit of his wife," the proceeds pass to her free of the claims of his creditors, executors, and administrators, except that premium payments by the husband in excess of five hundred dollars a year are subject to the claims of his creditors.[149] Even then, the creditor's remedy for the excess premiums does not mature until the husband's death.[150] Missouri courts, even without the benefit of statutory exemptions, have restricted recovery by creditors from life insurance policies and the proceeds of those policies.[151]

The discussion to follow addresses only those beneficiary designations

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143. *See* Judson v. Walker, 155 Mo. 166, 169, 55 S.W. 1083, 1086 (1900).
144. *See* Rulo v. Rubin, 468 F.2d 826, 827 (8th Cir. 1972).
145. *See generally* Riesenfeld, *supra* note 13.
146. *See* MO. REV. STAT. ch. 115, §§ 15-18 (1866) (current version at *id.* §§ 376.540, .550, .560 (1978)).
147. *Id.* § 376.540 (1978).
148. *Id.* § 376.550.
149. *Id.* § 376.560.
150. Kansas City v. Halvorson, 352 Mo. 1027, 1029, 180 S.W.2d 710, 712 (1944).
151. *See, e.g.*, First Nat'l Bank v. Simpson, 152 Mo. 638, 54 S.W. 506 (1899); Baker v. Young, 47 Mo. 453 (1871); Continental Casualty Co. v. Pleitsch, 111 S.W.2d 956 (Mo. App., St. L. 1938); Renfro v. Metropolitan Life Ins. Co., 148 Mo. App. 258, 149 S.W. 444 (St. L. 1910).

that combine proceeds with other estate assets of the insured by payment to the insured's estate, revocable trust, or testamentary trust.

1. Payment to the Estate

a. Estate—An Ambiguous Term

This discussion assumes that a direction to pay proceeds of a life insurance policy to the insured's estate will expose the proceeds to the claims of the insured's creditors and estate beneficiaries. But unless the policy contains language defining the term, a beneficiary designation to "the estate" is ambiguous.[152]

The ambiguity affects not only the creditors and estate beneficiaries under state law but may also affect the liability for federal estate tax on the policy proceeds. If someone other than the insured owns the policy at the time of the insured's death, the proceeds of the policy are not subject to the federal estate tax in the estate of the insured unless the proceeds are "receivable by the executor" of the insured.[153] The settled interpretation of the quoted phrase turns on state law; the proceeds are receivable by the executor if they are subject to the claims of creditors under the law of the state of the insured's domicile.[154] The designation of the insured's estate as beneficiary has prompted litigation as to the meaning of the term "estate" for federal estate tax purposes. Decisions of the Tax Court[155] and other federal courts[156] reflect the ambiguity of the term.

Case law in Missouri illustrates the same ambiguity. In *Renfro v. Metropolitan Life Insurance Co.*,[157] an appellate court found the beneficiary designation "estate" to be ambiguous and permitted parol evidence to establish the insured's intention to pass the proceeds to her only son. The court noted:

> This testimony had no tendency to vary or contradict the policy but was the explanation, by extrinsic evidence, of what took place at the time of the delivery of the policy, of an ambiguous term, that is to say, the term "estate" found in the policy itself. . . .
>
> . . . .
>
> [I]t cannot be said, with any propriety or with any proper consideration of this form of insurance, that they are intended to pro-

152. *See* Fox, *Estate: A Word To Be Used Cautiously, If At All*, 81 HARV. L. REV. 992 (1968).

153. I.R.C. § 2042 (1976).

154. United States v. First Nat'l Bank & Trust Co., 133 F.2d 886, 888 (8th Cir. 1943); Commissioner v. Jones, 62 F.2d 496, 497 (6th Cir. 1932); M.B. Morton, 23 B.T.A. 236, 240 (1931); Treas. Reg. 20.2042-1(b) (1958).

155. Estate of Nyemaster, 2 T.C.M. (CCH) 1183 (1943); Estate of Lucky, 2 B.T.A. 1268 (1925).

156. Proutt's Estate v. Commissioner, 125 F.2d 591 (6th Cir. 1942); Webster v. Commissioner, 120 F.2d 514 (5th Cir. 1941); Commissioner v. Jones, 62 F.2d 496 (6th Cir. 1932).

