[Missouri Law Review](https://scholarship.law.missouri.edu/mlr)

Volume 53
Issue 1 *Winter 1988*

Article 7

Winter 1988

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AS IT SHOULD BE: A RATIONAL APPROACH TO THE AGGREGATION OF EMPLOYEE BENEFITS UNDER SECTION 2039

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INTRODUCTION

Death and taxes, Benjamin Franklin once said, are the two certainties of life.[1] In the federal estate tax, these two certainties coalesce. The coalescence in not complete, however, because not all property in which a decedent has an interest is subject to the tax.

Although sound estate tax policy requires that certain items be exempt from estate taxation,[2] not all estate tax exemptions implement sound tax policy. Some items are exempt in furtherance of non-tax policy objectives.[3] Thus, until 1982, the federal estate tax generally exempted the proceeds of qualified pension, profit sharing and stock bonus plans ("qualified plans") from taxation.[4] This exemption was consistent with the preferential status accorded such

1. Letter from Benjamin Franklin to M. Leroy (1789), *reprinted in* J. BARTLETT, FAMILIAR QUOTATIONS 423 (14th ed. 1968). Mr. Franklin was expressing his uncertainty about the longevity of the Constitution. The sentence in its entirety is as follows: "Our Constitution is in actual operation; everything appears to promise that it will last; but in this world nothing is certain but death and taxes." *Id.*

2. *See, e.g.*, I.R.C. §§ 2053, 2054 (1986), which provide deductions for, and therefore exempt from estate taxation, amounts used to satisfy expenses of administration, claims against the estate and property which has been destroyed.

3. *See, e.g.*, I.R.C. § 2055 (1986), which provides a deduction for charitable contributions.

4. Qualified plans are deferred compensation plans which meet the requirements of I.R.C. § 401(a). Section 401(a) describes the requirements that a trust which contains the assets of such a plan must meet in order to constitute a "qualified trust." I.R.C. § 401(a) (1986). A qualified trust established by an employer provides substantial income tax advantages to both the employee participants in the plan and the sponsor employer. Thus, although amounts contributed to the trust are shielded from the claims of the employer's creditors and are irrevocably set aside for the benefit of the employee participants, the employees do not recognize income as a result of the contributions until they receive them. I.R.C. § 402(a) (1986); Treas. Reg. § 1.402(a)-

plans under the income tax laws,[5] and was intended to further the non-tax objective of encouraging the formation and maintenance of private retirement plans.[6] Nevertheless, in 1982, Congress reduced the exemption to $100,000.[7] In 1984 it eliminated the exemption completely[8] by repealing section 2039(c) of the Internal Revenue Code of 1954.[9]

The result of repealing the qualified plan exemption is that the value of any annuity or other payment which a survivor beneficiary receives from a qualified plan[10] is in included in a decedent's gross estate, and is thus subjected to federal estate taxation. Although it implemented sound estate tax policy,[11] the repeal of the qualified plan exemption could also have broad, and almost certainly unforeseen, consequences. It could allow the Internal Revenue Service (the "Service") to aggregate benefits provided under qualified plans with benefits provided under non-qualified plans[12] and thus conclude that sur-

1(a)(1)(i) (1986). In addition, the employer may deduct the contributions when made. I.R.C. § 404(a)(1) (1986). Any income generated by the amounts contributed to the trust is not subject to federal income tax until distributed to the employees because the trust is a tax exempt entity. I.R.C. § 501(a) (1986). *See infra* note 45 and accompanying text.

5. *See supra* note 4.

6. H. R. Rep. No. 1337, 83d Cong., 2d Sess. 4067, *reprinted in* 1954 U.S. Code Cong. & Admin. News, 4017; *see also* Commerce Union Bank v. United States, 76-2 U.S. Tax Cas. (CCH) ¶ 13,157, at 85,705-07 (M.D. Tenn. 1976).

7. Pub. L. No. 97-248, § 245(b), 96 Stat. 524 (1982).

8. Pub. L. No. 98-369, § 525(a), 98 Stat. 873 (1984) [hereinafter the Deficit Reduction Act of 1984, "DEFRA"], repealed the qualified plan exemption. DEFRA substituted a new section 2039(c) which exempted a spouse's interest in a qualified pension or profit sharing plan from estate taxation in that spouse's gross estate when the interest arose by reason of the community property laws of a state. I.R.C. § 2039(c) (1986). Section 1852(e)(i) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986), [hereinafter "TRA 1986"] repealed this provision in its entirety, effective for decedents dying after the date of enactment, October 22, 1986.

9. Unless otherwise stated all section references are to the Internal Revenue Code of 1986. References to prior versions of a section will be indicated by a parenthetical reference to the year during which the prior version in question was in effect.

10. The repeal of § 2039(c) actually resulted in the inclusion in a decedent's gross estate of other survivor benefits in addition to benefits payable under qualified pension or profit sharing plans because § 2039(c) had also excluded benefits payable under § 403(a) plans and benefits payable by § 170(b)(1)(A)(ii) or (vi) charitable organizations or by religious organizations that were exempt from tax under § 501(a) as well as military benefits payable under Chapter 73 of Title 10 of the United States Code (10 U.S.C. § 1431 (1982)). *See infra* notes 58-60.

11. Sound estate tax policy requires that all wealth which passes at death be subject to the tax. Section 2039(c) exempted certain qualified plan proceeds from taxation even though those proceeds represented wealth that passed at death. The exemption was based on the source of the wealth. Sound estate tax policy requires that the transfer of wealth, not its source, determine the incidence of taxation. *See infra* note 49.

12. Non-qualified plans are deferred compensation plans which do not meet the requirements of § 401(a). To succeed in deferring income taxation of the amounts contributed to any such plan on behalf of an employee, the plan must be structured so as

vivor benefits provided under both types of plans should be included in a decedent's gross estate. The Service could reach this result by applying an aggregation rule sanctioned by the Regulations[13] and the courts.[14] The Service could therefore use the repeal of the qualified plan exemption as a means to subject to federal estate taxation many non-qualified survivor benefits[15] which it has found difficult to subject to such taxation in the past.[16]

This Article examines the appropriate scope of the aggregation rule and formulates a test for determining its application. Because it is impossible to understand the aggregation rule without understanding section 2039, the Article begins by analyzing that section in Part I. It then sets forth the genesis and scope of the aggregation rule in Part II and discusses its application in Part III. Having analyzed the current state of the law, the Article then develops a two-pronged test for determining whether particular employee benefits should be aggregated for purposes of section 2039. Part IV of the Article describes that test.

Application of the test reveals that qualified and non-qualified plans should not be aggregated for purposes of section 2039 because qualified plans are subject to such strict statutory constraints that they simply do not provide an opportunity for the abuse which the aggregation rule was designed to prevent. Part V therefore suggests that the Treasury's regulations and the Service's rulings should be revised and expanded to reflect a more analytically sound expression of the aggregation rule. Such action will clarify the law and prevent the Service from using the repeal of the qualified plan exemption to tax survivor benefits provided under non-qualified plans. It will ensure that estate taxation proceeds from a deliberate decision grounded in sound estate tax policy, not from inadvertence.

I. THE STATUTE

Faced with a case involving section 2039(c), Judge Raum of the Tax

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to avoid the application of normal principles of federal income taxation. *See infra* note 214. Thus, although non-qualified plans are spared the rigors of compliance with § 401(a), they are denied the benefits provided by §§ 402(a), 404(a)(1) and 501(a). *See supra* note 4.

13. Treas. Reg. § 20.2039-1(b)(2) (1986).

14. Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962); *see infra* note 132.

15. Non-qualified survivor benefits are benefits payable to an employee's survivors under a non-qualified plan.

16. The Service is apparently so determined to subject death benefits provided under non-qualified plans to transfer taxation that it has even taken the position that an employee makes a taxable gift by continuing to perform services for an employer which will provide death benefits to his survivors. Estate of DiMarco v. Commissioner, 87 T.C. 653 (1986). Although the Tax Court easily rebuffed this attempt, the Service's persistence suggests that it will use whatever tools are at its disposal to subject such benefits to tax. In the aggregation rule, the Service might find the perfect tool for that purpose. *See infra* note 94.

Court wrote that he shared in the taxpayer's "indignation . . . about the complexity of the statutory provisions involved,"[17] and noted that "[i]t is virtually mindboggling to thread one's way through this maze."[18] Because Judge Raum's reaction to section 2039 is far from unique and because an understanding of the statute is essential to an understanding of the issue addressed in this Article, it will be useful to begin by understanding how the statute became so imponderable.

A. *Estate Taxation of Annuities Generally*

Section 2039(a) includes in a decedent's gross estate and thus subjects to federal estate taxation the value of any annuity or other payment which a decedent's survivors may receive.[19] Amounts payable to a survivor are taxable under section 2039 if they meet three requirements. First, the amounts must constitute an annuity or other payment — the post-death payment requirement.[20] Second, the payments must result from a contract or agreement — the contract requirement.[21] Third, the decedent must have had a right to receive the payments during his or her life — the lifetime payment requirement.[22]

When Congress enacted section 2039 in 1954, it intended to subject the value of the survivor benefits payable under the typical joint and survivor annuity to federal estate taxation.[23] Such survivor benefits represent wealth

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17. Estate of Rosenberg v. Commissioner, 86 T.C. 980, 984 (1986).

18. *Id.* at 987.

19. Section 2039 provides as follows:

SEC. 2039 ANNUITIES.

(a)GENERAL. — The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b)AMOUNT INCLUDIBLE. — Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension, annuity, retirement, bonus or profit sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

I.R.C. § 2039(a), (b) (1986).

20. I.R.C. § 2039(a) (1986).

21. *Id.*

22. *Id.*

23. H.R. REP. No. 1337, 83d Cong., 2d Sess. 90-91, A314-16 (1954), *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4117; S. REP. No. 1622, 83d Cong., 2d

which the decedent accumulated but which passes to the survivor upon the decedent's death.[24] Such wealth should be subject to estate taxation as if it had been a part of the decedent's probate estate.[25] Section 2039(a) ensures that it will be.

The three requirements of section 2039(a) are tailored to reflect the characteristics of the typical joint and survivor annuity.[26] Such an annuity would most commonly be evidenced by a contract, hence the contract requirement. The contract would typically provide that the individual would receive payments of a specific amount for his or her life, hence the lifetime payment requirement. The contract would also provide that at the individual's death, the payments would either continue for the life of a named survivor or be payable

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Sess. 123-24, 469-72 (1954), *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4756-57; H.R. REP. NO. 2543 (Conference Report), 83d Cong., 2d Sess. 74 (1954), *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 5335-36; *see* Bittker, *Estate and Gift Taxation Under the 1954 Code: The Principal Changes*, 29 TUL. L. REV. 453, 469 (1955); Colliton, *Conforming Section 2039 to the Goals of Estate Tax*, 34 U. FLA. L. REV. 693, 695-96 (1982).

24. By purchasing a joint and survivor annuity, rather than a single life annuity, the decedent in effect transfers funds to the holder of the annuity in return for such holder's promise to pay a certain amount to a survivor. Economics prove that this is so. Thus, a joint and survivor annuity typically costs more than a single life annuity. For example, if the primary annuitant is 45 years old at the time of purchase, each $100 of monthly benefit for a single-life annuity with benefits which begin at age 60, would cost $154.98. The same benefit under a joint and survivor contract, assuming both parties are the same age at the time of purchase, would cost $163.74. (Figures derived from telephone conversation with a representative of a national insurer on June 23, 1987; information on file with author). The additional amount paid for the survivor annuity, plus earnings thereon, represents wealth accumulated by the decedent and transferred to the survivor.

25. All property in which a decedent had an interest at the time of death is included in his or her gross estate. I.R.C. § 2033 (1986). Property which forms a part of the probate estate will almost certainly meet that requirement. Indeed, in 1926 Congress found it necessary to broaden the language of the predecessor of § 2033 to ensure that property which passed outside the probate estate would nevertheless form part of the decedent's gross estate for federal estate tax purposes. Revenue Act of 1926, Pub. L. No. 20, § 302(a), 44 Stat. 70 (1926).

26. Joint and survivor annuities take many different forms, as the insurance industry responds to the needs of the market and the public. Because the terms of the annuity are a matter of contract between the insurer and the holder of the policy, the specific terms of the policies can vary greatly. The terms of the joint and survivor annuity described here reflect the essential elements of the joint and survivor annuity: payments to a primary beneficiary for life with payments continuing for the life of a survivor. This is the model that Congress had before it when it enacted § 2039. *See* S. REP. NO. 1622, 83d Cong., 2d Sess. 469-70 (1954). The variations which the insurance industry has developed, such as joint and survivor annuities for a term certain, share this basic characteristic. *See supra* note 24. Therefore, this Article will refer to annuities which provide for payments for the life of a primary beneficiary and a survivor as typical joint and survivor annuities. For a brief discussion of various forms and types of commercial annuities and alternatives to such annuities, see Lefrak, *When to Use Private Annuities*, N.Y.U. FORTIETH ANNUAL INST. ON FED. TAX'N 2-1 (1982).

to the survivor in a lump sum, hence the post-death payment requirement.

B. *Taxation of Survivor Annuities Prior to the 1954 Code*

Neither the Internal Revenue Code of 1939 nor any of its predecessors contained any provision that specifically included the value of survivor benefits payable under a joint and survivor annuity in the gross estate.[27] The Service therefore had to use the more general provisions of the Code to tax such annuities.[28] Although the Service usually succeeded in doing so, its theories varied from case to case.[29] The cases do not reveal whether the Service also attempted to reach survivor's annuities paid by what were then called "employee's trusts," the forerunners of today's qualified plans, but no published announcement of an exemption for such annuities exists.[30]

The general confusion over the scope of the more general provisions of the estate tax and the courts' unwillingness to extend the reach of those provisions during this period led to much uncertainty.[31] In the Internal Revenue Code of 1954 Congress attempted to resolve that uncertainty by adding section 2039.[32]

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27. *See* Joseph, *The Estate Tax Impact on Survivor Annuities; How Far Can Section 2039 Reach?*, 25 J. TAX'N 214 (1966); Murphy, *Federal Tax Treatment of Annuities*, 16 U. PITT. L. REV. 311, 320 (1955). It has even been noted that annuities "had no real home in the gross estate provisions which could be called their own" until 1954. J. MERTENS, LAW OF FEDERAL ESTATE & GIFT TAXATION 399 (1958).

28. In some cases the value of the survivor annuity was included under the predecessor of section 2036. Mearkle's Estate v. Commissioner, 129 F.2d 386 (3d Cir. 1942); Commissioner v. Clise, 122 F.2d 998 (9th Cir. 1941), *cert. denied*, 315 U.S. 821 (1942). In others, it was included as a transfer which was intended to take effect at death under the predecessor of section 2038.

29. *See supra* note 28.

30. Employee's trusts are trusts which would qualify under § 401(a).

31. The development of some of the more specialized estate tax provisions, such as §§ 2036 (transfers with retained life estates), 2037 (transfers taking effect at death), 2038 (revocable transfers), 2041 (powers of appointment) and even 2042 (life insurance), shows that historically the courts have been reluctant to extend the reach of § 2033, the "catch all" estate tax provision, to items which might not literally and technically fall within its terms. Taxpayers' success in avoiding the estate tax through artful structuring of their affairs caused Congress to respond by enacting specific provisions designed to curb specific types of perceived abuses. For a discussion of the taxpayer action — government reaction pattern that resulted in the evolution of some of the foregoing provisions, see Bittker, *The Church and Spiegel Cases: Section 811(c) Gets a New Lease on Life*, 58 YALE L.J. 825 (1949); Bittker, *Church and Spiegel: The Legislative Sequel*, 59 YALE L.J. 395 (1950); Eisenstien, *The Hallock Problem: A Case Study in Administration*, 58 HARV. L. REV. 1141 (1945); Spencer, *The Federal Estate Tax on Inter Vivos Trusts: A Common Sense Rule for Hallock Cases*, 59 HARV. L. REV. 43 (1945); Surrey & Aronson, *Inter Vivos Transfers and the Federal Estate Tax*, 32 COLUM. L. REV. 1332 (1932).

32. H.R. REP. NO. 1337, 83d Cong., 2d Sess. 90-91, A314-16, *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4019, 4117, 4457-59; S. REP. NO. 1622, 83d Cong., 2d Sess. 123-24, 469-72, *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4623, 4756-57, 5113-16.

C. *Section 2039, The Statutory Model*

1. Policy Considerations

The addition of section 2039 resolved the uncertainty over the inclusion of a joint and survivor annuity in a decedent's gross estate. This uncertainty had been particularly troublesome because of the disparity it created in the treatment of unconsumed single life annuities and joint and survivor annuities.[33]

33. I.R.C. §§ 2031, 2033 (1986); Treas. Reg. §§ 20.2031-1, 20.2033-1 (1986); *see* Connecticut Bank & Trust Co. v. United States, 465 F.2d 760 (2d Cir. 1972); Greene v. United States, 171 F. Supp. 459 (Ct. Cl. 1959); Estate of Gamble v. Commissioner, 69 T.C. 942 (1978). The need to have estate tax parity between the unconsumed single life annuity and the joint and survivor annuity exists regardless of whether the decedent purchases the annuity of his or her own accord or receives it as a benefit from his employer. If an individual receives a single life annuity from an employer, the only portion of the payments which would be included in his or her gross estate would be the portion which the individual had received but not consumed during life. The single life annuity is then like the individual's salary. It is part of the compensation received from the employer for services rendered; it ceases at death and, like salary, it should be subject to the federal estate tax only to the extent that it is not consumed during life. If, instead of a single life annuity, an individual's employer uses the same amount to purchase a joint and survivor annuity which provides for lower payments during the employee's life but which provides that payments continue for the life of a designated survivor, the result should not differ. As in the case of the single life annuity, the joint and survivor annuity is like an individual's salary. It is part of the compensation for services rendered. Like the unconsumed portion of the single life annuity, the survivor portion of the employer provided joint and survivor annuity is also compensation to the employee for services rendered. Since, by hypothesis, the survivor portion was not consumed during the employee's life but passes to the survivor, it should be subject to the estate tax in the same way that unconsumed salary would have been. Section 2039 was designed to ensure that it will be.

To illustrate, if A's employer provided her with an annuity of $1000 per week for life and A actually received the annuity for 10 years (a total of $520,000), the only portion of those payments that would be included in A's gross estate would be the portion, if any, that A had not consumed as of the time of her death. If only $104,000, or 20 percent, of the total remained in A's bank account at her death and was bequeathed to her husband, then only $104,000 of the total would be included in A's gross estate under § 2033.