157. 148 Mo. App. 258, 129 S.W. 444 (St. L. 1910).

vide a fund for the benefit of creditors, unless that is distinctly set out in the policy itself . . . .[158]

Under Missouri law, death taxes are equitably apportioned among estate beneficiaries unless the decedent's will or other estate plan directs the source of payment for these taxes. A will clause directing the executor to pay death taxes "assessed against my estate" has been interpreted to apply to death taxes attributable to property passing under the will to legatees and devisees, but not to death taxes on the proceeds of life insurance, a part of the death tax estate, passing to a named beneficiary.[159]

If a beneficiary designation "to my estate" is ambiguous as to the rights of the insured's creditors and others to the policy proceeds, the ambiguity may not be removed by designation to "my executor or administrator" or to "my personal representative."[160] In Missouri a personal representative has a duty to inventory the property of the decedent, including "insurance policies payable to the personal representative."[161] Except for exempt property, items appearing in the inventory are presumptively available to satisfy the claims of the creditors of the insured and his estate.[162] Yet a beneficiary designation "to my personal representative" may be ambiguous as to the rights of creditors and others if the policy owner intends that the beneficiaries of the proceeds shall be his legal heirs.[163]

Any ambiguity in a reference to the "estate" or to the "personal representative" may be clarified by the terms of the policy, which may provide that a designation to either the "estate" or "the personal representative" makes the proceeds a part of the probate estate subject to the claims of creditors and others. Unless the policy itself removes the ambiguity, however, it is advisable for a policy owner to write the beneficiary designation in such form as to clarify his intentions as to creditors and others.[164]

b. Rights of Interested Persons

The owner-insured of an insurance policy may designate that on his death the proceeds of a policy be paid to his estate and intend by this designation that the proceeds become property subject to estate administration and to the claims of his creditors. In *Prudential Insurance Company v. Gatewood*,[165]

158. *Id.* at 267, 270, 129 S.W. at 447-48, 450.
159. Priedeman v. Jamison, 356 Mo. 627, 631, 202 S.W.2d 900, 904 (1947).
160. Southwestern Life Ins. Corp. v. Wilson, 63 S.W.2d 185, 189 (Mo. App., Spr. 1933).
161. MO. REV. STAT. § 473.233.1(5) (Cum. Supp. 1981). This section was revised in 1980 to change "payable to the executor or administrator" to "payable to the personal representative." *See* 1980 Mo. Laws 463.
162. MO. REV. STAT. §§ 473.233, .260, .263, .267 (1978).
163. Southwestern Life Ins. Corp. v. Wilson, 63 S.W.2d 185, 189 (Mo. App., Spr. 1933).
164. Fox, *supra* note 152, at 1001-02.
165. 317 S.W.2d 382, 387 (Mo. 1958).

the insured's personal representative was an unsuccessful claimant when the administered estate was not sufficient to pay claims. The court indicated that had the insured wanted the proceeds to be available to creditors he could have designated his estate the beneficiary of the proceeds.[166]

If another person owns the policy and designates that the proceeds be paid to the insured's estate, the proceeds will also be subject to the claims of the insured's creditors if the policy owner intends that result. In this situation, the creditors of the policy owner probably have no rights to reach the proceeds to satisfy claims against the owner.[167]

The legatees and intestate heirs of a decedent look to the same source for satisfaction of their rights as do the creditors of the decedent and his estate. The amount remaining after removal of exempt property, the homestead allowance, the satisfaction of the marital and support rights of the surviving spouse and children, and the claims of creditors passes to the heirs at law or to the decedent's legatees.[168] Life insurance proceeds paid to the estate become a part of that fund if the insured or other policy owner so directs. The proceeds paid to a revocable or testamentary trust of the decedent are not, in Missouri, a part of the estate available to the heirs at law unless the insured or other policy owner designates his heirs to be beneficiaries of the fund.[169] The clear policy of the law is to permit, even encourage, a property owner to make dispositions of property in this manner which are substitutes for what would otherwise be testamentary dispositions. In *Tootle-Lacy National Bank v. Rollier*,[170] the unsuccessful claimant was a pecuniary legatee named in the insured's will; the court held that payment of insurance proceeds to the decedent's testamentary trustee was for the exclusive benefit of the beneficiaries of that trust. Under the court's theory, the beneficiaries of the testamentary trust participate as beneficiaries of an express inter vivos trust and not as residuary legatees under the will.[171]

A personal representative has authority to pay expenses incident to the administration of an estate.[172] These expenses are payable from the same fund available to satisfy the debts and other liabilities of the decedent accrued at the time of death.[173] A major expense of administration is the fee of the personal representative[174] and his attorney.[175] The proceeds of a life insurance policy payable to the insured's estate become part of the personal property administered and will increase the minimum compensation for the personal representative and the attorney for the personal representative.

166. *Id.*
167. *See* notes 124-42 and accompanying text *supra.*
168. MO. REV. STAT. § 474.010 (Cum. Supp. 1981).
169. *See* notes 124-42 and accompanying text *supra.*
170. 340 Mo. 1027, 1032, 111 S.W.2d 12, 17 (1937).
171. *Id.*
172. MO. REV. STAT. §§ 473.403.2, .810(20) (Cum. Supp. 1981).
173. *Id.* §§ 473.387, .397, .403, .540, .543.
174. *Id.* §§ 473.153.1, .2 (supervised); .823 (independent).
175. *Id.* §§ 473.153.1, .3; .823(3).

2. Payment to Revocable Trust

Probably the most common method for combining life insurance proceeds with other estate assets of the insured is for the insured owner of the policy to create a revocable trust and to designate the trustee the beneficiary of the proceeds of the policy.[176] In some states, legislation addresses the rights of creditors and others to the policy proceeds paid to the trustee of a revocable trust.[177] Missouri has not yet adopted such legislation,[178] and creditors, heirs, and legatees of the insured may not reach the proceeds. The *Tootle-Lacy* and *Prudential* opinions are the strongest indication that Missouri courts will respect the insured's intentions and insulate insurance proceeds from claims enforceable only against property subject to estate administration.

If someone other than the insured owns the policy and designates the trustee of a revocable trust created by the insured as beneficiary of the proceeds, reasons for insulating the proceeds from claims of the insured's creditors, heirs, and legatees are just as strong as when the insured owns the policy.[179] In such a case the policy owner may designate any person, including himself, as beneficiary of the proceeds, and if he dies before the insured, the policy is an asset of his estate.[180] Unless a prior transfer of the

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176. *See* G. BOGERT, *supra* note 12, § 235, at 57.

177. *Id.* at 87 n.50.

178. A Subcommittee for Revision of Missouri Trust Law of the Missouri Bar Probate and Trust Committee has proposed adding a new section 456.030 governing insurance trusts and placing the language of the existing section 456.030 into section 456.010. This recommendation was introduced as H.R. 1733 in the 81st General Assembly, but the House took no action on the bill. The language of the proposed new section is as follows:

> Proceeds of life insurance policies heretofore made payable to a trustee or trustees named as beneficiary or hereafter to be named beneficiary under an inter vivos trust shall be paid directly to the trustee or trustees and held and disposed of by the trustee or trustees as provided in the trust agreement or declaration of trust in writing made and in existence on the date of death of the insured, whether or not such trust or declaration of trust is amendable or revocable or both, or whether it may have been amended, and notwithstanding the reservation of any or all rights of ownership under the insurance policy or annuity contract; subject however, to a valid assignment of any part of the proceeds. It is not necessary to the validity of such trust agreement or declaration of trust that it be funded or have a corpus other than the right, which need not be irrevocable, of the trustee or trustees named therein to receive such proceeds as beneficiary. A policy of life insurance or annuity contract may designate as beneficiary a trustee or trustees named or to be named by will if the designation is made in accordance with the provisions of the policy or contract whether or not the will is in existence at the time of the designation.

H.R. 1733, 81st Gen. Assem., Reg. Sess. (1982).

179. *See* notes 124-42 and accompanying text *supra*.

180. J. MUNCH, *supra* note 40, at 126-27, 143-44.

policy by the insured is in some sense fraudulent,[181] a court should give proceeds the protection accorded by *Tootle-Lacy* and *Prudential*.