If instead of giving her a $1000 per week single life annuity, A's employer had given her a joint and survivor annuity pursuant to which she would only receive $800 per week during her life but her husband would begin to receive payments of $500 per week at her death, the present value of which was $104,000 at the time of her death, the federal estate tax consequences should not differ. Nevertheless, § 2033 might have allowed the $104,000 value of the husband's annuity in the second case to escape estate taxation. *See supra* note 31. In both the unconsumed single life and the joint and survivor annuity cases the $104,000 which A in effect earned during her life passed to her husband and should be included in A's gross estate.

To the extent that the joint and survivor annuity was provided by A's employer, its cost represents compensation for services rendered. If A's employer spends $1000 to purchase an annuity for A, that $1000 is compensation to her in the same way as if A's employer had paid A $1000 which A then used to purchase an annuity for herself. For federal income tax purposes the $1000 would be income in either case unless the annu-

An individual who had single life annuity but did not consume all of the amounts received would face certain inclusion of those amounts in his or her gross estate.[34] By contrast, an individual who used those otherwise unconsumed amounts to purchase a survivor annuity (or who initially purchased a joint and survivor annuity rather than a single life annuity) might be able to avoid estate taxation of the survivor benefits.[35]

2. Statutory Requirements and Judicial Construction

Although Congress could have chosen to tax only the prototypical joint and survivor annuity under section 2039, it did not do so.[36] Instead, Congress chose to cast its net widely to include in a decedent's gross estate the value of any

> annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement . . . if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death."[37]

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ity was purchased through the employer's contribution to a qualified plan. *See* I.R.C. § 403(c) (1986).

34. *See supra* note 33.

35. The potential disparity existed regardless of whether the individual purchased the annuity with his or her own capital or received it as an additional benefit from his or her employer.

36. It is possible to craft a statutory provision that defines a joint and survivor annuity narrowly. In the Retirement Equity Act of 1984, Pub. L. No. 98-397, 98 Stat. 1426 (1984) [hereinafter "REACT"], Congress did just that. REACT amended section 401(a)(11) to require that qualified plans provide retirement benefits in the form of a "qualified joint and survivor annuity" unless the plan participant and his or her spouse waived their right to such an annuity. I.R.C.. §§ 401(a)(11), 417 (1986). REACT also added § 417 to the Code. Section 417(b) defines the term "qualified joint and survivor annuity" as an annuity:

> (1) for the life of the participant [in the qualified plan] with a survivor annuity for the life of the spouse which is not less than 50 percent of (and is not greater than 100 percent of) the amount of the annuity which is payable during the joint lives of the participant and the spouse, and (2) which is the actuarial equivalent of a single annuity for the life of the participant.

I.R.C. § 417(b) (1986). Such term also includes any annuity having the effect of an annuity described in the preceding sentence. The § 417(b) definition is not materially different from the definitions contained in § 401(a)(11)(G)(iii) prior to REACT. A definition like the § 417(b) definition could have been used in § 2039 if Congress had chosen to include only the value of survivor's benefits under the prototypical joint and survivor annuity in a decedent's gross estate. Congress would only have needed to eliminate the 50 percent requirement of § 417(b)(1). While such a requirement is desirable in a provision like § 417(b), which in effect sets forth the minimum benefit that a qualified plan must provide, its inclusion in a provision like § 2039 would make avoidance too simple.

37. I.R.C. § 2039(a) (1986). For a comprehensive analysis of § 2039, see

Although the requirements of section 2039(a) reflect the structure of the typical joint and survivor annuity, the courts have not limited application of the provision to such annuities. For example, the words "or other payment", which Congress probably inserted after the work "annuity" solely to prevent avoidance by creative taxpayers,[38] have served to broaden the reach of the provision. Courts and the Service have treated any death benefit payment made to a survivor as an "other payment," even if the payment was made in a lump sum without regard to life expectancy and thus bore little resemblance to payments under the prototypical joint and survivor annuity.[39] Under this approach even pure death benefits easily fulfill the post-death payment requirement.[40]

Pure death benefits also fulfill the contract requirement. Although the statute requires that the annuity or other payment be payable under a "contract or agreement," the Service and the courts have had little trouble finding that a contract or agreement existed between an employer and employee.[41] In

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Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341; Note, *Estate Taxation of Employee Death Benefits*, 66 YALE L.J. 1217 (1957).

38. If § 2039 applied only to annuities but not to "other payments," an individual could avoid the provision by receiving a lump sum instead of an annuity. Alternatively, in the absence of a statutory definition of the term "annuity," an individual could arrange for a series of payments which do not depend on life expectancy and might arguably not constitute an annuity. Since such an arrangement would have the same effect as an annuity insofar as it would represent a transfer of wealth from the living to the dead, it should also be subject to the federal estate tax. The addition of the words "or other payment" in § 2039 ensure that it will be.

39. *See, e.g.*, Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962).

40. Throughout this Article, the term "pure death benefit" will be used to refer to death benefits provided under plans which do not provide for any payments whatsoever except upon an individual's death. The term was coined by Dean Wolk in Wolk, *The Pure Death Benefit: An Estate and Gift Tax Anomaly*, 66 MINN. L. REV. 229 (1982), an excellent article urging inclusion of such benefits in the gross estate. *See infra* note 44.

41. Treas. Reg. § 20.2039-1(b)(1) defines the term "contract or agreement" to include "any arrangement, understanding or plan, or any combination of arrangements, understandings or plans arising by reason of the decedent's employment." Although the regulations appear to require that the employee have the right to enforce the terms of a plan unilaterally adopted by the employer, they also appear to conclude that under some circumstances the employer's past practice will suffice. Treas. Reg. § 20.2039-1(b)(2), example 4 (1986). In example 4 the Treasury posits a situation where the employers' plan provided for payments to the employee and a designated beneficiary if the employee retired at age 60. If the employee died before retiring at age 60 and the employer nevertheless paid an annuity to his survivor, the example concludes that no contract or agreement existed because the employee possessed no enforceable right to receive benefits. The Treasury notes, however, that if it could be established that the employer had "consistently paid an annuity under such circumstances, the annuity will be considered as having been paid under a 'contract or agreement.'" Treas. Reg. § 20.2039-1(b)(2), example 4 (1986). Although the courts have not always interpreted this last provision as broadly as the Service might like (*see, e.g.*, Estate of Barr v. Commissioner, 40 T.C. 227 (1963), *acq. in result*, 1964-1 C.B. 4; Courtney v. United States, 54 A.F.T.R.2d 6492, 84-2 U.S. Tax Cas. (CCH) § 13,580 (N.D. Ohio 1984)),

some cases, the employment relationship itself has sufficed to fulfill this requirement.[42] The courts find the contract requirement unmet only where the employer makes a payment which neither a written agreement nor the employer's prior practice gives the beneficiary any right to expect.[43]

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its very existence allows the Service to try to sweep into the gross estate under § 2039 death benefits paid pursuant to the employer's custom or practice even when the employer has no contractual obligation to make them.

Where the employee had enforceable rights the courts have had little trouble finding a contract or agreement. Thus, the Tax Court has concluded that the need for a committee to determine whether a qualified beneficiary existed did not prevent the plan which so required from constituting a contract or agreement for purposes of § 2039. Estate of Beal v. Commissioner, 47 T.C. 269 (1966). In Gray v. United States, 410 F.2d 1094 (3d Cir. 1969), the value of benefits payable under a survivorship plan was included in the employee's gross estate even though the estate had argued that there was no contract or agreement between the employer and the beneficiary. The court found it unnecessary to determine whether § 2039 created a federal contract relationship because it found that the beneficiary could enforce the contract as a third party beneficiary under contract principles defined by reference to state law. *Id.* at 1106.

In some cases courts have found the contract requirement satisfied even though no contract existed. In Neely v. United States, 613 F.2d 802 (Ct. Cl. 1980), the court held that a contract or agreement existed for purposes of § 2039 because the board of directors of the decedent's employer, a corporation in which the decedent owned 50 percent of the stock, had voted to award him a pension which would provide survivor benefits to his widow. The court was not persuaded by the estate's argument that no enforceable contract existed. *Id.* at 808. It concluded that holding otherwise would allow closely held corporations to avoid § 2039. *Id.*

The tax court and one district court have placed the only existing constraint upon the definition of the term "contract or agreement" for purposes of § 2039. In Estate of Barr v. Commissioner, 40 T.C. 227 (1963), *acq. in result*, 1964-1 C.B. 4, the court refused to find a contract or agreement where the employer had a plan under which it had the option of paying an amount to an employee's survivors. The court found that the employer's practice of making such a payment did not suffice to make the plan an enforceable contract or agreement. *Id.* at 235-36. The court distinguished the situation posed in Treas. Reg. § 20.2039-1(b)(2), example 4, *supra*, because in *Barr*, it had found no enforceable agreement at all. *Barr,* 40 T.C. at 235-36. In Courtney v. United States, 54 A.F.T.R.2d 6492, 84-2 U.S. Tax Cas. (CCH) § 13,580 (N.D. Ohio 1984), the court reached a similar conclusion.

42. Treas. Reg. § 20.2039-1(b)(1)(ii) (1986), quoted *supra*, note 41, is certainly broad enough to allow such a reading. *See, e.g.,* Estate of Bahen v. United States, 305 F.2d 827, 831-32 (Ct. Cl. 1962). The *Bahen* court concluded that "[a] compensation plan unilaterally adopted by the employer, but made irrevocable and communicated to the employee, falls directly within [the definition of contract or agreement], at least where the employee continues in the company's service after adoption of the plan." *Id.* at 830.

43. *See, e.g.,* Courtney v. United States, 54 A.F.T.R.2d 6492, 84-2 U.S. Tax Cas. (CCH) § 13,580 (N.D. Ohio 1984) (company's promise to pay beneficiary's annuity made in recognition of decedent's past services was not in substance or fact an enforceable contract; widow had no power to compel payment, nor had company consistently paid annuities under the plan in the past); Estate of Barr v. Commissioner, 40 T.C. 227 (1963) (although employer consistently paid annuity benefits to beneficiaries, even where employees did not live long enough to qualify for those benefits, the court found no enforceable contract or agreement). *But see* Neely v. United States, 613 F.2d

The courts' willingness to construe both the payment and the contract requirements so broadly would have made section 2039 applicable to all pure death benefits if not for the lifetime payment requirement also contained in section 2039(a).[44] This requirement should have ensured that section 2039 would apply only to arrangements that had the salient characteristic of a joint and survivor annuity: payments that are made during the life of one individual continue to be made to another individual after the first individual's death. A lump sum payment made by an employer to an employee's survivors under an agreement which did not give the employee any right to lifetime payments does not possess this characteristic, and therefore should not be included in the employee's gross estate under section 2039.[45]

Nevertheless, the Service's use of the aggregation rule to satisfy the lifetime payment requirement and the courts' unwillingness to place significant bounds on that use have caused pure death benefits to be included in the gross estates of employees.[46] This has resulted in the need to examine the extent to which the repeal of the qualified plan exclusion will give rise to new attempts to include pure death benefits in a decedent's gross estate under section 2039.

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802 (Ct. Cl. 1980) (because the surviving beneficiary held a controlling interest in the company the court found an agreement to pay annuity benefits under an "arrangement, understanding or plan" as contemplated by Treas. Reg. § 20.2039-1(b)(1)(ii)). *See also supra* note 41.

44. Some commentators have suggested that pure death benefits should be included in the gross estate. *See* Wolk, *supra* note 40, at 230 (concluding that § 2038 can be applied to include pure death benefits in the gross estate despite the courts' reluctance to do so; also suggesting gift taxation of such benefits as an alternative to estate taxation); and Colliton, *Conforming Section 2039 to the Goals of Estate Tax*, 34 U. FLA. L. REV. 693 (1982) (suggesting that the lifetime payment requirement is inconsistent with the policies of estate taxation and leads unnecessarily to inconsistent conclusions). While such suggestions have strong policy justifications, as both Dean Wolk and Professor Colliton point out, the broader issue they address is beyond the scope of this article. The article seeks to develop a foundation for the sound application of the aggregation rule given § 2039 as it currently exists. The author believes that if the reach of § 2039 is to be broadened, Congress, not the Service or the courts, should do so.

45. The manner in which the Service and the courts have construed the lifetime payment requirement so as to make § 2039 applicable to survivor's benefits paid under plans which provided for no payments to the employee is discussed in the text accompanying notes 98-108. That is not the type of payment Congress sought to include in the gross estate by enacting § 2039. *See supra* text accompanying notes 19-23.

46. The leading example of this appears in Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962). In that case the Service used the decedent's rights to receive payments under his employer's Sickness and Accident Plan to satisfy the lifetime payment requirement of § 2039(a). By aggregating the Sickness and Accident Plan with a different and separate Survivor's Benefit Plan that provided exclusively for payments to survivors, the Service succeeded in taxing a pure death benefit payment which the employer had made to the decedent's widow under the latter plan.

3. The Qualified Plan Exclusion

a. Origin

From the time it was first introduced section 2039 excluded annuities payable under qualified plans from the gross estate.[47] Although the legislative history of section 2039 does not set forth the reason for the qualified plan exclusion, the exclusion probably reflected a Congressional desire to give qualified plans tax favored status to encourage their formation.[48] Indeed, there seems to be no other compelling reason for the exclusion. First, the policies implemented by the federal estate tax do not require that the source of wealth determine taxation at death.[49] Second, the status of a plan as qualified derives

47. I.R.C. § 2039(c) (1954). H.R. REP. No. 8300, 83d Cong., 2d Sess.; H.R. REP. No. 1337, 83d Cong., 2d Sess. 90-91, *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4017. Technically, § 2039(c) excluded payments received under qualified plans not only from the coverage of § 2039 but from the estate tax provisions generally. Prior to amendment by the 1984 Act, § 2039(c) provided that "notwithstanding the provisions of this section *or of any provision of law*, there shall be excluded from the gross estate the value of an annuity or other payment. . . ." I.R.C. § 2039(c) (1979) (emphasis added). Thus, even though an annuity or other payment which escapes inclusion in the gross estate under § 2039(a) can still be included if it meets the requirements of another section (*see, e.g.*, Estate of Barr, 40 T.C. 227 (1963) (inclusion sought under §§ 2033 or 2039)), § 2039(c) exempted qualified plan annuities from inclusion in the gross estate under any provision whatsoever. *Cf.* Estate of Perl v. Commissioner, 76 T.C. 861, 863-66 (1981) (value of an insurance policy would have been excluded from the decedent's gross estate if the court had been able to conclude that it was provided under a pension plan).

48. Although H.R. REP. No. 1337, 83d Cong., 2d Sess. (1954), *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 4025, 4067 notes that "[t]he bill continues the present policy of granting tax advantages to encourage the growth of qualified pension, profit-sharing and stock bonus plans. . . ," it does so in a general context, not in the context of § 2039 and the estate taxation of distributions from such plans. *See supra* note 6 and accompanying text.

49. The estate tax was designed to prevent large accumulations of wealth. New York Trust Co. v. Eisner, 256 U.S. 345 (1921); Knowlton v. Moore, 178 U.S. 41, 55-56 (1900). The reasons for embracing such a policy were eloquently detailed by President Franklin D. Roosevelt in a speech which shortly preceded the enactment of the Revenue Act of 1935, Pub. L. No. 407, 49 Stat. 1014 (1935), which imposed estate taxes at rates up to 70 percent. In that 1935 speech, the President said:

> The desire to provide security for one's self and one's family is natural and wholesome, but it is adequately served by a reasonable inheritance. Great accumulations cannot be justified on the basis of personal and family security. In the last analyses such accumulations amount to the perpetuation of great and undesirable concentrations of control in a relatively few individuals over the employment and welfare of many, many others. Such inherited power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our government.

Address by Franklin D. Roosevelt, *excerpted in* SURREY, MCDANIEL & GUTMAN, FEDERAL WEALTH TRANSFER TAXATION 5-6 (succ. ed. 1987). President Roosevelt's beliefs echoed those of Andrew Carnegie and Theodore Roosevelt. *See* Andrew Carnegie, The Gospel of Wealth, *reprinted in* A. CARNEGIE, THE GOSPEL OF WEALTH AND OTHER from the federal income tax law and need not have relevance to the estate taxation of the proceeds received from the plan.[50]

Nevertheless, Congress apparently reasoned that qualified plans would be more attractive if such plans offered estate tax as well as income tax advantages. The qualified plan exclusion encouraged employers to establish qualified plans and encouraged employees to elect lifetime distribution in the form of a joint and survivor annuity.[51]

TIMELY ESSAYS (1933); speech of Theodore Roosevelt, April 14, 1906, and Presidential message of December 3, 1906, *reprinted in* 10 MESSAGES AND PAPERS OF THE PRESIDENTS 7042 (Richardson ed. 1911). For a history of the federal estate tax, see Casner, *American Law Institute Federal Estate and Gift Tax Project*, 22 TAX L. REV. 515, 518-32 (1967); Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223 (1956); R. PAUL, FEDERAL ESTATE AND GIFT TAXATION (1942); A. TAIT, THE TAXATION OF PERSONAL WEALTH (1967).

50. It is well established that although the estate and gift taxes should be construed *in pari materia* (Merrill v. Fahs, 324 U.S. 308, 311 (1945); Estate of Sanford v. Commissioner, 308 U.S. 39, 44 (1939)), the income and estate taxes need not be construed *in pari materia.* Farid-es-Sultaneh v. Commissioner, 160 F.2d 812, 814-15 (2d Cir. 1947). As the *Farid* court recognized, the estate and gift tax provisions do not implement the same policies and do not have the same objectives as the income tax provisions. *Id.* It follows that they need not be construed the same way.

In the case of qualified plans, the factors that required special income tax treatment do not require special estate tax treatment. Absent a provision like § 402(a), pursuant to which an employee is taxed only when he or she actually receives a distribution from a qualified plan, employees would be taxed when an employer made a contribution on his or her behalf, as the doctrine of constructive receipt and § 83 would require, particularly if the contribution were non-forfeitable. The prospect of facing taxation on income which the employee has not received and probably would not receive for many years would make employer provided pension plans terminally unattractive to many employees. To make them attractive, Congress had to modify the normal tax rules.

The problem that required special provisions in the income tax does not exist in the case of the estate tax. Including qualified plan proceeds in an employee's gross estate does not cause undue hardship because death will occasion a distribution of the proceeds and the estate will therefore have the funds with which to pay the tax. Thus, the policies which required favored income tax treatment of qualified plans do not require favored estate tax treatment.