The owner of a policy on the life of another may create a revocable inter vivos trust using the same plan of disposition as that in the insured's own estate plan. If the insured dies before the policy owner, the insurance proceeds may eventually be combined with other estate property of the insured.[182] Creditors, heirs, and legatees of the insured should have no claim to the proceeds on the insured's death unless a prior transfer of the policy by the insured is in some sense fraudulent.

A Missouri statute makes void, as against existing or subsequent creditors, a conveyance in trust to the use of the grantor.[183] A revocable life insurance trust created by the insured may constitute a transfer for the benefit of the insured, and while he is living his creditors would have the same rights with respect to the policy as if the trust had not been created. But once the insured is dead, his creditors should have no greater rights to the proceeds than if he owned the policy at death and designated his beneficiary as someone other than the trustee of a revocable trust.[184]

3. Payment to Testamentary Trustee

Several states have legislation authorizing payment of life insurance proceeds to a testamentary trustee designated by the insured.[185] Some of these statutes address the rights of creditors and others and commonly provide that the insurance proceeds paid to a testamentary trust are insulated from the claims of the insured's creditors.[186] Although Missouri has not yet enacted

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181. *See* Judson v. Walker, 155 Mo. 166, 169, 55 S.W. 1083, 1086 (1900).

182. A trust created in the testamentary estate plan of the insured and the revocable trust created by the owner of the policy would have the same dispositive provisions and each document would authorize the combination of the two trusts for the purpose of administration. *See* note 114 *supra*.

183. MO. REV. STAT. § 428.010 (1978). The statute refers to a "deed of gift and conveyance of *goods and chattels*, in trust." Typically, the grantor of a revocable life insurance trust designates the trustee the beneficiary of the proceeds and reserves the right to retain possession of the policy itself and to change the beneficiary designation.

184. *See* notes 124-42 and accompanying text *supra*.

185. *See* G. BOGERT, *supra* note 12, § 239, at 89 n.55.

186. New York, for example, has specific legislation dealing with creditors' rights in insurance proceeds:

> (c) Except to the extent otherwise provided by the trust agreement, declaration of trust or will, proceeds received by the trustee shall not be subject to the debts of the insured, employee or participant, to any greater extent than if such proceeds were payable to the beneficiaries named in the trust, and for all purposes including transfer or estate tax purposes they shall not be deemed payable to or for the benefit of the estate of the insured, employee or participant.

N.Y. EST. POWERS & TRUSTS LAW § 13-3.3(c) (McKinney 1973).

such legislation,[187] the Missouri Supreme Court, in *Tootle-Lacy* and *Prudential*,[188] has held that an insured's intention and direction to pay the proceeds to a testamentary trust will be respected and his creditors may not assert their claims against the proceeds. Under the reasoning of *Tootle-Lacy*, the rights of creditors and others to the proceeds paid to a testamentary trust should be the same as for proceeds payable to a revocable trust.[189]

IV. MARITAL RIGHTS OF SPOUSE

In the context of this discussion, marital property rights become important in two instances: on dissolution of marriage and on the death of a spouse. On dissolution, a Missouri court has authority to make a just division of the marital property of the spouses.[190] Subject to certain exceptions, marital property is all property acquired subsequent to marriage.[191] Missouri decisions establish that a life insurance policy acquired during marriage is marital property.[192] The ownership of a life insurance policy,[193] the designation of the beneficiary,[194] and the duty to make premium payments[195] may be determined by the parties to a dissolution proceeding by agreement[196] or a court by decree.[197] A policy owner who is obligated by contract or decree to maintain a designation in favor of a former spouse or children cannot designate

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187. For a proposed Missouri statute, see note 178 *supra*.

188. *See* notes 124-37 and accompanying text *supra*.

189. *See* text accompanying notes 124-42 *supra*.

190. MO. REV. STAT. § 452.330.1 (Cum. Supp. 1981).

191. *Id.* § 452.330.2.