51. The tax benefits attendant to qualified plans and to distributions from such plans would make employers who offer them more attractive to employees than employers who do not offer them. An employee whose employer does not or could not establish a qualified plan but pays the amounts as salary would not only face current income taxation of the amounts received but also estate taxation of any amounts unconsumed at his or her death. I.R.C. §§ 61, 2033 (1986). If the employer contributes the amounts to a qualified plan but the employee received a lump sum distribution upon retirement, the employee would avoid current income taxation but would face estate taxation of amounts unconsumed at his or her death. I.R.C. §§ 402(a), 2033 (1986). By contrast, if the employer makes contributions to a qualified plan and the employee receives a joint and survivor annuity upon retirement, the employee would avoid both current income taxation of the amounts and estate taxation of the survivor annuity. I.R.C. §§ 402(a), 2039(c) (1984). Any employee contributions to such a plan would enjoy favorable income tax treatment but would nevertheless be subject to the

The exclusion thus implemented three desirable policies. First, it encouraged the establishment of qualified plans by making them more attractive because they offered an estate tax advantage that non-qualified plans did not.[52] The exclusion thus ensured that the income and estate taxes would act in unison to encourage the formation of retirement plans. Second, it encouraged employees to elect to receive lifetime distributions from a qualified plan in the form of a joint and survivor annuity. The existence of the qualified plan exclusion meant that the survivor portion of such an annuity would escape estate taxation whereas the same total amounts, if paid to the employee and left unconsumed at his or her death, would not.[53] Third, it ensured that surviving spouses would receive the full amount of the qualified plan death benefit accrued by an individual during his or her life, undiminished by the estate tax. In an era of low estate tax exemption amounts and a limited marital deduction, this was an important consideration.[54]

Notwithstanding the range of policies served by providing an estate exemption for distributions from income tax favored plans, the exclusion provided by section 2039(c) as originally enacted did not extend to all such plans.[55] The exclusion provided by section 2039(c) initially covered only plans which satisfied the requirements of what are now sections 401(a) and 403(a).[56] Section 401(a) covers qualified pension, profit sharing and stock bonus plans while section 403(a) covers annuity plans.[57]

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estate tax.

52. *See supra* note 51.

53. *See supra* note 51.

54. Until 1976, no more than $60,000 would pass free of the estate tax. I.R.C. § 2052 (1976). No more than $30,000 could pass free of the gift tax, I.R.C. § 2521 (1976) except to the extent covered by the present interest exclusion. I.R.C. § 2503 (1976). In 1976, when Congress replaced the section 2052 and 2521 exemptions with the unified credit (I.R.C. §§ 2010, 2505) no more than $120,666 could pass free of the transfer taxes. I.R.C. §§ 2010, 2505, 2602(c) (1977). This amount rose to $175,625 in 1981. I.R.C. §§ 2010, 2505, 2602(c) (1981). In that year, Congress amended § 2010 to increase the unified credit so that by 1988, it would reach $162,800 (I.R.C. §§ 2010, 2505), the equivalent of a $600,000 estate and gift exemption. Generation skipping transfers are subject to a separate rate structure which provides generally for a $1,000,000 lifetime exemption. I.R.C. § 2602 (1986).

As the foregoing illustrates, it was not until 1981 that the amounts which could pass free of transfer taxes rose significantly. It is therefore not surprising that only after 1981 did Congress begin significant erosion of the benefits provided by § 2039(c). *See infra* text accompanying notes 66-67. Indeed, the substantial increase in the transfer tax exemption equivalent and the advent of the unlimited marital deduction in 1981 may have made the repeal of the qualified plan exemption possible. *See infra* text accompanying notes 72-75.

55. *See infra* discussion in text accompanying notes 111-24.

56. As originally enacted, § 2039(c) referred to retirement annuities which met the requirements of § 401(a)(3), but this cross reference was changed in 1962 to reflect the amendment of §§ 401(a) and 403(a). Pub. L. No. 87-792, § 7(i) (1962). The change was merely a technical one and did not affect the substantive coverage of § 2039(c). S. REP. No. 992, 87th Cong., 1st Session 55 (1961).

57. I.R.C. §§ 401(a), 403(a) (1986). Although §§ 401(a) and 403(a) plans differ

b. Expansion

It was not long before Congress expanded the scope of the exemption provided by section 2039(c). Apparently realizing that the income tax also gave favored treatment to some employee retirement benefits which were not provided under section 401(a) and 403(a) plans, Congress quickly began to add to the list of survivor benefits that would not be subject to federal estate taxation by reason of section 2039(c). The first to be added, in 1958, were annuities purchased by certain tax-exempt charitable organizations.[58]

Congress again expanded the list of annuities covered by the section 2039(c) exclusion in 1966, when it added annuities provided by the United States government to certain members of the uniformed services.[59] With both the 1958 and 1966 amendments, Congress intended to round out the favored tax status of such annuities.[60]

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in the manner in which employers determine the amount of their contributions and in the amount of benefits payable to the participants, both bear the burden of complying with the non-discrimination rules of § 401(a)(4), the minimum participation standards of § 410, the minimum vesting standards of § 411 and the minimum funding standards of § 412. In addition, § 403(a) plans must also comply with most of the other provisions of § 401(a) itself. In return for compliance with all of these requirements the Code accords both types of plans favored income tax status. Thus, employers may deduct their contributions when made even though participants will not recognize any income on account of such contributions until they actually receive them. I.R.C. §§ 402(a), 404(a)(1) (1986). In addition, earnings on the amounts contributed to both types of plans are not subject to income tax until distributed to the participants. I.R.C. § 501(a) (1986).

58. Pub. L. No. 85-866, § 23(e), 72 Stat. 1622-23 (1958). The addition of these annuities to the list of annuities covered by the § 2039(c) exclusion shows that the exclusion itself arose from a desire to encourage employers to provide retirement benefits to most of their employees. The legislative history of the 1958 amendments that expanded § 2039 makes it clear that the primary aim of those amendments was to subject charitable tax-exempt organizations to rules similar to the non-discrimination rules which already applied to § 401(a) and 403(a) plans. *See* S. REP. No. 1983, 85th Cong., 2d Sess. 91, 228, *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 4791, 4824, 4827. In return for making a tax-exempt organization's plans comply with these rules, Congress thought it only fair to extend to them the same favorable tax treatment already accorded § 401(a) and 403(a) plans. It therefore added such plans to the list covered by § 2039(c). Although annuities provided by charitable, educational or religious organizations had to comply with the non-discrimination rules in order to ensure that their employees received favorable income tax treatment, only annuities provided by educational institutions which maintained a faculty, curriculum and a regularly enrolled student body and publicly supported charitable organizations were subject to the § 2039(c) exclusion. The legislative history provides no rationale for the existence of this distinction. In addition to the § 2039(c) exclusion, Congress extended the § 101(b) $5,000 income tax death benefit exclusion and the § 2517 gift tax exclusion to such annuities.

59. Pub. L. No. 89-365, § 2(a), 80 Stat. 32, H.R. REP. No. 1118, 89th Cong., 1st Sess. 8 (1966); S. REP. No. 1004, 89th Cong., 2d Sess. 603, *reprinted in* 1966 U.S. CODE CONG. & ADMIN. NEWS 1918.

60. Without special legislation, plans benefiting members of the uniformed ser-

This pattern of extending the estate tax exclusion to annuities payable under plans which enjoyed favored status under the income tax provisions continued into 1976. In that year, as part of a major revision of the wealth transfer tax provisions, Congress added section 2039(e) to the Code. Section 2039(e) excluded from the gross estate any survivor annuities payable under the individual retirement account provisions of section 408 or the retirement bond provisions of section 409.[61] In 1976 Congress also amended section 2039(c) to cover survivor annuities payable under qualified self-employed plans (so-called Keogh or H.R. 10 plans).[62] Again, Congress felt that if the tax system was to encourage the establishment of retirement savings, all tax provisions should operate toward that end.[63]

c. Contraction

Ironically, it was also in 1976 that Congress began to erode the scope of the exclusion which 2039(c) had once provided. Believing that survivor benefits paid in a lump sum would generate sufficient cash to pay any estate tax attributable to their inclusion in a decedent's gross estate, Congress in 1976 made the section 2039(c) exclusion applicable only to benefits which either were not paid in a lump sum or, if paid in a lump sum, were paid to a beneficiary who elected to forgo the special 10-year averaging treatment then available under the income tax provisions.[64] In 1978, Congress further tightened this

vices could not have taken advantage of the favorable tax treatment afforded qualified plans. Although they complied with the non-discrimination rules, the uniformed services plans did not comply with the funding requirements applicable to qualified plans. *See* S. REP. No. 1004, *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 1918, 1920. Since compliance with the non-discrimination requirements is the cornerstone of qualification, it followed that like qualified plans, plans covering members of the uniformed services should receive the favorable tax treatment accorded other qualified, non-discriminatory plans. Congress therefore extended the same tax benefits to such plans as were available to other qualified plans. The 1966 amendments made benefits paid under uniformed services plans eligible for the § 101(b) $5,000 income tax death benefit exclusion as well as the § 2517 gift tax exclusion. I.R.C. §§ 101(b)(2), 2517 (1986). In addition, the 1966 amendments provided for other income tax advantages for service personnel and their beneficiaries. *See* I.R.C. §§ 72(o), 122(a) (1986).

61. Pub. L. No. 94-455, § 2009(c)(1), 90 Stat. 1894 (1976). In 1976 Congress attempted to integrate the estate and gift taxes by providing a single, unified rate structure and enacting the generation skipping tax. For an informative and comprehensive description of the changes wrought by the 1976 legislation, see Surrey, *Reflections on the Tax Reform Act of 1976*, 25 CLEV. ST. L. REV. 303 (1976).

62. Pub. L. No. 94-455, § 2009(c)(2), 90 Stat. 1894 (1976).

63. H.R. REP. No. 1380, 94th Cong., 2d Sess. 68, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 3356, 3422-23.

64. Pub. L. No. 94-455, § 2009(c)(3), 90 Stat. 1894 (1976), H.R. REP. No. 94-1380, 94th Cong., 2d Sess. 68, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 3356, 3422-23. This rationale for so limiting the availability of the § 2039(c) exclusion is of questionable validity. First, Congress had never indicated that it had enacted § 2039 out of a concern for the liquidity of an estate which might be subject to tax on the value of a survivor annuity. Indeed, to do so would have made no sense given that

restriction so that the section 2039(c) exclusion would not apply to lump sum distributions unless the beneficiary elected to forgo both 10-year averaging and the special capital gains treatment accorded distributions attributable to pre-1974 participation in a qualified plan.[65] Congress apparently attempted to balance the desire to raise revenue with the desire to encourage savings through qualified plans by making beneficiaries choose between favorable income tax treatment and favorable estate tax treatment.

Not until 1982, did Congress examine the merits of the section 2039(c) exclusion from an estate tax perspective. This examination led to the conclusion that the section 2039(c) exclusion was regressive and not a proper part of a transfer tax system.[66] Although it was unwilling to eliminate the exclusion altogether, in 1982 Congress limited the amount subject to the exclusion to $100,000.[67] However, the $100,000 limitation proved difficult to apply in prac-

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an annuity under a non-qualified plan did not enjoy the exclusion although it would encounter precisely the same type of liquidity problem, if any. Second, the Code already contained provisions designed specifically to deal with the liquidity problems caused by the estate taxation of amounts payable in the future. *See, e.g.*, I.R.C. §§ 6166, 6161, 6163 (1986). Third, the § 2039(c) exclusion applied only to a payment made to a beneficiary other than the executor. I.R.C. § 2039(c) (1984). Since any such beneficiary has only secondary liability for payment of the estate tax, I.R.C. § 6324(a) (1986), the theoretical existence of the cash with which to pay the tax in case of a lump sum distribution may have little practical significance for the estate, which has the primary liability for the payment of the tax. I.R.C. § 2002 (1986). Fourth, the § 2039(c) exclusion only applied to amounts attributable to employer contributions. I.R.C. § 2039(c) (1984). It did not apply to amounts attributable to employee contributions even though the same liquidity problems if any, faced both amounts. *Id.*

Congress appears to have been truly persuaded by the liquidity argument, however. The Conference on the 1976 legislation even used it to justify modifying the exclusion for individual retirement account annuities so as to permit the exclusion only where the schedule of payments would not provide funds with which the pay any resulting federal estate tax. I.R.C. § 2039(c) (1986); Statement of Managers for Amendment Numbered 35, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 4246, 4262.

65. Pub. L. No. 95-600, § 142(b), 92 Stat. 2796; Pub. L. No. 96-222, § 101(a)(8)(B), 94 Stat. 201 (1980); Pub. L. No. 97-448, § 103(c)(9)(B), 96 Stat. 2377 (1982). The Tax Reform Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, revised the entire structure of the lump sum distribution exception to the § 2039(c) exclusion by taking it out of § 2039(c) itself and putting it in a new subsection, (f). Changes made by Technical Corrections Acts passed after enactment of the 1978 Act completed this revision effective as if all of the changes had been made as part of the 1978 legislation. Pub. L. No. 96-222, 94 Stat. 201 (1978); Pub. L. No. 97-448, 96 Stat. 2377 (1978). The courts agree that the 1978 changes broadened the lump sum distribution exception to cover both lump sum distributions for which the beneficiary used the 10-year averaging provisions as well as those to which the special capital gain provisions applied. Estate of Rosenberg v. Commissioner, 86 T.C. 980 (1986); Giardina v. Commissioner, 85-1 U.S. Tax Cas. (CCH) § 13,600 (S.D.N.Y. 1984), *aff'd*, 776 F.2d 406 (2d Cir. 1985); Giardina v. United States, 80-2 U.S. Tax Cas. (CCH) § 13,383 (D. Md. 1980), *aff'd without published opinion*, 661 F.2d 921 (4th Cir. 1981).

66. *See supra* note 54.

67. Pub. L. No. 97-248, § 245(a), (b), 96 Stat. 524; I.R.C. § 2039(g) (1986); *see* JOINT COMMITTEE ON TAXATION, General Explanation of the Revenue Provisions of

tice. Among other things, it required an allocation in any case where the payments in question exceeded the excluded amount.[68]

d. Elimination

In 1984 Congress finally repealed the section 2039(c) exclusion.[69] The 1984 amendments to the Code repealed the section 2039(c) exclusion in all but a limited number of cases relevant only to individuals domiciled in community property states.[70] The exclusion was finally repealed in its entirety in 1986.[71]

Two factors contributed to the eventual repeal of the section 2039(c) exclusion. First, Congress reasoned that the exclusion had become unnecessary because in many cases the benefits in question would not be subject to the estate tax.[72] For example, even if amounts payable to a survivor under a qualified plan were included in the decedent's gross estate, the amounts would qualify for the unlimited marital deduction whenever a surviving spouse received them.[73] In such a case, no federal estate tax would actually be paid on the

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the Tax Equity and Fiscal Responsibility Act of 1982, at 285, 288 [hereinafter 1982 Blue Book]. This limitation also applied to annuities received under individual retirement accounts and self-employed plans. I.R.C. § 2039(g) (1986); Pub. L. No. 97-248, § 245(a), (b), 96 Stat. 524 (1982); 1982 Blue Book, *supra*, at 288.

68. The need for allocation would arise because of the $100,000 exclusion. The exclusion would have to be allocated among various distributions in every case where a decedent participated in various plans. *See* Fair, *Section 2039(g): The Death Knell for Death Tax Exclusion*, 8 J. OF PENSION PLAN. & COMPLIANCE 398 (1982); Frank, *Death Benefits Must be Reviewed in Light of $100,000 Exclusion Limitation Added by TEFRA*, 10 EST. PLAN. 2 (1983).

69. Pub. L. No. 98-369, § 525(a), 98 Stat. 873 (1984); *see* JOINT COMMITTEE ON TAXATION, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 824 [hereinafter 1984 Blue Book].

70. DEFRA repealed § 2039(c) as it had theretofore existed. *See supra* note 8. It replaced the previous § 2039(c) with a new § 2039(c), however. As it existed immediately after DEFRA, § 2039(c) provided for the exclusion which was previously contained in § 2039(d). This provision excluded from the gross estate of the spouse of an employee covered by a qualified plan, as well as § 403(a) plans and plans established by charitable organizations, the value of the interest which state community property laws might give such spouse in the employee's plan.

71. The technical corrections provisions of TRA 1986 repealed § 2039(c) in its entirety. Pub. L. No. 99-514, § 1852(e)(1)(A), 100 Stat. 2868 (1986). They also repealed the gift tax exemption provided by § 2517. Pub. L. No. 99-514, § 1852(e)(2)(A), 100 Stat. 2868 (1986); *see supra* note 8.

72. 1984 Blue Book, *supra* note 69, at 824.

73. I.R.C. § 2056 (1986). The qualified plan proceeds would not constitute a terminable interest in most cases because they would not pass to anyone else upon the death of the surviving spouse. I.R.C. § 2056(b)(1)(B) (1986). Even if the surviving spouse's interest were otherwise terminable, it might be subject to the exceptions provided by § 2056(b)(6) (life insurance or annuity payments with power of appointment in the surviving spouse), or § 2056(b)(7) (election for qualified terminable interest property). Of course, if the survivor beneficiary was not the spouse, the annuity would not qualify for the marital deduction.

employee's transfer of those amounts.[74] In addition, any estate tax generated by including such benefits in a decedent gross estate could be offset by the unified credit.[75] Thus, even if the benefits did not qualify for the marital deduction, only employees possessing substantial wealth would actually have to pay estate tax on them.

Second, Congress believed that the section 2039(c) exclusion was inappropriate because it was based on the source of the assets.[76] If the estate tax is to achieve its objective of preventing large accumulations of wealth, the source of the wealth ought to be irrelevant.[77]

Even though Congress did not consider the estate taxation of pure death benefits when it repealed the section 2039(c) exclusion, the Service could use that repeal to sweep such benefits into the estate tax base. The Service would do this by taking the position that qualified plans are now subject to aggregation.

II. THE AGGREGATION RULE

A. *Purpose*

The regulations promulgated under section 2039 adopt a broad interpretation of the post-death payment and contract requirements.[78] They also adopt

74. The estate tax marital deduction is not subject to any dollar limitation. I.R.C. § 2056(a) (1986). Any amounts transferred by the employee during his or her lifetime would be eligible for the gift tax marital deduction. I.R.C. § 2523 (1986). The gift tax marital deduction is not subject to any dollar limitation either. *Id.*

75. I.R.C. § 2010 (1986); 1984 Blue Book, *supra* note 69, at 824. The availability of the unified credit is not a persuasive reason for the elimination of any estate or gift tax exclusion because the unified credit is available for any estate tax liability regardless of the type of assets that generates it. Perhaps the reference to the unified credit simply indicates the regressive nature of the exclusion. Thus, the exclusion would be of greatest benefit to the wealthiest individuals who would be subject to tax at the highest rates if the amounts were included in the gross estate. The availability of the unified credit would avoid estate tax liability for qualified plan proceeds only for individuals with taxable estates of less than $600,000. I.R.C. §§ 2001(c), 2010 (1986).