192. LoPiccolo v. LoPiccolo, 581 S.W.2d 421, 425 (Mo. App., E.D. 1979) (policy with cash surrender value was marital property); Hilger v. Hilger, 570 S.W.2d 736, 741 (Mo. App., K.C. 1978) (cash award to wife for marital property represented by insurance policies with cash surrender value held by the parties). Where there was no evidence to indicate the cash value added by premium payments from family funds, an award to the insured husband was held to be proper. *In re* Marriage of Pitluck, 616 S.W.2d 861, 862-63 (Mo. App., W.D. 1981). In several decisions, Missouri courts have indicated that term insurance policies with no cash surrender or loan value should be awarded to the insured. *See, e.g., In re* Marriage of Biancard, 611 S.W.2d 250, 251 (Mo. App., E.D. 1980); Nilges v. Nilges, 610 S.W.2d 58, 61 (Mo. App., E.D. 1980); *In re* Marriage of Robinson, 570 S.W.2d 320, 322 (Mo. App., W.D. 1978).

193. LoPiccolo v. LoPiccolo, 581 S.W.2d 421, 425 (Mo. App., E.D. 1979); Hilger v. Hilger, 570 S.W.2d 736, 741 (Mo. App., K.C. 1978).

194. Perry v. Perry, 484 S.W.2d 257, 258-59 (Mo. 1972); General Am. Life Ins. Co. v. Rogers, 539 S.W.2d 693, 697-98 (Mo. App., St. L. 1976); Prudential Ins. Co. v. Gibson, 421 S.W.2d 26, 30 (Mo. App., St. L. 1967).

195. Metropolitan Life Ins. Co. v. Marcoulier, 322 F. Supp. 246, 250 (E.D. Mo. 1971).

196. MO. REV. STAT. § 452.325 (1978).

197. *Id.* § 452.330.

someone else as beneficiary or combine the proceeds with other estate assets in a manner inconsistent with his obligation.[198]

Under Missouri law, a gift by a married person in fraud of the marital rights of a surviving spouse may be recovered from the donee and applied to the surviving spouse's share, determined in the same manner as an elective forced share.[199] The elective forced share is available when it is more advantageous to the surviving spouse than accepting the property otherwise passing from the decedent to the spouse.[200] Before 1981, the estate subject to an elective forced share included only property subject to administration in the decedent's estate,[201] but beginning that year the estate on which the elective forced share is based includes not only property passing under the decedent's will but also certain nonprobate property passing to the surviving spouse, including life insurance proceeds.[202] Under the legislation now in effect, a surviving spouse must offset certain property he receives outside the will, including life insurance proceeds, against a proportionate share of the augmented estate.[203] Only if the elective forced share of the estate reduced in this manner exceeds in value the property otherwise received will the surviving spouse normally elect to take against the will.[204]

A recent Missouri appellate decision, *Bishop v. Eckhard*,[205] involves both features of marital rights law in Missouri: dissolution and death. The decedent husband participated in employee benefit plans maintained by his employer, one of which, a life insurance plan, permitted the decedent to designate the beneficiary of the proceeds and to change the beneficiary anytime prior to death. After his wife filed for dissolution of their marriage, the decedent changed the beneficiary designation from his wife to his daughter. He died while the dissolution proceeding was still pending.[206] The court affirmed an award of the insurance proceeds to the daughter and rejected the wife's contention that the change in the beneficiary designation was a transfer in fraud of her marital rights.[207] Without extended discussion, the court held that the beneficiary designation in effect at the time of death controlled the disposition of the proceeds.[208] The wife also contended that she had acquired rights in the policy as a result of the dissolution proceeding. The court rejected this theory, noting that the husband's death

198. 322 F. Supp. at 250-51. *See* G. BOGERT, *supra* note 12, § 239, at 89 n.55.
199. MO. REV. STAT. § 474.150 (1978).
200. *Id.* § 474.160. A surviving spouse may rescind a forced share election if it appears that provision made for the spouse under the will is more advantageous than the elective forced share. *Id.* § 474.163.6 (Cum. Supp. 1981).
201. *Id.* § 474.160.1(1) (1978) (repealed 1980).
202. *Id.* § 474.163.2 (Cum. Supp. 1981) (effective January 1, 1981).
203. *Id.* § 474.163.1 (1978).
204. *See* note 200 *supra.*
205. 607 S.W.2d 716 (Mo. App., E.D. 1980).
206. *Id.* at 717.
207. *Id.* at 718.
208. *Id.*

rendered the dissolution proceeding moot and terminated the court's jurisdiction.[209]