76. 1984 Blue Book, *supra* note 69, at 824.

77. The repeal of the qualified plan exclusion does not imply that Congress no longer wishes to encourage the formation and funding of qualified plans. It only means that Congress has realized that estate and gift tax preferences are all highly regressive and not needed to encourage the formation and maintenance of such plans. *See supra* note 50, and text accompanying notes 66-67.

78. Treas. Reg. § 20.2039-1(b)(1) provides:

> The terms "annuity or other payment" as used with respect to both the decedent and the beneficiary has reference to one or more payments extending over any period of time. The payments may be over any period of time. The payments may be equal or unequal, conditional or unconditional, periodic or sporadic. The term "contract or agreement" includes any arrangement, understanding or plan, or any combination of arrangements, understandings or plans arising by reason of the decedent's employment.

Treas. Reg. § 20.2039-1(b)(1) (1976).

a broad interpretation of the lifetime payment requirement.[79] The text of the regulations suggests the aggregation rule by defining the term "contract or agreement" to include "any combination of arrangements, understandings or plans arising by reason of the decedent's employment."[80] The aggregation rule is clearly set out, however, in the often cited Example 6.[81]

Example 6 posits an employer which had established two plans.[82] The plans were established at different times and were administered separately in every respect. Neither plan was qualified under section 401(a). Under one plan, an employee was to receive a single life annuity upon retirement. Under the other plan the employee's designated beneficiary was to receive a single life annuity beginning at the employee's death. The example concludes that the employee's gross estate will include the value of the survivor's annuity because "all rights and benefits accruing to an employee and to others by reason of the employment . . . are considered together in determining whether or not section 2039(a) and (b) apply."[83] That is the aggregation rule.

The need for the aggregation rule is obvious. The two plans described in

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79. Treas. Reg. § 20.2039-1(b)(1) further provides:

> An annuity or other payment "was payable" to the decedent if, at the time of his death, the decedent was in fact receiving an annuity or other payment, whether or not he had an enforceable right to have the payments continued. The decedent "possessed the right to receive" an annuity or other payment if, immediately before his death, the decedent had an enforceable right to receive payments at some time in the future, whether or not, at the time of his death, he had a present right to receive payments. In connection with the preceding sentence, the decedent will be regarded as having had "an enforceable right to receive payments at some time in the future" so long as he had complied with his obligations under the contract or agreement up to the time of his death. For the meaning of the phrase "for his life for any period not ascertainable without reference to his death or for any period which does not in fact end before his death," see section 2036 and § 20.2036-1.

Treas. Reg. § 20.2039-1(b)(1) (1976).

80. Treas. Reg. § 20.2039-1(b)(2) example 6 (1976).

81. Treas. Reg. § 20.2039-1(b)(2) example 6 (1976).

82. Example 6 provides:

> The employer made contributions to two different funds set up under two different plans. One plan was to provide the employee upon his retirement at age 60, with an annuity for life, and the other plan was to provide the employee's designated beneficiary upon the employee's death, with a similar annuity for life. Each plan was established at a different time and each plan was administered separately in every respect. Neither plan at any time met the requirements of section 401(a) (relating to qualified plans). The value of the designated beneficiary's annuity is includible in the employee's gross estate. All rights and benefits accruing to an employee and to others by reason of the employment (except rights and benefits accruing under certain plans meeting the requirements of section 401(a) (see § 20.2039-2)) are considered together in determining whether or not section 2039(a) and (b) apply. The scope of section 2039(a) and (b) cannot be limited by indirection.

Treas. Reg. § 20.2039-1(b)(2) example 6 (1976).

83. Treas. Reg. § 20.2039-1(b)(2) example 6 (1976).

Example 6 have the same effect as a joint and survivor annuity and should be taxed accordingly.[84] The aggregation rule ensures that they will be.[85] The ag-

84. Without the aggregation rule, the benefits provided under both plans described in example 6 would have escaped inclusion in the employee's gross estate. The annuity under the first plan would not have been included in the employee's gross estate. A single life annuity, like any property in which a decedent has only a life interest, would not be included in the decedent's gross estate under this provision because the decedent's interest terminates with his or her death. *See, e.g.*, Estate of Stinchfield v. Commissioner, 4 T.C.M. 511 (1945), *rev'd on other grounds*, 161 F.2d 555 (9th Cir. 1947). Section 2039 would not have applied because there was no payment to a survivor under that plan.

The annuity under the second plan would probably not have been included in the employee's gross estate either. Because the decedent had no rights to receive any amounts under the second contract, it would be difficult to conclude that he or she had an interest in it which could be included in his or her gross estate under § 2033. *See* Dimock v. Corwin, 19 F. Supp. 56 (E.D.N.Y. 1937), *aff'd on other grounds*, 99 F.2d 799 (2d Cir.), *aff'd sub nom.* United States v. Jacobs, 306 U.S. 363 (1938); Estate of Salt v. Commissioner, 17 T.C. 92 (1951); Estate of Barr v. Commissioner, 40 T.C. 227 (1963). *But see* Estate of Porter v. Commissioner, 442 F.2d 915 (1st Cir. 1971). While the Service might take the position that the benefits payable under the second contract were in the nature of deferred compensation to the decedent and should therefore be included in his or her gross estate under section 2033, it is not clear that such an agreement would succeed given that the decedent possessed no rights to receive the amounts. *But see* Estate of Garber v. Commissioner, 271 F.2d 97 (3d Cir. 1959); Goodman v. Granger, 243 F.2d 264 (3d Cir.), *cert. denied*, 355 U.S. 835 (1957); Estate of Wolf v. Commissioner, 29 T.C. 441 (1957); Estate of King v. Commissioner, 20 T.C. 930 (1953).

The absence of any rights in the decedent under the second contract might also preclude its inclusion in the decedent's gross estate under the retained interest provisions, i.e., §§ 2036, 2037, 2038, or even 2041. All of those provisions require the decedent to have held rights or powers with respect to the property. I.R.C. §§ 2036, 2037, 2041 (1986). While aggregating the two contracts might result in inclusion of the survivor's benefits payable under the second contract in the decedent's gross estate as a transfer with a retained life estate under § 2036, aggregation for purposes of § 2036 would have been unlikely in the absence of a statutory or regulatory directive.

In order for § 2036 to apply, a decedent has to have had an interest in the property. Absent aggregation, the decedent would have had no interest in the second contract. In the case of the first contract, the decedent's interest amounts only to a life estate; because the transfer of a life estate does not result in inclusion under § 2036, the first contract would not be included in the decedent's gross estate under that section. *See* Rev. Rul. 66-86, 1966-1 C.B. 216 (transfer of a life estate into a trust does not cause inclusion of the trust res in the transferor's estate under § 2036); Rev. Rul. 70-84, 1970-1 C.B. 188 (trust established by decedent entitled to receive a fixed monthly sum for life, but who received the amounts as a lump sum, found not includible in her gross estate under § 2036). *But see* Commissioner v. Wilder's Estate, 118 F.2d 281, 283 (5th Cir.), *cert. denied*, 314 U.S. 634 (1941).

It would also have been difficult to argue successfully that the value of the benefits payable under the second contract should be included in the decedent's gross estate as insurance under § 2042. An annuity does not possess either of the key elements of insurance: risk shifting and risk distribution. Fidelity-Philadelphia Trust Co. v. Smith, 356 U.S. 274 (1958); *see* All v. McCobb, 321 F.2d 633 (2d Cir. 1963); Estate of Montgomery v. Commissioner, 56 T.C. 489 (1971), *aff'd per curiam*, 458 F.2d 616 (5th Cir. 1972); Sussman v. United States, 76-1 U.S. Tax Cas. (CCH) § 13,126 gregation rule accomplishes this by allowing the lifetime payments which the first plan provides to satisfy the lifetime payment requirement which the second plan alone does not satisfy.[86] The rule therefore prevents individuals from avoiding section 2039 by splitting what is in substance one joint and survivor annuity into two single life annuities. Its function is sound and easy to understand. It is more difficult to understand why the Treasury excepted qualified plans from the coverage of the rule.

B. *Qualified Plan Exception*

Example 6 not only establishes that neither of the plans in question is qualified but goes on to explain specifically that the rights and benefits to be aggregated include "[a]ll rights and benefits accruing to an employee and to others by reason of the employment (except rights and benefits accruing under certain plans meeting the requirements of section 401(a) (see §20.2039-2)). . . ."[87] In Rev. Rul. 76-380,[88] the Service confirmed that the parenthetical statement in Example 6 excepted qualified plans from aggregation.[89] Neither the example, the text of the regulations nor the ruling explains the reason for ex-

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(E.D.N.Y. 1975).

Finally, § 2039 would not have applied either. Although the annuity under that plan would satisfy the payment and contract requirements of § 2039, it could not have satisfied the lifetime payment requirement. Under the second plan the employee possessed no right to receive any payments during his or her lifetime.

The aggregation rule solves this problem by treating the two plans as one contract or agreement. If the contract or agreement which gives the employee a single life annuity and thus fulfills the lifetime payment requirement is the same contract or agreement which provides the survivor's annuity, then the employee can be found to have been entitled to lifetime payments under "such contract or agreement." The lifetime payment requirement will thus be satisfied and § 2039 will apply. The value of the survivor's annuity will therefore be included in the employee's gross estate.

85. The aggregated plan satisfies the contract requirement, as did the two separate plans. More significantly, it also satisfies the post-death payment requirement because it provides for payments to the survivor beneficiary. Finally, the aggregated plan also satisfies the lifetime payment requirement because under it the individual had the right to receive payments during his or her lifetime as a result of the provisions of the first contract.

86. Estate of Schelberg v. Commissioner, 612 F.2d 25, 29 (2d Cir. 1979); Gray v. United States, 410 F.2d 1094, 1105 (3d Cir. 1969); All v. McCobb, 321 F.2d 633, 636 (2d Cir. 1963); Estate of Beal v. Commissioner, 47 T.C. 269, 274 (1966); Estate of Bahen v. United States, 305 F.2d 827, 830 (Ct. Cl. 1962); *see* Silberman v. United States, 333 F. Supp. 1120 (W.D. Pa. 1971); Hetson v. United States, 209 Ct. Cl. 691 (1976); Kramer v. United States, 406 F.2d 1363 (Ct. Cl. 1969); Estate of Siegel v. Commissioner, 74 T.C. 613 (1980).

87. Treas. Reg. § 20.2039-1(b)(2) example 6 (1976).

88. 1976-2 C.B. 270.

89. Rev. Rul. 76-380, 1976-2 C.B. 270, stated that the Service interpreted a statement in example 6 of Treas. Reg. § 20.2039-1(b)(2) to mean that "rights and benefits accruing under plans meeting the requirements of section 401(a) of the Code are not to be considered together with rights and benefits accruing under plans not meeting the requirements of section 401(a)."

cepting qualified plans from the aggregation rule.

The cross reference to Treas. Reg. § 20.2039-2, which describes and applies the section 2039(c) exclusion, suggests that the Treasury saw a relationship between the qualified plan exception to the aggregation rule and the peculiarities of the section 2039(c) exclusion. The cross reference suggests that Treasury intended that the qualified plan exception to the aggregation rule be co-extensive with the section 2039(c) exclusion from the gross estate. No other compelling reason for it exists.

Given that section 401(a) is extensive, detailed and self-executing, a cross reference to section 401(a) alone would have sufficed to except section 401(a) plans from the aggregation rule. Indeed, section 2039(c) itself did no more than refer to plans which "met the requirements of section 401(a)."[90] If Treasury had wanted to except section 401(a) or section 403(a) plans from the aggregation rule without regard to the estate taxation of the benefits provided under those plans, citation to those sections alone would have sufficed.

Treasury needed the cross reference to Treas. Reg. §20.2039-2 and, by inference, to section 2039(c), if it sought to narrow the type of section 401(a) plans that would enjoy the exception from the aggregation rule. Notably, Example 6 provides that the exception from the aggregation rule applies only to "certain" section 402(a) plans.[91] The cross reference to section 20.2039-2 of the regulations is superfluous unless it was intended to define which qualified plans would be excepted from the aggregation rule.

For example, section 2039(c), and therefore section 20.2039-2 of the regulations, does not exclude survivor annuities paid by all qualified plans from the gross estate.[92] Treasury would have needed the cross reference to section 20.2039-2 of the regulations if it had wanted to make the qualified plan exception from the aggregation rule co-extensive with the section 2039(c) exclusion from the gross estate. A reference to section 401(a) alone would not have sufficed.

Since Treasury apparently intended for the section 2039(c) exclusion to be co-extensive with the qualified plan exception from the aggregation rule, the repeal of the exclusion raises the question of the continued vitality of the

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90. I.R.C. § 2039(c)(1) prior to amendment by TRA 1984.

91. Treas. Reg. § 20.2039-1(b)(1) example 6 (1976); *see supra* text accompanying note 87.

92. I.R.C. § 2039(c)(1) (1984). For example, § 2039(c) only excluded proceeds from a plan that met the requirements of § 401(a) either at the time the decedent's employment terminated or at the time the plan itself terminated, if earlier. Section 2039(c) would not have excluded from an employee's gross estate survivor benefits paid by a plan which was not qualified when the employee retired but which was qualified when the employee died. Treas. Reg. § 2039-2(b)(1) (1976). The cross reference in example 6 suggests that such a plan would not be excepted from the aggregation rule because the value of survivor benefits payable by such a plan would be included in the employee's gross estate. Mere reference to § 401(a) in example 6 might have yielded a different result because the survivor annuity would have been paid by a qualified plan.

qualified plan exception from the aggregation rule.[93] This question cannot be answered without an understanding of the way in which the Service and the courts have interpreted the aggregation rule.

III. Application of the Lifetime Payment Requirement and the Aggregation Rule

The Service recognizes the importance of the aggregation rule. In light of the breadth with which the courts have construed the contract and post-death payment requirements of section 2039, broad construction of the lifetime payment requirement together with the aggregation rule could result in the inclusion of nearly all non-qualified survivor's benefits in an employee's gross estate. The Service has therefore taken some rather extreme positions in what appears to have been an attempt to set the outer limits of the lifetime payment requirement and the aggregation rule.[94]

The positions the Service has taken do not follow from either the purpose for the aggregation rule or the purpose for the lifetime payment requirement. They appear to follow only from a naked desire to raise revenue. Nevertheless, the Service's attempts to expand the scope of the aggregation rule and the lifetime payment requirement beyond the purpose for which they were intended have generated a confusing and seemingly contradictory body of law.

This body of law is in disarray for two reasons. First, both the Service and the courts have failed to distinguish between the issue of satisfying the lifetime payment requirement and the issue of aggregation.[95] Logically, these are two separate issues which must be decided sequentially. If an amount fails to meet the lifetime payment requirement, aggregation is irrelevant. It is only when an amount satisfies the lifetime payment requirement that aggregation will result in inclusion of the survivor's benefit in the decedent's gross estate. Therefore, the appropriate analysis must first focus on fulfillment of the lifetime payment requirement; aggregation is irrelevant. It is only when an amount satisfies the lifetime payment requirement that aggregation will result in inclusion of the survivor's benefit in the decedent's gross estate. Therefore,

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93. The scope of the qualified plan exception from the aggregation rule needs to be addressed even if Treasury and the Service did not intend that the exception depend on the § 2039(c) exclusion. First, the phrasing of the exception in both Treas. Reg. § 20.2039-(1)(b)(2) example 6 suggests the dependency and raises a question about the effect of the repeal of the § 2039(c) exclusion. A clearly articulated expression of the aggregation rule would resolve that question. Second, the cross reference to Treas. Reg. § 20.2039-2 raises the possibility that other plan benefits subject to the § 2039(c) exclusion might also be excepted from the aggregation rule. Neither the regulation nor the Service's rulings provide a mechanism for determining the scope of the exception. The two pronged test proposed here would provide this mechanism.

94. The Service has needed to take extreme positions because pure death benefits which fail the lifetime payment requirement could probably escape inclusion in the gross estate under §§ 2033, 2035, 2036, 2037 and 2038. For an excellent and exhaustive discussion of why this would be so, see Wolk, *supra* note 40, at 235-64.

95. *See infra* notes 146-55 and accompanying text.

the appropriate analysis must first focus on fulfillment of the lifetime payment requirement. Only after it is determined that the payment in question satisfies the lifetime payment requirement should the analysis proceed to the question of aggregation.[96]

Second, neither the Service nor the courts have articulated a standard for deciding what constitutes a lifetime payment or what plans should be aggregated.[97] Instead, they have made pronouncements that make little sense and provide scant guidance for future application. It is hardly surprising that the law on the aggregation of employee benefits under section 2039 is a morass. Nevertheless, a review of this body of law will provide the foundation for the analytically sound formulation of the lifetime payment requirement and the aggregation rule which this article seeks to develop. Like the test which this article will propose, the review should begin with a study of the lifetime payment requirement.

A. *Scope of the Lifetime Payment Requirement*

The Service first sought to construe the lifetime payment requirement so broadly that all plans would satisfy it. The Service did this by looking to the most common type of lifetime payment which an employee receives from an employer: the payment of salary.

1. Judicial Response

In *Estate of Fusz*,[98] the Service took the position that an employee's right to receive a salary under the terms of an employment contract fulfilled the lifetime payment requirement.[99] The employment contract in question pro-

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96. If an amount receivable during an employee's lifetime is not an "annuity or other payment" within the meaning of § 2039(a), then it cannot satisfy the lifetime payment requirement. Therefore, even if a plan which provides for payment of such an amount were aggregated with a particular pure death benefit, the death benefit would escape inclusion in the gross estate because it would fail to satisfy the lifetime payment requirement.

The foregoing suggests that in order for the aggregation rule to result in inclusion of a pure death benefit in a decedent's gross estate, two conditions must be satisfied. First, there has to have been a contract or agreement under which the decedent was entitled to receive an "annuity or other payment" during his or her lifetime. Second, that contract or agreement has to be aggregated with the contract or agreement which provides for the payment of the pure death benefit to the survivor.

97. *See infra* discussion in text accompanying notes 111-24.

98. 46 T.C. 214 (1966), *acq. in result*, 1967-2 C.B. 2.

99. *Fusz* was evidently a test case. The Tax Court realized that the Service deliberately refrained from pressing any other theories for including the survivor's benefits in the employee's gross estate. *Id.* at 215 n.2. In the opening sentence of its opinion in *Fusz* the court noted that "[i]n asserting includability in the estate of decedent of the commuted value of the payments to his widow, respondent has shot from his bow the single arrow of section 2039(a); he has deliberately left other possible arrows locked in his quiver." *Id.* at 215 (footnotes omitted). The Service apparently wanted to

vided that the employee would receive a salary and that upon his death his widow would receive payments in specified amounts for a specified period of time.[100] Because the death benefit payments to the widow failed to meet the lifetime payment requirement, the Service took the position that since the salary due the employee was payable during his lifetime, the salary would satisfy the lifetime payment requirement.[101]

The Tax Court did not agree. Reasoning that Congress intended to tax joint and survivor annuities but not all death benefits under section 2039, the Tax Court articulated the first limitation on the scope of the lifetime payment requirement.[102] Based on the legislative history of section 2039 the Tax Court concluded that amounts would not constitute "other payments" which would satisfy the lifetime payment requirement unless they were "post-employment benefits which, at the very least, are paid or payable during the decedent's lifetime."[103] Salary payments, almost by definition, are not post-employment benefits. Therefore, the employee's right to receive a salary for services rendered during his lifetime would not qualify as a right to receive an "other payment" for purposes of section 2039.[104] *Fusz* thus established that salary would not satisfy the lifetime payment requirement of section 2039(a).

2. Administrative Acquiescence

The Service acquiesced in the Tax Court's decision in *Fusz*.[105] Although

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force the court to decide the scope of § 2039. *See infra* note 101. Although the Service had previously taken the position that all incidents of the employment relationship, including salary, should be taken as a whole for purposes of determining whether the requirements of § 2039 were satisfied, it had not obtained a decision in a case which presented purely the issue of whether salary could constitute an "other payment" for purposes of the lifetime payment requirement of § 2039. Thus, in Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962), the Service also argued that the decedent's salary was an "other payment." *See also* Eichstedt v. United States, 354 F. Supp. 484, 491 (N.D. Cal. 1972); Estate of Kramer v. United States, 406 F.2d 1363 (Ct. Cl. 1969). The court rejected the Service's argument in *Bahen*, reasoning that to accept it would be to nullify the lifetime payment requirement. *Bahen*, 305 F.2d at 834. The court did not discuss the issue at length, however, because there were other amounts which, in its opinion, did constitute "other payments." *See infra* text accompanying note 136.

100. *Fusz*, 46 T.C. at 215.

101. *Id.* at 215-16. The amounts due the widow were an annuity or other payment and were paid under a contract or agreement, thus satisfying the first two requirements of § 2039(a). But the amounts due the widow were not part of a joint and survivor annuity. Under the employment contract the decedent did not have any right to receive any lifetime payments other than his salary. Arguably, then, the payments to the widow failed to meet the lifetime payment requirement. Recognizing this, the Service took the position that since the salary due the decedent was payable during his lifetime, the salary would satisfy the lifetime payment requirement.

102. *Fusz*, 46 T.C. at 217.

103. *Id.* at 218 (footnote omitted).

104. *See id.* at 217-18.

105. 1967-2 C.B. 2; *see* Rev. Rul. 77-183, 1977-1 C.B. 274.

it sometimes disagrees with taxpayers over whether a particular amount is a post-employment benefit as contemplated by the Tax Court,[106] the Service has been willing to limit its construction of the lifetime payment requirement in accordance with the Tax Court's rationale in *Fusz*.[107] It now agrees that to be an "other payment" for purposes of the lifetime payment requirement of section 2039(a) a payment must be a post-employment benefit.[108]

The Service's acquiescence in *Fusz* and its acceptance of the rationale articulated by the court in that case is important because the *Fusz* rationale is consistent with the purpose of the lifetime payment requirement and represents an analytically sound approach to its application. The lifetime payment requirement mirrors one of the salient characteristics of the prototypical joint and survivor annuity: the making of payments to the primary annuitant during his or her lifetime. An employee's receipt of salary is totally unlike the receipt of payments under a joint and survivor annuity.[109]

Unlike the receipt of salary, the receipt of an annuity is not inextricably tied to the employment relationship.[110] Unlike the payment of salary, the pay-

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106. *See, e.g.*, Eichstedt v. United States, 354 F. Supp. 484 (N.D. Cal. 1972) (insurance renewal commissions payable during employee's lifetime and to his widow pursuant to agreement with employer held not post-employment payments; however, such payments were includible in decedent's gross estate under § 2033 as property in which decedent had an interest at the time of his death and alternatively includible under § 2039(a) and (b) when considered together with a deferred compensation agreement that entitled decedent to a post-employment annuity); Silberman v. United States, 333 F. Supp. 1120 (W.D. Pa. 1971) (consulting payments held post-employment benefits because they continued regardless of the employee's ability to perform services); Estate of Siegel v. Commissioner, 74 T.C. 613 (1980) (agreement which provided for payments to the employee in the event of disability did not provide for post-employment benefits); Hetson v. United States, 209 Ct. Cl. 691 (1976) (commuted value of pension payments receivable by widow under an agreement providing that husband would be paid a salary regardless of time devoted to corporation or ability to perform services and that upon his death widow would receive $13,000 per year in consideration of his services held includible in decedent's gross estate as an annuity or other payment); Kramer v. United States, 406 F.2d 1363 (Ct. Cl. 1969) (wage continuation payments for decedent's services as an advisor were not post-employment payments; decedent apparently could not receive payments if he performed no services).

107. *See, e.g.*, Rev. Rul. 77-183, 1977-1 C.B. 274.

108. *Id.*

109. Although it is conceivable that an employee would agree to receive increased salary in lieu of a post-employment single life annuity (as a kind of reverse deferred compensation), that is highly unlikely because of the disadvantages of immediate taxation. The mere existence of the possibility should not form the basis for concluding that salary should satisfy the lifetime payment requirement. To do so would be to allow a remote and difficult to establish possibility to dictate the scope of a rule which has very general application.

110. The term salary is used here in a generic sense to represent all cash compensation for services rendered by employees. The term includes amounts paid to employees who are compensated on an hourly basis as well as amounts paid to employees who receive a specific amount per period. The term excludes non-cash compensation and fringe benefits.

ment of an annuity typically begins after the employment relationship terminates. The individual needs to perform no services to receive the annuity payments. Salary is base compensation. Annuity payments are not.

The Tax Court recognized these fundamental differences between salary and the payments due under an annuity. Its refusal to find that salary fulfilled the lifetime payment requirement in *Fusz* mooted the question of aggregation. By acquiescing in *Fusz* the Service laid the foundation for an analytically sound approach to the application of the lifetime payment requirement and the aggregation rule. Regrettably, instead of building on that foundation, the Service trampled it.

B. *The Analysis Goes Awry*

In 1977 the Service published a ruling in which it appeared to expand the rationale articulated by the Tax Court in *Fusz.* In Rev. Rul. 77-183[111] the Service held that payments which an employee was entitled to receive under an employer's Sickness and Accident Income Plan did not satisfy the lifetime payment requirement. Under the terms of the Plan described in the ruling an employee would continue to receive his or her salary for a specified period of time if he or she were absent from work as a result of sickness or injury.[112] The Service noted that the employee was expected to return to work after the period of incapacity. It therefore concluded that payments under the Plan did not satisfy the lifetime payment requirement.[113]

Although the Service purported only to apply the *Fusz* rationale to the facts posited in Rev. Rul. 77-183, its conclusion and its description of that rationale were, in fact, a significant and analytically unjustified extension of it. In Rev. Rul. 77-183 the Service interpreted *Fusz* to exclude from the definition of "other payments," and thus from fulfillment of the lifetime payment requirement, any "rights and benefits to receive compensation for services actually rendered or to be rendered."[114] Such a formulation of the *Fusz* rationale would mean that no amounts which are compensatory in nature could ever fulfill the lifetime payment requirement.

Indeed, the Service has so stated. In Rev. Rul. 77-183 it concluded that the benefits which an employee would receive under the Plan in question in that ruling were "in the nature of compensation" and therefore could not be an "annuity or other payment" which fulfilled the lifetime payment requirement of section 2039(a).[115]

The Service could not possibly have meant what it said. It is difficult to conceive of any significant pecuniary benefit that an employer bestows upon an employee that is not in the nature of compensation for services rendered or to

111. Rev. Rul. 77-183, 1977-1 C.B. 274.
112. *Id.*
113. *Id.* at 275.
114. *Id.*
115. *Id.* at 276.

be rendered. The Service itself has often taken the position that any property transferred by an employer to an employee must represent compensation.[116] Thus, the Service has long sought to treat as income the value of almost all fringe benefits which employers provide for employees.[117] The Code even presumes the compensatory nature of payments made by employers to or for the benefit of employees by forbidding their characterization as gifts.[118] If the Service really excluded all compensatory payments from the definition of "other payments" for purposes of the lifetime payment requirement, few employer-provided payments would ever fulfill the requirement.

In addition, if *Fusz* really stood for the proposition that compensatory payments cannot fulfill the lifetime payment requirement, then even the payments under the prototypical joint and survivor annuity would fail to meet the requirement. Certainly, such payments compensate the employee for services rendered.[119] An employer would not provide such an annuity if the employee had not worked for the employer. If such payments were not compensatory,

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116. For example, the Service has long taken the position that amounts paid by an employer to an employee's surviving spouse is income to that spouse. Although the federal district and appellate courts have not agreed, (*see, e.g.*, Harper v. Commissioner, 314 F. Supp. 360 (C.D. Cal. 1970), *aff'd*, 454 F.2d 222 (9th Cir. 1971); Kuntz v. Commissioner, 300 F.2d 849 (6th Cir. 1962), *cert. denied*, 371 U.S. 903 (1962)), the Tax Court usually has agreed with the Service and held that such amounts were not gifts but were income to the surviving spouse. *See, e.g.*, Olsen v. Commissioner, 20 T.C.M. 897 (1961), *rev'd*, 302 F.2d 671 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); Waters v. Commissioner, 22 T.C.M. 1258 (1963). The issue has probably been settled by the enactment of § 102(c) in 1986. TRA 1986, § 122(b). That section provides that amounts transferred by an employer to or for the benefit of an employee will not be excluded from income under the provisions of § 102(a), which generally excludes gifts and inheritances. By enacting § 102(c) and virtually eliminating the exclusion available under § 74 (relating to prizes and awards) (*see* TRA 1986, § 122(a)), Congress hoped to resolve the uncertainties of prior law. 1986 Blue Book at 32-33, 37. Congress also acknowledged that such amounts represent compensation.

117. With the exception of gains specifically exempted by statute, the courts have broadly construed § 61 to include in gross income many forms of employee benefits. *See* Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429-30 (1955). The increase in the types and use of employer-provided fringe benefits prompted the Treasury Department in 1975 to issue a discussion draft of proposed regulations to determine the tax treatment of non-statutory fringe benefits. 40 Fed. Reg. 4118 (1975). The public reacted so adversely to the positions taken in that proposal that Treasury eventually withdrew it. 41 Fed. Reg. 5634 (1976). In 1978, Congress enacted a moratorium prohibiting the Treasury Department from issuing final regulations addressing the fringe benefit issue until 1980. Pub. L. No. 95-427, § 1, 92 Stat. 996 (1978). Two extensions of the moratorium followed. Pub. L. No. 96-167, § 1, 93 Stat. 1275; Pub. L. No. 97-34, § 801, 95 Stat. 349 (1981). Finally, as part of TRA 1984, Congress amended § 61(a) and added new § 132 to clarify the income and payroll tax treatment of fringe benefits. Pub. L. No. 98-369, § 531, 98 Stat. 877 (1984). The enactment of § 132 resolved some of the issues raised by the previously proposed regulations and effectively prevented their issuance as final regulations under § 61.

118. I.R.C. § 102(c) (1986).

119. The Service itself has so argued in all of the cases in which it has attempted to treat death benefits paid to a surviving spouse as income. *See supra* note 106.

none of the special rules which defer income taxation of employer contributions to qualified plans would be necessary.[120] That the rules exist and that the consequence of running afoul of them is immediate taxation to the employee shows that Congress and the Service agree that such payments are compensatory.[121]

That section 2039(c) existed to exclude qualified plan payments from the gross estate for over 30 years also shows that compensatory payments could indeed satisfy the lifetime payment requirement. The amounts payable to the employee during his or her lifetime under a qualified plan are clearly compensatory in nature, as explained above. If that had prevented such amounts from fulfilling the lifetime payment requirement, then the survivor's annuity payable under a qualified plan could not have been included in the employee's gross estate under section 2039. The plan would have failed to meet the lifetime payment requirement. That section 2039(c) was needed to exclude the value of such an annuity from the employee's gross estate shows that a qualified plan providing for lifetime payments to the employee would meet the lifetime payment requirement even though those payments could be nothing but compensatory.

As the foregoing demonstrates, the very existence of section 2039(c) shows that the Service could not have meant to bar the use of compensatory payments to fulfill the lifetime payment requirement. Its actions subsequent to the issuance of Rev. Rul. 77-183 show that compensatory payments could indeed fulfill the lifetime payment requirement notwithstanding the broad language of that ruling.

Even after 1977, the Service had little difficulty in arguing that payments which an employee was entitled to receive under a non-qualified pension plan,

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120. If the payments were not compensation and thus included in the employee's income under §§ 61 or 83, § 402(a), which provides that amounts contributed to a qualified plan will be included in the employee's income when distributed, would not be necessary. Similarly, Treas. Reg. § 1.402(a)-1(a)(1)(i) (1985), which provides specifically that "the employee is not required to include [the amount of the employer's] contribution in his income except for the year or years in which such contribution is distributed or made available to him," would be superfluous if §§ 61 and 83 did not require inclusion of such amounts in the employee's income at the time the contribution is made.

121. Indeed, § 2039 itself shows that Congress recognized the compensatory nature of amounts expended by an employer on behalf of an employee. Section 2039(b) provides that any amount contributed by an employer to purchase an annuity contract or agreement will be treated as contributed by the employee. The provision has the effect of making such amounts subject to the estate tax precisely as if the employee contributed them. *See also* Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962); S. REP. No. 1622, 83d Cong., 2d Sess. 471, *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 5115. In the case of employer's contributions to qualified plans, § 2039(c) (1974) provided that such contributions would not be treated as employee contributions for purposes of § 2039(c) only. This had the effect of making amounts attributable to employee contributions to qualified plans subject to the estate tax notwithstanding § 2039(c).

which clearly are compensatory, fulfilled the lifetime payment requirement.[122] The courts have rightfully agreed.[123] Pension payments differ from salary not because one is compensatory and the other not, but because salary is paid during the period of employment while pension payments are not. The Tax Court understood this in *Fusz*.[124] The Service's unfortunate mischaracterization of the *Fusz* rationale in Rev. Rul. 77-183 has only confused both the lifetime payment requirement and the aggregation rule. A more analytically sound explanation of both is necessary to understand the way in which qualified plan payments should be treated. The *Fusz* rationale and the purpose of the aggregation rule provide the tools for that analysis.

IV. Toward a More Sound Analysis

A. *Qualitative Similarity, The First Prong*

1. Scope of the Lifetime Payment Requirement

The *Fusz* rationale, properly articulated, requires that only amounts due for a period following the termination of employment be found to constitute an "other payment" for purposes of the lifetime payment requirement.[125] Only these amounts are qualitatively similar to amounts due under a joint and survivor annuity.

Qualitative similarity to a joint and survivor annuity, not compensatory nature, should be the test. Since Congress modelled the requirements of section 2039(a) on the joint and survivor annuity, the joint and survivor annuity ought to serve as the focal point in the interpretation of those requirements.[126] To construe the requirements so as to encompass amounts other than those which are qualitatively similar to a joint and survivor annuity does violence to the congressional intent behind the enactment of section 2039.

The *Fusz* court recognized this when it held that an amount had to represent a post-employment benefit in order to satisfy the lifetime payment requirement of section 2039. Payments due under an employer-provided joint and survivor annuity represent a post-employment benefit. The Service, after

122. The Tax Court has even begun to apply precisely such a test even though it has not defined it. Estate of Siegel v. Commissioner, 74 T.C. 613, 620 (1980); *see, e.g.*, Estate of Wadewitz v. Commissioner, 339 F.2d 980 (7th Cir. 1964); Estate of Beal v. Commissioner, 47 T.C. 269 (1966); Estate of Allen, 39 T.C. 817 (1963).

123. *See supra* note 121.

124. In *Fusz* the Tax Court specifically stated that the term "other payment" for purpose of the lifetime payment requirement was "qualitatively limited to post-employment benefits. . . ." Estate of Fusz, 46 T.C. 214, 218 (1966), *acq. in result*, 1967-2 C.B. 2.

125. *Fusz* itself addressed only the question of the definition of "other payment." The Service did not argue that salary was an annuity. The post-employment component which the *Fusz* court injected into its definition of "other payment" is already a part of the term "annuity." *Id.* at 216.

126. *See supra* text accompanying notes 23-26.

acquiescing in *Fusz*, incorrectly applied that court's rationale when it held, in Rev. Rul. 77-183, that amounts due under a Sickness and Accident Plan were not "other payments" for purposes of the lifetime payment requirement because they were compensatory in nature.[127]

Although the Service reached the correct conclusion in the ruling, it did so for the wrong reason. The Service should have analyzed, as did Congress when it enacted section 2039 and the *Fusz* court when it decided that salary did not fulfill the lifetime payment requirement, whether the payments due under the plan described in Rev. Rul. 77-183 were qualitatively similar to those due under a joint and survivor annuity. They were not.

Payments due an employee under an employer-provided joint and survivor annuity begin after termination of employment. They are retirement payments. As such, they have two salient characteristics. First, they are due to follow the voluntary or chronological termination of employment. Second, they depend only upon the employee's survival.

Payments due under the Sickness and Accident Plan at issue in Rev. Rul. 77-183 possessed neither of these characteristics. Although they were intended to provide a source of support during a period of absence from employment, the absence resulted not from the voluntary or chronological termination of employment but from the enforced, and perhaps temporary, cessation of employment. This fundamental difference in the circumstance that occasioned the cessation of employment made the payments qualitatively different.

In addition, the payments due under the Sickness and Accident Plan were not certain. Payment was contingent upon the employee's becoming disabled. If the employee never suffered any misfortune which would entitle him or her to benefits under the Plan, no payments would ever be made. The uncertainty over whether the employee would ever receive any payments under the Plan made them qualitatively different from payments due under a joint and survivor annuity.

Receipt of payments due under a joint and survivor annuity is contingent only upon the employee's survival. It is not contingent upon the employee's sickness, accident, or other misfortune. The type of contingency ought to be determinative. Focusing on the type of contingency is crucial because it will result in treating as lifetime payments only payments which are qualitatively similar to payments made under a joint and survivor annuity.