The decision in *Bishop* is yet another indication of the favored status of life insurance proceeds. In holding that a change in the beneficiary designation from wife to daughter was not a transfer in fraud of the wife's marital rights, the court expressed the prevailing view that the owner of a policy with the right to change the beneficiary designation may do so at any time.[210] The policy in question was owned and maintained by the decedent's employer, and the opinion gives no indication that the decedent had any rights while living to a cash surrender, loan, or other value in the policy.

A more difficult case is presented if the decedent owns a policy with a large cash surrender value and, immediately before death, changes the beneficiary designation from his spouse to his child. Even there, courts will be reluctant to intervene, for a decision in favor of the wife would create doubt about the efficacy of *any* beneficiary change where a spouse was the existing beneficiary. Nonetheless, a beneficiary change just before death, intended to divert family resources from the spouse to someone else, might be manifestly unfair to the spouse if the life insurance was the decedent's principal asset.

The 1981 change in the elective forced share legislation probably does not change the result in *Bishop*. The newly enacted forced share election increases the estate subject to the election by adding insurance proceeds and other nonprobate property passing to the spouse, and then reduces the forced share by the amount of these proceeds and other property.[211] After this legislative change it will be even more difficult for a surviving spouse to establish elective forced share marital rights in life insurance proceeds passing to someone else. Had the legislature intended to broaden the estate subject to the election by including life insurance proceeds passing to someone other than the spouse, it could have done so in the new legislation. The change actually made may be read as legislative approval of *Bishop*.

A 1981 amendment to the marital dissolution legislation provides that marital rights shall "vest" on filing of a petition in a dissolution proceeding.[212] It is doubtful if the result in *Bishop* would have been different if the vesting language added in 1981 had been in the statute at the time the wife filed her dissolution petition in that case. The likely purpose of the vesting language

209. *Id.* at 717-18.

210. *See* cases cited note 1 *supra*. In Prudential Ins. Co. v. Gatewood, 317 S.W.2d 382 (Mo. 1958), the insured's second wife asserted that a beneficiary designation in favor of the insured's testamentary trustee, made by the insured after their marriage, was a fraud as to her. The Missouri Supreme Court rejected that contention, noting that all or nearly all of the premiums were paid before marriage and the beneficiary designation removed the property from the insured's estate. *Id.* at 387-88.

211. MO. REV. STAT. § 474.163 (Cum. Supp. 1981).

212. *Id.* § 452.330.3.

is to assist the parties in establishing that no taxable income tax exchange takes place when the parties make a property settlement incident to a dissolution.[213] Even with the vesting language in the statute, the courts will probably hold that on termination of the dissolution proceeding by the voluntary action of either or both of the spouses or by death of one of the spouses, the vested marital rights now provided in the statute cease.[214]

V. CONCLUSION

Life insurance proceeds are often an important part of an estate plan. Combining the proceeds with other property of the decedent in a single estate plan can help to carry out the decedent's wishes efficiently and economically.

In any individual case, the choice of a method to combine life insurance proceeds with other estate property will depend on the particular objectives sought. Each of the methods available—payment to the estate, to a revocable trust, or to a testamentary trustee—has advantages, and each must be examined in terms of its impact on transfer taxes and the rights of creditors, beneficiaries, spouses, and other interested persons.

VI. APPENDIX

It is reported from time to time that some insurers are reluctant or unwilling to accept a beneficiary designation that combines life insurance proceeds with the insured's other property in the manner discussed in these comments. Uncertainty about the legal consequences of such a designation has been mentioned as a reason for the insurer to refuse to accept such a designation.

The author of this Article asked a leading national life insurance company to respond to questions concerning its willingness to accept such a designation under assumed circumstances. The situation, the author's questions, and the insurer's responses are set out below.