Payments due under a joint and survivor annuity are either payable to the employee or the employee possesses the right to receive the payments. Further, the payments are due during the employee's life or for a period which is not ascertainable without reference to his death or which does not in fact end before his death. Such payments therefore satisfy the requirements of section 2039.[128] Payments under the Sickness and Accident Plan did not possess those

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127. Rev. Rul. 77-183, 1977-1 C.B. 274.

128. The *Fusz* court made it clear that the term "annuity or other payment" should have the same meaning in both places in which it appears in § 2039(a). *Fusz*,

charateristics. They were not payable for the employee's life because they would cease if the condition which necessitated them ceased, even if the employee's life did not cease.[129] In addition, the payments under the Sickness and Accident Plan were payable for a period which was ascertainable without reference to the employee's death and which might end before his death.[130] The length of the affliction, not the employee's life, would determine entitlement to the payments. Unlike the joint and survivor annuity payments which served as the model for section 2039 and whose characteristics are reflected in the requirements of that section, amounts payable under the Sickness and Accident Plan were uncertain. Therefore, amounts payable under the Sickness and Accident Plan should not have fulfilled the lifetime payment requirement. The Service was correct in its conclusion that the amounts payable under the Sickness and Accident Plan described in Rev. Rul. 77-183 were not "other payments" for purposes of the lifetime payment requirement. Only its analysis was unsound.

A sounder understanding of the genesis of the lifetime payment requirement would have led to the formulation of a test that would have been more consistent with Congressional intent than the Service's "compensatory" formulation. Qualitative similarity is such a test. It requires that in order to satisfy the lifetime payment requirement an amount must be qualitatively similar to amounts paid under a joint and survivor annuity. To satisfy the test, payment of the amount must follow the voluntary or chronological termination of employment and be contingent only upon survival, not upon the occurrence of sickness, accident or other disability. The formulation and application of such a test for determining the existence of a lifetime payment would have prevented the misapplication of the aggregation rule.

46 T.C. at 217. Indeed, one of the reasons the Tax Court objected to the Service's argument that salary was an "other payment" for purposes of the third requirement was that it would require construing the term differently in each of the places in which it appears in § 2039(a). (Although the term actually appears three times in § 2039(a), at the end of the section the term is only used to refer back, i.e. the section speaks of "such annuity or other payment." The term has no independent significance in that clause.)

The term first appears in the opening clause of § 2039(a). That clause includes in a decedent's gross estate the value of an "annuity or other payment" payable to a survivor. I.R.C. § 2039(a) (1986). The issue of whether payments to a survivor are post-employment payments will not arise because, by hypothesis, any payments made to an employee's survivors will be made after the employee terminates his or her employment. The issue will only arise in connection with the interpretation of the term in the second place it appears — in the statement of the lifetime payment requirement. Under that requirement an "annuity or other payment" must have been payable to the decedent during his or her lifetime. I.R.C. § 2039(a) (1986).

129. Rev. Rul. 77-183, 1977-1 C.B. 274.

130. *Id.*

2. Scope of the Aggregation Rule

The failure to look to congressional intent and to the model of the joint and survivor annuity led the Service astray in formulating a test for determining whether an amount was an "other payment" for purposes of the lifetime payment requirement. The same failure led both the Service and the Claims Court astray in applying the aggregation rule.[131]

In the leading case on the aggregation rule, *Estate of Bahen v. United States*,[132] the Service took the position that an employee's right to receive payments under his employer's non-qualified Deferred Compensation Plan satisfied the lifetime payment requirement even though the employee had to become totally disabled in order to receive any payments at all under the plan.[133] The Claims Court agreed and held for the Service.[134] Instead of examining whether the payments in question shared the salient characteristics of payments due under a joint and survivor annuity, the court merely concluded that the existence of a contingency would not prevent an amount from being an "other payment" and satisfying the lifetime payment requirement.[135] Such a summary conclusion misses the point.

It is not the existence of a contingency that is determinative, but rather the type of contingency that is important. As acknowledged above, payments due an employee under a joint and survivor annuity are generally contingent, at minimum, upon the employee's survival until retirement. Such a contin-

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131. *See infra* text accompanying notes 115-19.

132. 305 F.2d 827 (Ct. Cl. 1962). Judge Friendly, writing for the Second Circuit in Estate of Schelberg v. Commissioner, 612 F.2d 25 (2d Cir. 1979), said of the court's opinion in *Bahen* that it was "a virtuoso performance which has tended to dominate the field to the extent that . . . courts seem to look to the *Bahen* opinion rather than to the statute and the committee reports as indicative of the legislative intent." *Schelberg*, 612 F.2d at 32.

133. The Deferred Compensation Plan provided for payments to an employee's survivors in sixty equal installments. *Bahen*, 305 F.2d at 828. Only if the employee became totally incapacitated would the payments be made to him, with any unpaid installments going to his widow or minor children. *Id.* Following Mr. Bahen's death, his employer made the required payments to his widow as provided by the Plan. *Id.* In addition to the benefits provided by the Deferred Compensation Plan, Mr. Bahen was also entitled to benefits under his employer's Death Benefit Plan. That latter plan provided that his survivors would receive an amount equal to three months' salary. *Id.* The Service sought to include the benefits paid to Mrs. Bahen under both plans in Mr. Bahen's gross estate. It took the position that Mr. Bahen's right to receive payments under the Deferred Compensation Plan in the case of complete disability fulfilled the lifetime payment requirement, so that the payments made to Mrs. Bahen under that plan met all three requirements of § 2039(a). *Id.* at 831-32. It then took the further position that the Deferred Compensation and Death Benefit Plans should be aggregated for purposes of § 2039 so that Mr. Bahen's right to lifetime payments under the former plan could fulfill the lifetime payment requirement under the latter. *Id.* at 835.

134. *Bahen*, 305 F.2d at 831.

135. *Id.* The court relied on Treas. Reg. § 20.2039-1(b)(1) which states that amounts that constitute an "other payment" can be "equal or unequal, conditional or unconditional, periodic or sporadic." Treas. Reg. § 20.2039-1(b)(1) (1979).

gency is fundamentally different from a contingency upon sickness, accident or disability, none of which may ever occur. Had the *Bahen* court focused on the nature of the contingency involved, it would have concluded that the payments in question did not satisfy the lifetime payment requirement because they were qualitatively different from the type of payments due under a joint and survivor annuity. Such a conclusion would have eliminated the need to reach the issue of the applicability of the aggregation rule.

Regrettably, the *Bahen* court missed the opportunity to clarify the scope of the lifetime payment requirement and, in doing so, was primarily responsible for bringing the law on section 2039 to its present confused state. The court first concluded that the payments which Mr. Bahen would receive if he became disabled satisfied the lifetime payment requirement. Thus, the court next had to address a plan which provided payments to his widow.[136] If the two plans could be aggregated and treated as one for purposes of section 2039, the value of the payments due Mrs. Bahen under the second plan would be included in Mr. Bahen's gross estate under that section. If the two plans could not be treated as one, the amounts due under the second plan would escape inclusion in Mr. Bahen's gross estate because they would fail to meet the lifetime payment requirement.[137]

The *Bahen* court concluded that the two plans should be aggregated. It did so even after acknowledging that there was "no suggestion" that the two plans were established in an attempt to effect the type of annuity splitting which the aggregation rule was designed to prevent.[138] Instead of formulating the aggregation rule in a way that would accomplish its objective, the *Bahen* court interpreted Example 6 of Treas. Reg. §20.2039-1(b)(2) to require aggregation of all plans in all cases.[139] The only exception the court recognized was for qualified plans. The court was willing to except qualified plans from the aggregation rule because section 2039(c) explicitly excluded such plans from the gross estate.[140]

The aggregation rule, as formulated by the *Bahen* court, is easy to apply. Full aggregation requires little thought and no analysis. It simply happens. However, it does not effectuate congressional intent. It includes in the gross estate amounts which Congress could have but did not include under section 2039. If pure death benefits are to become subject to federal estate taxation, it

136. Having concluded that the Deferred Compensation plan provided for lifetime payments to Mr. Bahen, it was easy for the court to conclude that the value of Mrs. Bahen's right to receive payments under that plan as a result of Mr. Bahen's death was includible in Mr. Bahen's gross estate pursuant to § 2039.

137. Failure to meet the lifetime payment requirement would result in non-inclusion under § 2039. As previously explained, it is unlikely that the Service would have succeeded in including the value of Mrs. Bahen's payments under any other provision even though the existence of § 2039 does not preclude such an attempt. Treas. Reg. § 20.2039-1(a) (1979); *see supra* note 84.

138. Estate of Bahen v. United States, 305 F.2d 827, 835 n.16 (Ct. Cl. 1962).

139. *Id.* at 835.

140. *Id.*

should only be after thorough study of the reasons for doing so.[141]

Full aggregation as mandated by *Bahen* would also result in the aggregation of qualified and non-qualified plans now that section 2039(c) no longer excludes the proceeds of qualified plans from the gross estate. That would be a travesty. The aggregation rule is a legitimate response to a potential problem. It prevents taxpayers from avoiding section 2039 by resorting to formalistic distinctions. Applying the rule to situations that have no potential for avoidance extends it beyond the bounds contemplated by the Treasury and nullifies one of the requirements of section 2039.

Full aggregation, as the *Bahen* court requires, nullifies the contract requirement. It is well established that a payment need not be made under a written, bilateral agreement to satisfy the contract requirement.[142] Any plan unilaterally adopted by the employer will fulfill the contract requirement provided it has been communicated to the employee.[143] Thus, any incident of the employment relationship known to the employee fulfills the requirement. Full aggregation means that all such incidents will comprise one contract or agreement. The contract requirement would thus be a nullity in all cases where an employment relationship exists. The employment relationship itself would suffice to fulfill the contract requirement.

Surely, if Congress had wished to devise a system under which the whole of the employment relationship constituted a contract for purposes of section 2039, it would have done so. At a minimum, it would not have required the existence of a relationship between the payments due the surviving beneficiary and the lifetime payments due the employee. But the statute clearly requires that such a relationship exist. Section 2039(a) requires that the contract or agreement which provides the survivor benefits also provide the lifetime payments to the employee.[144] Congress would not have needed to require this relationship if it intended that the whole of the employment relationship would always constitute the contract or agreement.

Congress specified the need for a relationship between the benefits payable to the survivor and the lifetime benefits payable to the employee because it sought to tax joint and survivor annuities and qualitatively similar arrangements.[145] The *Bahen* court's use of full aggregation is not grounded in the purpose for the aggregation rule and serves to broaden the scope of section 2039 to the point where it could be used to include in an employee's gross estate the value of any survivor's benefits provided by his or her employer.

141. *See supra* note 44.
142. *See supra* note 41.
143. *See supra* note 42.
144. Section 2039(a) provides that a survivor's annuity or other payment will be included in an individual's gross estate if the annuity was payable "under any contract or agreement . . . if under *such* contract or agreement . . . [the individual was entitled to lifetime payments]." I.R.C. § 2039(a) (1986) (emphasis added). For the full text of § 2039(a), see *supra* note 19.
145. *See supra* text accompanying notes 23-39.

Like the *Fusz* court, which analyzed the purpose of the lifetime payment requirement and formulated a test that would achieve that purpose, the *Bahen* court should have examined the purpose of the aggregation rule and formulated a test which would achieve that purpose. It should not have merged the issue of fulfillment of the lifetime payment requirement with the issue of aggregation.

Only one court has come close to drawing a conceptual distinction between fulfillment of the lifetime payment requirement and application of the aggregation rule. In *Estate of Schelberg v. Commissioner*,[146] the Court of Appeals for the Second Circuit refused to aggregate benefits payable to an employee under a Total and Permanent Disability Plan (the "Disability Plan") with an annuity paid to the employee's widow under a Group Life Insurance Plan.[147] The Group Life Insurance Plan provided only for payments to the employee's survivors.[148] Considered alone, payments made under that plan would fall outside the scope of section 2039(a) because they would not meet the lifetime payment requirement. The Service therefore tried to aggregate the Group Life Insurance Plan with the Disability Plan. It took the position that the employee's right to receive payments under the Disability Plan satisfied the lifetime payment requirement.[149] If the two plans were treated as one, then all of the requirements of section 2039 would be satisfied and the payments to the employee's widow would be included in his gross estate.

Judge Friendly, writing for the court, disagreed. He found that the Disability Plan could not be aggregated with the Group Life Insurance Plan so as to cause the annuity paid under the latter to meet the lifetime payment requirement of section 2039.[150] To reach this conclusion, Judge Friendly first analyzed the benefits payable to the employee under the Disability Plan. He noted that the employee would receive benefits under that plan only if he became disabled and remained so for more than 52 weeks.[151] He also noted that

146. 612 F.2d 25 (2d Cir. 1979).

147. The employee's widow had also received a payment of group term life insurance under the Plan but the case did not involve any issues with respect to that payment. Proceeds of the life insurance policy would have been included in the employee's gross estate by § 2042, if at all. Section 2039 explicitly excludes from its coverage payments of life insurance. I.R.C. § 2039(a) (1986).

148. *Schelberg*, 612 F.2d at 27.

149. *Id.* at 29.

150. *Id.* at 31.

151. For the first 52 weeks of disability the employer's Sickness and Accident Plan would provide benefits. The Service had not argued that the benefit due under the Sickness and Accident Plan would fulfill the lifetime payment requirement because that plan was virtually identical to the plan described in Rev. Rul. 77-183, 1977-1 C.B. 274. The only significant difference between the Sickness and Accident Plan discussed in Rev. Rul. 77-183 and the Disability Plan at issue in *Schelberg* is that the Disability Plan provided benefits after those due the employee under a Sickness and Accident Plan were exhausted and would continue to provide the benefits until the employee reached retirement age. As the court acknowledged, the Sickness and Accident Plan described in the ruling was probably the same IBM plan that Mr. Schelberg partici-

this was a rather substantial contingency, which only one quarter of 1 percent of all employees had been unfortunate enough to fulfill.[152] Judge Friendly then applied the *Fusz* qualitative similarity test. After looking to the legislative history of section 2039 he determined that the payments due the employee under the Disability Plan were so unlike the joint and survivor annuity upon which Congress modelled section 2039 that the amounts could not qualify as other payments for purposes of that section.[153]

Schelberg could have provided the structure for a more sound analysis of the lifetime payment requirement and the aggregation rule except for two things. First, notwithstanding its use of the qualitative similarity test, the court explicitly based its holding on other grounds. Thus, it echoed the Service's notion that *Fusz* stood for the proposition that compensatory payments could not satisfy the lifetime payment requirement.[154] Second, the court did not address separately the questions of aggregation and fulfillment of the lifetime payment requirement.[155] While such separate analysis did not affect the result in that case given the court's conclusion that the Disability Plan benefits could not fulfill the lifetime payment requirement, separate analysis would be material in other situations. Any attempt to aggregate benefits payable under qualified and non-qualified plans would present such a situation.

B. *The Role of Qualified Plans: The Need For A Second Prong*

The result in *Schelberg* might have been very different if the Service had aggregated the benefits due under the employer's qualified pension plan with those due under the Group Life Insurance Plan. Because the employee could receive a pension during his lifetime and because a pension is qualitatively similar to the joint and survivor annuity, the payments due the employee under the qualified pension plan would have met the lifetime payment requirement. Taken together, the qualified pension and the Group Life Insurance Plan would have met all three requirements of section 2039(a). Aggregating the benefits provided by the qualified pension plan with the benefit provided by the Group Life Insurance Plan would thus have resulted in inclusion of the

pated in. *See infra* note 158.

152. *Schelberg*, 612 F.2d at 33.

153. *Id.* at 31. Although Judge Friendly did not purport to apply a "qualitative similarity" test, the analysis he employed was essentially like the analysis required to apply the qualitative similarity test. Both involve an examination of the similarity between the payments in question and those due the primary annuitant under a typical joint and survivor annuity. *See* Estate of Siegel v. Commissioner, 74 T.C. 613, 620 (1980).

154. Estate of Schelberg v. Commissioner, 612 F.2d 25, 31 (2d Cir. 1979).

155. Although the *Schelberg* court refused to accept the principle of full aggregation, *Id.* at 31, its conclusion blurred the distinction between the question of whether the Disability Plan benefits could satisfy the lifetime payment requirement and the question of whether, if so, they should be aggregated with the Group Life Insurance Plan benefits which Mr. Schelberg had received. *Id.* at 28.

latter in the employee's gross estate.[156]

1. Administrative Interpretation of the Qualified Plan Exception to the Aggregation Rule

The Service did not try to aggregate the benefits provided under the Group Life Insurance Plan and the qualified pension plan in *Schelberg*. Instead, the Service followed the position it had set forth in Rev. Rul. 76-380.[157] In that ruling the Service announced that it would not aggregate benefits provided by qualified plans with benefits provided by non-qualified plans.[158]

While refusing to aggregate benefits which enjoy a statutory exemption from federal estate taxation with benefits which are not exempt has superficial appeal,[159] such reasoning does not withstand close scrutiny.[160] First, neither the benefits which are most clearly subject to aggregation, such as an employee's right to a single life annuity, nor the benefits which the Service has succeeded in aggregating, such as Mr. Bahen's right to payments under his employer's Disability Plan, were themselves subject to federal estate taxation. If a benefit had to be subject to federal estate taxation to be subject to aggregation, aggregation would rarely occur.[161]

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156. *See also* Gray v. United States, 410 F.2d 1111, 1112 (3d Cir. 1969). In *Gray*, the court aggregated two plans because the estate failed to suggest that one of the plans was a qualified plan until the time of oral argument on appeal. The court declined to consider the issue at that stage but implied that it would have reached a different conclusion, refusing aggregation and preventing inclusion of the benefits in the employee's gross estate, if the issue had been raised earlier.

157. Rev. Rul 76-380, 1976-2 C.B. 270.

158. *Id.* As the *Schelberg* court recognized, Rev. Rul. 76-380, 1976-2 C.B. 270 and Rev. Rul 77-183, 1977-1 C.B. 274 seem to have analyzed the plans at issue in that case. *Schelberg*, 612 F.2d at 29 n.6. Although the identity of a taxpayer who requests a ruling is confidential (I.R.C. § 6103), it is likely that the *Schelberg* court was correct in its observation. Mr. Schelberg was employed by IBM. It is not unusual for large companies whose benefit plans affect so many employees to seek rulings on the tax consequences of their plans so that they can accurately advise their employees.

159. *See supra* text accompanying note 90.

160. Both courts and commentators have noted that the position expressed in Rev. Rul. 76-380, 1976-2 C.B. 270 does not follow inexorably from the § 2039(c) exclusion. *See* Estate of Schelberg v. United States, 612 F.2d 25, 29 n.7 (2d Cir. 1979); Wolk, *supra* note 40, at 234 n.38. Neither has attempted to define what, if any, analytical justification might exist for it.

161. The benefits which the Service aggregates are often not the type of benefits whose value would be included in the employee's gross estate. For example, the single life annuity which the Treasury aggregates with the survivor's annuity in Treas. Reg. § 20.2039-1(b)(2) example 6 (1976) (*see supra* note 82) would not be included in the employee's gross estate because it terminates upon the employee's death. I.R.C. § 2033 (1986). Similarly, the decedent's right to disability payments under his employer's Deferred Compensation Plan in *Bahen*, which the Service aggregated with payments made to his widow under that plan as well as under the Death Benefit Plan (*see supra* note 133), was not included in his gross estate. The decedent's right to lifetime payments ceased upon his death and thus had no value which could pass to his survivors

Second, section 2039(c) never provided a blanket exclusion for qualified plan proceeds. Qualified plan distributions were always included in an employee's gross estate to the extent they were attributable to the employee's contributions.[162] They were also included in full if paid to the executor.[163]

Third, even if the existence of a statutory exemption for qualified plans had been viewed as a Congressional directive to exclude such plans from consideration for any purpose under the federal estate tax,[164] in 1976, the very year Rev. Rul. 76-380 was issued, that directive was countermanded. In that year Congress amended section 2039(c) to make the estate tax exclusion of qualified plan proceeds contingent upon the waiver of favorable income tax treatment.[165] After 1976 qualified plan proceeds could actually be included in an employee's gross estate and probably were, at least in cases where the employee's estate did not exceed the amount exempted by the unified credit.[166]

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and be subject to the estate tax. I.R.C. §§ 2031, 2033 (1986); *see* Williams v. United States, 41 F.2d 895, 897 (Ct. Cl. 1930); Rev. Rul. 74-492, 1974-2 C.B. 298.

162. I.R.C. § 2039(c) (1984).

163. I.R.C. § 2039(c) (1984). Section 2039(c) only excluded from the employee's gross estate "the value of an annuity or other payment . . . receivable by any beneficiary (*other than the executor*). . . ." *Id.* (emphasis added).

164. The argument would be that if exclusion from the gross estate was necessary or desirable to make qualified plans more attractive, that attractiveness should not be undermined by allowing qualified plans to be used to subject other benefits to federal estate taxation.

165. The Tax Reform Act of 1976, Pub. L. 94-455, § 2009(c)(3), 90 Stat. 1895 (1976) [hereinafter "TRA 1976"] amended § 2039(c) to provide that annuities or other payments would be included in a decedent's gross estate if the payments were made in a lump sum. This 1976 amendment proceeded from a Congressional belief that lump sum payments would normally generate sufficient cash to cover the estate tax liability attributable to the inclusion of the benefits in the decedent's gross estate. H.R. REP. No. 1380, 94th Cong., 2d Sess. 68-71 (1976). The Revenue Act of 1978, Pub. L. No. 95-600, § 142(b), 92 Stat. 2796 (1978), as amended by the Technical Corrections Act of 1979, Pub. L. No. 96-222, § 101(a)(8)(B), 94 Stat. 201 (1979), restored the exclusion for lump sum distributions only where the recipient agreed irrevocably to forego favorable income tax treatment, including ten-year averaging and capital gains treatment, with respect to the distribution. Congress apparently wanted to restore the favorable estate tax treatment of distributions from qualified plans but felt that favorable income and estate tax treatment was too much. *See* H.R. REP. NO. 1800, 95th Cong., 2d Sess. 35, 210 (1978); *see also* Estate of Rosenberg v. Commissioner, 86 T.C. 980 (1986) (lump sum distribution properly included in decedent's gross estate where beneficiary-son reported the amount as capital gain); Nasuti, *How to Coordinate Income and Estate Tax Planning for Qualified Plan Distributions*, 49 J. TAX'N 194 (1978).

166. The unified credit, which applied to estates of decedents who died after December 31, 1976, had the effect of exempting $120,666 of the taxable estate from federal estate taxation. I.R.C. §§ 2010, 2001 (1977). This amount has risen steadily since then. *See supra* note 54. If an employee's taxable estate would not exceed the applicable exemption equivalent even with the inclusion of the value of a lump sum distribution from a qualified plan, the executor would have been well advised to urge the appropriate beneficiary to take the lump sum distribution and thus enjoy the benefits of ten-year averaging and possible capital gains treatment. I.R.C. § 2039(f)(2)

When it issued Rev. Rul. 76-380 the Service had to have known that the 1976 amendment to section 2039(c) would be enacted.[167] Perhaps the Service reasoned that as long as qualified plans were excluded from the gross estate under some circumstances, excepting them from the aggregation rule served to further the policy of preferential treatment for such plans. Such an exception would also prevent the additional complexity which would have resulted from any attempt to make aggregation contingent upon actual inclusion in a decedent's gross estate.

The possibility of a relationship between the qualified plan exception from the aggregation rule and the section 2039(c) exclusion from the gross estate became even more difficult to sustain after 1982. In that year Congress limited the section 2039(c) exclusion to $100,000 regardless of whether the employee's beneficiaries elected favorable income tax treatment of the plan proceeds.[168] The 1982 amendment signaled a change in the congressional view of the section 2039(c) exclusion.[169] No longer would exclusion be the rule and inclusion the exception. Now qualified plan proceeds would always be included in an employee's gross estate to the extent they exceeded $100,000. If the Service had excepted qualified plans from aggregation because of the estate tax exclusion for the proceeds of such plans, the 1982 change in the exclusion should have caused the Service to question whether it ought to change its policy of non-aggregation.

If the Service did question its policy after 1982, it did so in silence. If it questioned its policy following the 1984 repeal of the section 2039(c) exclusion it also did so in silence. The Service has not modified or amended Rev. Rul. 76-380 since it was issued; the ruling therefore continues to stand as a statement of the Service's position on the aggregation rule.[170] The time is ripe for a re-examination of that position.[171]

(1984); Estate of Rosenberg v. Commissioner, 86 T.C. 980 (1986); *see* Nasuti, *supra* note 165.

167. H.R. 10612 was passed by the House on December 4, 1975. Pub. L. No. 94-455, 90 Stat. 1520 (1976), was passed by the House and the Senate on September 16, 1976. It was signed by the President on October 4, 1976. That was the day on which the Service issued Rev. Rul. 76-380, 1976-2 C.B. 270. Since the amendment to § 2039(c) had been introduced in the House and was a part of the bill when that chamber passed it in 1975, the Service therefore had to have known that § 2039(c) would soon cease to provide a complete exclusion for qualified plans when it ruled that such plans would not be subject to aggregation.

168. *See supra* note 67 and accompanying text.

169. *See supra* note 66 and accompanying text.

170. While revenue rulings do not have the force and effect of Treasury Department Regulations, they may be used as precedent. *See* Rev. Proc. 86-15, 1986-1 C.B. 544, 545.

171. If the Service needed a further indication of the disfavor with which Congress viewed the grant of special estate tax treatment of qualified plan proceeds, the 1986 TRA certainly provided it. Section 4981A, which was added to the Code by § 1133 of that legislation, provides for a 15 percent increase in the estate tax payable by the estate of any individual who has an "excess retirement accumulation." I.R.C. §

2. As It Should Be: Use of a Two-Pronged Test

a. The Second Prong

The aggregation rule was developed to prevent avoidance of section 2039 by individuals who split a joint and survivor annuity into two single life annuities, neither of which would satisfy all of the requirements of section 2039.[172] As previously explained, the first inquiry should be whether the plan sought to be aggregated meets the lifetime payment requirement. That determination should be made by using the qualitative similarity test of *Fusz*.[173] If a payment is qualitatively similar to that provided under a joint and survivor annuity it will fulfill the lifetime payment requirement. That, however, is only the first prong of the test for aggregation.

A second inquiry is necessary. That second inquiry should determine whether the plan in question can be used to effect the annuity splitting which the aggregation rule seeks to prevent. Only plans which present the opportunity for the abuse that the aggregation rule seeks to prevent should be subject to aggregation.

This second inquiry is, in effect, the second prong of the test for aggregation. It will give the aggregation rule a scope consistent with its purpose. Limiting aggregation to benefits which present the opportunity for annuity splitting ensures that annuity splitting will not result in the avoidance of section 2039.[174] The aggregation rule will have served its purpose. Equally important, it will have done so without enlarging the scope of section 2039 beyond the bounds that Congress contemplated when enacting and amending that section.

b. Operation of the Proposed Test

The operation of this proposed two-pronged test can be illustrated by using it to determine whether benefits provided under qualified plans should be aggregated with benefits provided under non-qualified plans for purposes of section 2039. Benefits provided under qualified plans easily satisfy the first prong of the test. Payment of the benefits is contingent only upon survival to retirement age or age 70-½.[175] Thus, the employee is entitled to receive the

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4891A(d) (1986). Most distressingly, the unified credit cannot be used against that increase in the estate tax. I.R.C. § 4891A(d)(2) (1986).

172. Treas. Reg. § 20.2039-1(b) example 6 (1976); *see supra* note 82 and accompanying text.

173. *See supra* notes 125-30 and accompanying text.

174. That the second prong of the test requires a case by case determination does not make it undesirable. While bright line tests are easy to administer, they lack flexibility and can thus lead to unfair results. The test proposed here is tailored to the purpose of the rule and will ensure that the rule will accomplish it. The proposed test should not be difficult to administer because it should not be difficult to determine whether an individual can use a particular benefit to effect annuity splitting.

175. Section 401(a) requires that payment of benefits begin by April 1 of the calendar year following the latter of the year of retirement (I.R.C. § 402(a)(9)(C)(ii) (1986)) or the year the employee attains age 70-½ (I.R.C. § 401(a)(9)(C)(i) (1986)).

benefits during his lifetime. Benefits due under qualified plans are therefore post-employment benefits qualitatively similar to those provided by a joint and survivor annuity.[176] Indeed, the statute favors payment of such benefits in the form of a joint and survivor annuity.[177] The lifetime payments to which a participant in a qualified plan is entitled clearly fulfill the lifetime payment requirement of section 2039(a).

Nevertheless, benefits provided under qualified plans should not be aggregated with benefits provided under non-qualified plans because they do not pass the second prong of the test. Qualified plans do not present the opportunity for the annuity splitting which the aggregation rule seeks to prevent. Qualified plans are so heavily regulated that they do not present any opportunity for annuity splitting at all.

Qualified plans are self-contained, independent entities. Plan assets are held by a trust, not by the employer.[178] Benefits provided to participants emanate only from the assets contributed to and generated by the trust.[179] The level of benefits is determined by the trust and cannot discriminate in favor of officers, shareholders or highly compensated employees.[180] With one exception, factors outside the trust cannot affect the level or form of benefits.[181] The exception proves the rule.

The exception is the social security system.[182] Benefits provided by qualified plans can be integrated with social security.[183] Plans which are so integrated provide comparatively fewer benefits to employees covered by social

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See Prop. Reg. § 1.401(a)(9)-(1)-(2).

176. Even if the employee had elected to receive benefits in a lump sum, the plan would fulfill the lifetime payment requirement because the lump sum would be an "other payment" which would satisfy the lifetime payment requirement. For an excellent discussion of the treatment of distributions from qualified plans, see Hoyt, *Taxation of Qualified Plan Distributions: History and Analysis*, 5 VA. TAX. REV. 287 (1985).

177. I.R.C. § 417 (1986). Section 417 even requires certain married participants to obtain the written consent of their spouse before they can receive benefits in any form other than a qualified joint and survivor annuity. I.R.C. § 417(a) (1986). Indeed, since 1976, § 401(a)(11) required plans to offer payment in the form of a qualified joint and survivor annuity. Pub. L. No. 93-406, § 1021(a)(1), 88 Stat. 935 (1974). Congress added § 417 in 1984 to remedy the inequities which resulted when a participant elected to receive a single life annuity but died prematurely, potentially leaving a spouse unprotected. Pub. L. No. 98-397, § 203, 98 Stat. 1426, 1441-45 (1984); S. REP. No. 98-575, 98th Cong., 2d Sess. 12 (1984).

178. I.R.C. § 401(a) (1986); Treas. Reg. § 1.401-1(a)(3) (1971); Treas. Reg. § 1.401-2(a) (1971); Treas. Reg. § 1.401(a)-2 (1971).

179. I.R.C. § 401(a) (1986); Treas. Reg. § 1.401-1(a)(3)(v) and (vi) (1971); Treas. Reg. § 1.401-4 (1971).

180. I.R.C. § 401(a)(4) (1986); Treas. Reg. § 1.401-1(a)(3)(v) and (vi) (1971); Treas. Reg. § 1.401-4 (1971).

181. I.R.C. § 401(a)(5) (1986); Treas. Reg. § 1.401-3(e)(1).

182. *See supra* note 181.

183. *Id.* The regulations prescribe the method of integration, however. Treas. Reg. § 1.401-3(e)(2) (1971).

security than to employees not covered by social security.[184] In effect, benefits are split between the plan and the social security system. The need for special statutory authority to allow such benefit splitting[185] and the need for several pages of regulations to govern its operation[186] show that qualified plans could not be used for any other type of benefit splitting.

Yet, benefit splitting is precisely what the aggregation rule was designed to prevent. Since the statutory and regulatory provisions which govern qualified plans already prevent it, application of the aggregation rule would be superfluous.

Congress has regulated qualified plans extensively. Every detail of such a plan, from who must participate,[187] the maximum benefits they can receive,[188] the minimum benefits they must receive,[189] and the time when their benefits must become vested[190] to when and in what form they will receive the benefits,[191] is the subject of an intricate web of statutory and regulatory provisions. Always concerned that taxpayers not abuse the significant tax advantages offered by qualified plans, Congress has often fine-tuned the statute and further restricted an employer's freedom to set the terms of its qualified plans.[192] The

184. Integrated plans may even exclude from coverage employees whose remuneration does not exceed the social security wage base (I.R.C. § 3121(a)(1) (1986); Treas. Reg. § 1.401-3(e)(1)) or provide different contributions or benefits with respect to remuneration included in the social security wage base. Treas. Reg. § 1.401-3(e)(1) (1971).

185. I.R.C. § 401(a)(5) (1986). Absent statutory dispensation, an integrated plan would fail the minimum coverage (I.R.C. § 401 (1986)) and non-discrimination requirements (I.R.C. § 401(a)(4) (1986)) because lower rank employees, whose compensation would be subject to social security, would either not be covered by the plan or be covered to a lesser degree than more highly compensated employees.

186. *See, e.g.*, Treas. Reg. § 1.401-3(e).

187. I.R.C. § 410 (1986).

188. I.R.C. § 415(b) (1986).

189. I.R.C. § 412 (1986).

190. I.R.C. § 411 (1986).

191. I.R.C. §§ 401(a)(9), (a)(11), 417 (1986).

192. Including technical corrections, § 401(a) alone has undergone more than 45 amendments over the past ten years. *See* Pub. L. No. 99-514, §§ 1106(d)(1), 1111(b), 1112(b), 1114(b)(7), 1119(a), 1121(b), 1136(a), 1145(a), 1171(b)(5), 1174(c)(2)(A), 1175(a)(1), 1176(a), 1852(a)(4)(A), 1852(a)(6), 1852(b)(8), 1898(b)(2)(A)(i)(ii), 1898(b)(7)(A), 1898(b)(13)(A), 1898(B)(14)(A), 1899(A)(10), 100 Stat. 2423, 2435, 2444, 2451, 2463, 2465, 2485, 2490, 2513, 2518, 1519, 2865, 2866, 2867, 2945, 2948, 2950, 2958 (1986); Pub. L. No. 98-397, §§ 203(a), 204(a), 301(b), 98 Stat. 1440, 1441, 1445 (1984); Pub. L. No. 98-369, §§ 211(b)(5), 474(r)(13), 491(e)(4) and (5), 521(a)(1) and (2), 524(d)(1), 98 Stat. 754, 842, 853, 865, 867, 872 (1984); Pub. L. No. 97-448, § 103(g)(2)(A), 96 Stat. 2379 (1983); Pub. L. No. 97-248, §§ 237(b), 237(e)(1), 240(b), 242(a), 254(a), 96 Stat. 511, 512, 520, 521, 533 (1982); Pub. L. No. 97-34, §§ 312(b)(1), 335, 338(a), 95 Stat. 283, 297, 298 (1981); Pub. L. No. 96-605, §§ 221(a), 225(b)(1), 94 Stat. 3528, 3529 (1980); Pub. L. No. 96-364, §§ 208(a), 208(e), 410(b), 94 Stat. 1289, 1290, 1308 (1980); Pub. L. No. 96-222, §§ 101(a)(7)(L)(i)(V), 101(a)(9), 101(a)(14)(E)(iii), 94 Stat. 199, 201, 205 (1980); Pub. L. No. 95-600, § 141(f)(3), 143(a), 152(e), 92 Stat. 2795, 2796, 2799 (1978); Pub. L.

result of such extensive legislative scrutiny is a complex set of rules that prohibit both employers and employees from using a qualified plan to do practically anything but what it is supposed to do.

In 1984 Congress even amended the qualified plan provisions to require that benefits due many married participants be paid in the form of a joint and survivor annuity.[193] Only if the participant's spouse waives his or her right to receive such an annuity or cannot be located can the plan pay the benefits in any other form.[194] In such a case the benefits are paid in accordance with the terms of the plan.[195] Realistically, the options will be either a lump sum distribution or some other type of annuity, either single life or joint.[196]

If a spouse does not waive the right to receive a survivor annuity, the value of the annuity will be included in the employee's gross estate under section 2039.[197] If a spouse waives the right to the survivor annuity or if the employee is unmarried, the employee may receive the benefits in a lump sum. Whatever amount remains unconsumed at the employee's death will then be included in his or her gross estate.[198] If such an employee elects a single life annuity, whatever remains unconsumed at his or her death will be included in his or her gross estate.[199] Because nothing will pass to the survivors nothing

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No. 94-455, 803(b)(2), 90 Stat. 1584 (1976).

193. *See supra* note 36. In the case of a married plan participant who dies before he or she begins to receive an annuity, (the "annuity starting date," I.R.C. § 417(f)(2) (1986)), § 401(a)(11) requires that the surviving spouse receive a qualified preretirement survivor annuity. I.R.C. § 401(a)(11)(A)(ii) (1986). Section 417(c) defines a qualified preretirement survivor annuity generally as an annuity which is essentially equivalent to the survivor annuity which the surviving spouse would have received if the deceased spouse had retired with a qualified joint and survivor annuity the day before the date of death or, if the participant could not have retired prior to the date of death, an annuity which is equivalent to the survivor annuity the surviving spouse would have received if the participant had died the day after the earliest possible retirement date provided in the plan. I.R.C. § 417(c)(1) (1986); Temp. Treas. Reg. § 1.417(e)-1T(c)(1).