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213. In United States v. Davis, 370 U.S. 65 (1962), a case involving Delaware law, a marital property settlement involved a taxable exchange to the transferor husband. But in Imel v. United States, 523 F.2d 853 (10th Cir. 1975), decided under a Colorado marital property law similar to Missouri's, the court held that a marital property settlement was a division of property jointly owned by the spouses and was not a taxable exchange to the husband. The Missouri statute now provides: "Each spouse has a common ownership in marital property which vests not later than the time of commencement by one spouse against the other of an action in which a final decree is entered for dissolution of marriage or legal separation, the extent of the vested interest to be determined and finalized by the courts pursuant to the chapter." MO. REV. STAT. § 452.330.3 (Cum. Supp. 1981).

214. MO. REV. STAT. § 452.330.3 (Cum. Supp. 1981). Vesting is tied to an action in which a final decree is entered.

Situation

Insured *A*, a Missouri resident, owns a policy on his life. The insurance is an individual policy and may be either term or whole life. *A* may want to transfer the ownership of the policy to *B*, also a Missouri resident, and if the transfer of ownership is made, it will be in a manner consistent with the terms of the policy and any state laws which may be involved, including those which protect creditors and spouses from fraudulent transfers.

A. *Payment to the Estate*

Question 1: Will you accept a beneficiary designation made by *A* which in effect provides for payment of the proceeds on *A*'s death to the executor or administrator of *A*'s estate, the proceeds to be held and administered as a part of *A*'s estate?

Answer: Yes.

Question 2: If *A* transfers ownership of the policy to *B*, and *B* is *A*'s spouse, will you accept a beneficiary designation by *B* which in effect provides for payment of proceeds on *A*'s death to the executor or administrator of *A*'s estate?

Answer: Yes.

Question 3: Same question as 2, except *B* is not *A*'s spouse?

Answer: Yes.

B. *Payment to Revocable Trust*

Question 4: Will you accept a beneficiary designation made by *A* that directs that the proceeds be paid to the trustee of a revocable trust created by *A*, which is adequately identified in the beneficiary designation?

Answer: Yes.

Question 5: Do you insist on inclusion of a savings or other protective clause of some kind as part of the beneficiary designation which protects the insurance company in the event there is a dispute over the proceeds after *A*'s death between the trustee of the revocable trust and other persons?

Answer: Yes. The language of the protective clause is:

> It is understood and agreed that [the insurer] shall not be responsible for any failure of a trustee to perform the duties of trustee nor for the application or disposition of any money paid to a trustee and such payment shall fully discharge [the insurer] for the amount so paid.

Question 6: If *A* transfers ownership of the policy to *B* and *B* is *A*'s spouse, will you accept a beneficiary designation by *B* directing payment of the proceeds on *A*'s death to the trustee of the revocable trust created by *A* which is adequately identified in the beneficiary designation?

Answer: Yes. See also response to question 5.

Question 7: Same question as 6, except that *B* is not *A*'s spouse?

Answer: Yes. See also response to question 5.

C. *Payment to Testamentary Trustee*

Note: One purpose of this designation may be to insulate the proceeds from claims and liabilities which may be enforced against *A*'s estate.

Question 8: Will you accept a beneficiary designation made by *A* which directs payment of the proceeds to the trustee of a testamentary trust properly identified in *A*'s will?

Answer: Yes.

Question 9: Do you insist on inclusion of a savings or other protective clause to protect the company from the possible claims of *A*'s creditors, heirs, legatees, etc.?

Answer: Yes. See response to question 5 for language of the protective clause. In addition, provision is made for the possibility that the insured may die intestate, leave a will which contains no trust, or leave a will that is not probated.

Question 10: If *A* transfers ownership of the policy to *B* and *B* is *A*'s spouse, will you accept a beneficiary designation by *B* directing payment of the proceeds on *A*'s death to a trustee of a testamentary trust properly identified in *A*'s will?

Answer: Yes, but see response to question 9 for protective clause and provision for contingencies.

Question 11: If *A* transfers ownership of the policy to *B*, who is not *A*'s spouse, will you accept a beneficiary designation by *B* directing payment of the proceeds on *A*'s death to a trustee of a testamentary trust properly identified in *A*'s will?

Answer: Yes, but see response to question 9 for protective clause and provision for contingencies.