194. I.R.C. § 417(a)(2) (1986). This provision generally applies only to participants who have been married at least one year. I.R.C. § 417(d) (1986). The statute provides detailed rules setting forth the period during which the election can be made (I.R.C. § 417(a)(1)(A)(i), (a)(5) (1984)) as well as the information which must be provided to a participant with respect to such an election (I.R.C. § 417(a)(3)(A) (1986)), and the periods during which a participant may revoke any such election. I.R.C. § 417(a)(1)(A)(ii), (a)(5) (1986).

195. The Code does not otherwise limit the form in which benefits can be paid, although it does mandate when payment must be made. I.R.C. § 401(a)(9) (1986); *see infra* note 200.

196. The only alternative to payment in a lump sum or payment in some form of annuity is forfeiture, an economically unsound and therefore unrealistic alternative.

197. A qualified plan meets all of the requirements of § 2039(a). Given the repeal of § 2039(c), the value of the survivor annuity would be included in the employee's gross estate because no other provision would exclude it. *See supra* note 193.

198. Any amounts not consumed but gratuitously transferred during the employee's life will be subject to the gift tax. I.R.C. § 2501 (1986).

199. I.R.C. § 2033 (1986).

else need be included on account of the plan. If the plan provides for some other type of joint and survivor annuity, the value of the survivor annuity will be included in the employee's gross estate under section 2039. The benefits provided by the qualified plan will therefore be subject to the estate tax to the extent that they pass to the employee's survivors either through non-consumption during the employee's life or through the payment of a survivor annuity.[200]

As the foregoing discussion demonstrates, the qualified plan provisions themselves ensure that any benefits attributable to contributions made to such plans will be included in the employee's gross estate unless consumed during the employee's lifetime. The benefits cannot be split.[201] They cannot be used to avoid section 2039. They fail the second prong of the test.

Because payments due under qualified plans fail the second prong of the test they should not be aggregated with other benefits for purposes of section 2039. To do otherwise would be to use the aggregation rule to prevent an occurrence which the qualified plan provisions have been meticulously drafted to prevent. It would be superfluous and inappropriate.

3. Non-Aggregation: The Right Result for Qualified Plans

a. Effectuating Congressional Intent

The proposed two-pronged test yields the right result in the case of qualified plans. Applying the aggregation rule to qualified plans would give the government a windfall not contemplated by Congress. The repeal of section 2039(c) would then result not only in subjecting qualified plan proceeds to federal estate taxation, which Congress clearly intended, but also subjecting to estate taxation many non-qualified death benefits paid to survivors.[202] There is

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200. I.R.C. § 2039 (1986). Benefits payable under a qualified plan will be included in the gross estate even if the employee elects to have benefits payable in the form of a single survivor annuity. In such a case all of the requirements of § 2039(a) will be satisfied. The amount will clearly be an annuity paid under a contract or agreement (the plan). The plan itself will also satisfy the lifetime payment requirement because of § 401(a)(9). That section requires that a qualified plan distribute an employee's interest to him or her by the later of the year after retirement or the year he or she turns 70-½. I.R.C. § 401(a)(9)(A), (c) (1986); *see* Prop. Reg. § 1.401(a)(9)-(1), 52 Fed. Reg. 28075 (1987) and (2), 52 Fed. Reg. 28098 (1987). The plan itself will therefore provide for payments to the employee during his or her lifetime. Since such payments depend only upon the employee's survival until a particular date, they clearly satisfy the lifetime payment requirement. *See supra* note 106 and accompanying text.

201. Use of qualified plan contributions to provide a pure death benefit outside the plan would violate § 401(a)(1) and disqualify the plan.

202. For example, aggregation of qualified and non-qualified plans would have resulted in federal estate taxation of the benefits payable to Mrs. Schelberg. *See supra* note 155 and accompanying text. Assuming that the benefit package offered by Mr. Schelberg's employer, International Business Machines (IBM) is not atypical, aggregation of qualified plans would provide a simple way for the Service to succeed in taxing benefits payable to survivors of many employees of corporate America.

no indication that Congress even considered, much less intended, such a result. Indeed, the legislative history suggests that Congress did not believe that the repeal of section 2039(c) would have very far reaching consequences at all.[203]

The test proposed would ensure a result consistent with the congressional intent in repealing section 2039(c) as well as in enacting section 2039. If Congress had wanted to tax pure death benefits, it would have done so directly. That the requirements for inclusion in the gross estate under section 2039 so meticulously reflect the characteristics of a joint and survivor annuity shows that such annuities are all Congress intended to tax with the provision. If Congress had wanted to tax pure death benefits it could easily have done so by simply eliminating the lifetime payment requirement.[204] Congress did not intend to use section 2039 to tax pure death benefits.[205] The repeal of the qualified plan exclusion should not be used to accomplish that result.

b. Consistency with Prior Administrative Practice

Not aggregating qualified and non-qualified benefits would also be consistent with the Service's prior practice. The Service's response to previous

203. In their discussion of the consequences of the repeal of the qualified plan exclusion both the Senate Finance Committee and the Joint Committee on Taxation noted that qualified plan benefits would be eligible for the unlimited marital deduction if included in the gross estate and would therefore generate no actual estate tax liability if left to a surviving spouse. I.R.C. § 2056 (1986); *see* 1984 Blue Book, *supra* note 69, at 824; *supra* note 73. In addition, those committees noted that to the extent that qualified plan benefits generated any estate tax liability such liability could be offset by the unified credit. I.R.C. § 2010 (1986); *see* 1984 Blue Book, *supra* note 69, at 824; *supra* note 75. Although this does not mean that benefits paid under qualified plans would never generate any actual estate tax liability, it does show that Congress did not perceive the inclusion of such proceeds in the gross estate as a change that would have far reaching implications for the estate taxation of employee benefits. There is no suggestion in the legislative history that Congress even considered that the repeal of § 2039(c) might lead to the inclusion in the gross estate of not only qualified plan benefits but non-qualified pure death benefits as well.

Indeed, Congress did not even expect to raise comparatively large amounts of revenue through the repeal of § 2039(c). The measure was expected to raise $50 million in each of the three years following its enactment. 1984 Blue Book, *supra* note 69, at 825. That amount is paltry when compared to that raised by other provisions of the 1984 legislation. Freezing tax reforms alone was expected to raise $10,546 million in 1985, $18,071 million in 1986 and $24,123 million in 1987. 1984 Blue Book, *supra* note 69, at 1235.

204. Indeed, at least one commentator has suggested that Congress should eliminate the lifetime payment requirement so as to allow § 2039 to reach pure death benefits. Colliton, *Conforming Section 2039 to the Goals of Estate Taxation*, 34 U. FLA. L. REV. 693, 711-12 (1982); *see also* Wolk, *supra* note 40.

205. Nothing in the legislative history of the 1982 (TEFRA) amendment which restricted the § 2039(c) exemption to $100,000 or in the 1984 TRA provisions which repealed the exemption altogether suggests that Congress, Treasury, or even the Service itself saw the repeal of the § 2039(c) exemption as a way to subject otherwise nontaxable survivors benefits to the federal estate tax. *See supra* note 204.

changes to the section 2039(c) exclusion would not have suggested that the complete repeal of that exclusion could have such far reaching consequences. When Congress amended section 2039(c) in 1976 to limit the qualified plan exclusion to situations where the beneficiary did not elect favorable income tax treatment,[206] the response of the Treasury and the Service did not suggest that benefits provided by qualified plans would be subject to aggregation when the proceeds were included in the employee's gross estate because the beneficiary elected favorable income tax treatment. On the contrary, in 1976 the Service issued Rev. Rul. 76-380, which confirmed that the aggregation rule did not apply to benefits paid by qualified plans.[207] If non-aggregation depended on exclusion from the gross estate, it would have followed that when the exclusion did not apply, the aggregation rule would. Yet, in no reported case or ruling has the Service asserted such a position.[208]

Furthermore, when Congress in 1982 reduced the section 2039(c) exclusion to \$100,000,[209] the Service did not similarly reduce the scope of the exception from the aggregation rule. Thus, although qualified plan proceeds in excess of \$100,000 were no longer excluded from the gross estate under any circumstances, the Service did not announce any change in its position regarding the treatment of benefits provided by qualified plans for purposes of the aggregation rule.

The Service's silence on this point notwithstanding statutory revisions that suggested changes in the Service's position on the aggregation rule[210] would have reinforced Congress' assumption that the complete repeal of the section 2039(c) exclusion would have no collateral effects. It might even suggest that the Service has come to recognize the existence of another justification for expecting qualified plans from aggregation. Formal adoption of the suggested two-pronged test would provide that justification. It would also bring much needed clarity to a complicated and confusing area of the law.

V. SUGGESTED ACTION

A. *Amendment of Existing Regulations and Rulings*

The tremendous popularity of qualified plans makes it imperative that the Treasury and the Service set forth a comprehensive analysis of the effect of the repeal of section 2039(c) on the estate taxation of employee death bene-

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206. *See supra* note 64 and accompanying text.
207. *See supra* note 89 and accompanying text.
208. Although the absence of a reported case does not mean that the Service has never asserted such a position, it does show that the Service has not asserted the position with sufficient regularity to result in litigation. The absence of a ruling is even more telling, since the Service could have used the issuance of a ruling to indicate a change in its position without having to litigate a case.
209. *See supra* note 67 and accompanying text.
210. *See supra* note 67.

fits.[211] Doing so will require an examination of section 2039 and the aggregation rule. Such an examination should proceed along the lines presented here and should conclude with the adoption of the proposed two-pronged test. The Treasury should then set forth the test in the regulations and the Service should amend its rulings accordingly.[212]

Amendment of the existing regulations and rulings would serve several desirable ends. It would prevent the unexpected taxation of pure death benefits not currently subject to such taxation. It would clarify a confusing area of the law. It would also provide a mechanism for determining whether certain other plans should escape aggregation.[213]

B. *Extension Beyond Qualified Plans*

The two-pronged test suggested here should be applied before any payments are aggregated for purposes of section 2039. In many cases, particularly those involving non-qualified plans, payments which satisfy the first prong of the test will also satisfy the second prong. Non-qualified plans reflect only a contractual relationship between the employer and employee.[214] The parties

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211. In the first six months of 1987 alone, the Service issued 42,713 determination letters on initial applications for qualified plans benefitting approximately 13,096,317 employees. I.R.S. News Release IR-87-97 (August 19, 1987).

In addition, an independent survey of 256 major employers conducted between 1981 and 1986 found that over 95 percent of these employers offered defined benefit plans. The survey included 75 percent of Fortune 100 and 68 percent of Fortune 250 companies, as well as 38 percent of Fortune 50 commercial banking companies and 46 percent of Fortune 50 life insurance companies. Pens. & Benefits Daily (BNA) (July 10, 1987).

212. At minimum, Treas. Reg. § 20.2039-1(b)(2) example 6, should be amended. The amendment should delete the parenthetical reference to § 401(a) plans and to Treas. Reg. § 20.2039-2, which is obsolete in light of the repeal of § 2039(c). Treasury should then add another example illustrating the application of the aggregation rule as proposed here. The example should involve a qualified plan and a pure death benefit and should set forth the analysis which leads to the conclusion that aggregation is not appropriate. In addition, the Service should issue another ruling clarifying Rev. Rul. 76-380, 1976-2 C.B. 270 so as to make explicit the limitations on the aggregation rule and the role of qualified plans.

213. Defining the scope of an aggregation rule would not be a novel endeavor for Treasury. The qualified plan area contains aggregation rules which Treasury has meticulously delineated in its regulations. *See, e.g.*, Treas. Reg. § 1.415-10 (1986).

214. Non-qualified deferred compensation plans need only to be structured so as to avoid current inclusion of the deferred amounts in the employee's income. Thus, they cannot result in constructive receipt by the employee (Treas. Reg. § 1.451-2 (1986), Rev. Rul. 60-31, 1960-1 C.B. 174, Rev. Proc. 71-19, 1971-1 C.B. 698) or bestow an economic benefit on the employee. Sproull v. Commissioner, 16 T.C. 244, 247 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952); Rev. Rul. 72-25, 1972-1 C.B. 127, 128; Rev. Rul. 68-99, 1968-1 C.B. 193, 194; *see* McDonald, *Deferred Compensation: Conceptual Astigmatism*, 24 TAX L. REV. 201, 204 (1969); Metzer, *Constructive Receipt, Economic Benefit and Assignment of Income: A Case Study in Deferred Compensation*, 29 TAX. L. REV. 525, 551 (1974); *see also* Minor v. United States, 772 F.2d 1472, 1474-75 (9th Cir. 1985) and cases cited therein. Non-qualified deferred compensation

determine the details of that relationship without interference from Congress. Therefore, many non-qualified plans might well present an opportunity for the kind of annuity-splitting which the aggregation rule sought to prevent. Payments made under such plans would generally fail the second prong of the test and would be subject to aggregation.

Not all plans which are not qualified plans would fail the second prong of the test, however. In addition to the section 401(a) qualified plans which the Treasury specifically referred to in Treas. Reg. §20.2039-1, Example 6, and which have been the focus of discussion here, Congress has legislated the requirements for other types of income tax favored employee benefit plans.[215] For example, benefits provided by section 403(a) plans are subject to the same non-discrimination, vesting and minimum funding requirements as section 401(a) qualified plans.[216] Like section 401(a) qualified plans, section 403(a) plans must provide a joint and survivor annuity for married participants unless the participant's spouse waives the right to the annuity.[217] Like payments made under section 401(a) qualified plans, payments made under section 403(a) plans would fail the second prong of the test and should not be subject to aggregation.

Section 403(b) annuity plans are also subject to detailed statutory proscriptions.[218] They are subject to virtually the same restrictions as are section

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arrangements can contain any provisions negotiated by employer and employee so long as they avoid the application of those two general doctrines. While the doctrines generally require that the employer's promise be unfunded and that the employee's interest not exceed that of a general creditor (*see, e.g.*, Rev. Rul. 72-75, 1972-1 C.B. 127; Rev. Rul. 68-99, 1968-1 C.B. 193), they do not mandate the form or timing of the distributions.

215. Section 2039(c), prior to amendment by DEFRA, also excluded from a decedent's gross estate (1) the value of a retirement annuity contract purchased by an employer under a section 403(a) plan, (I.R.C. § 2039(c)(2) (1984)), (2) the value of a retirement annuity contract purchased by a § 170(b)(1)(A)(ii) or (vi) charitable organization or religious organization exempt from tax under § 501(a) for its employees (I.R.C. § 2039(c)(3) (1984)), and (3) the value of an annuity or other payment received under chapter 73 of Title 10 of the United States Code (relating to armed services personnel) (I.R.C. § 2039(c)(4) (1984)). If an employer who provided any of the foregoing types of benefits also provided pure death benefits to an employee's survivors, the question of aggregation could have arisen. Since Treas. Reg. § 20.2039-1(b)(2) example 6, excepted from the aggregation rule only qualified plans (example 6 specifically refers to § 401(a) and does not refer to § 403(a) plans or to plans provided by particular types of employers) the regulation would not have prevented the aggregation of benefits excluded from the decedent's gross estate by § 2039(c) with other death benefits. By amending the existing regulations and rulings, the Treasury and the Service would resolve any questions about the propriety of aggregating pure death benefits with benefits provided under these other, quasi-qualified, plans.

216. I.R.C. § 404(a)(2) (1986).

217. *Id.*

218. I.R.C. § 403(b) (1986). Section 403(b) plans are subject to the limitations on benefits and contributions of § 415. I.R.C. § 415(a)(2)(B) (1986).

401(a) plans with respect to benefit distributions.[219] Payments made under such plans would also fail the second prong of the test. Therefore, they would not be subject to aggregation even though such payments could have been included in the gross estate before the repeal of section 2039(c).[220]

The result of applying the proposed test to other types of employee benefits is less clear. Perhaps courts will find that amounts due under simplified employee pension plans satisfy the second prong of the proposed test because distribution of those amounts is subject to the distribution requirements of section 401(a)(9), which also apply to qualified plans.[221] In addition, payments under such plans probably satisfy the second prong of the test because they are either subject to the joint and survivor annuity provisions of section 417 or will provide for payment of a lump sum to the participant's surviving spouse.[222]

Courts might also debate whether amounts due under incentive stock option plans[223] would fulfill either prong of the proposed test. While an examination of the desirable answers to these questions is beyond the scope of this Article, the test which the Article has endeavored to develop should assist both the Service and the courts in conducting such an examination. It will enable

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219. I.R.C. §§ 401(a)(11)(B)(iii), 415(k)(1)(C) (1986). To the extent that a § 403(b) plan is not subject to the joint and survivor annuity provisions of § 417, it must provide for a lump sum payment to the participant's surviving spouse. I.R.C. § 401(a)(11)(B)(iii) (1986). Neither of these alternatives presents an opportunity for annuity splitting. *See supra* note 84.

220. For example, benefits provided by § 403(b) annuity plans were excluded from the gross estate under § 2039(c) when the decedent's employer was a charitable organization described in § 170(b)(1)(A)(ii) or (vi). Because not all organizations which can adopt § 403(b) plans are described in § 170(b)(1)(A)(ii) or (vi), however, benefits provided by some § 403(b) annuity plans were included in the gross estate.

221. I.R.C. § 408(c), (a)(6) (1986). Simplified employee pension plans which are described in § 408(c), are essentially employer-sponsored individual retirement accounts.

222. I.R.C. §§ 401(a)(11)(B)(iii), 415(k)(1)(F) (1986). Neither of those alternatives presents an opportunity for annuity splitting and avoidance of § 2039. *See supra* note 219.

223. Incentive stock option [hereinafter "ISO"] plans are governed by § 422A. Because an employee can exercise the ISO during his or her life (I.R.C. § 422A(b)(5) (1986)) and because once the employee exercises the ISO he or she will be entitled to dividends on the option stock and any appreciation upon sale, the Service might take the position that the grant of an ISO, if not mere participation in the ISO plan, will satisfy the lifetime payment requirement. The Service might then aggregate the ISO plan with other plans in which the employee participates. Section 422A provides detailed requirements for ISO plans and prohibits transfers of the option except by will or the laws of descent and distribution. I.R.C. § 422A(b)(5) (1986). It does not prohibit sale of the option stock, nor does it restrict the use to which the optionee may put the proceeds of any such sale. I.R.C. § 422A (1986). A disqualifying disposition of the shares prior to the expiration of two years from the date the ISO was granted or one year from the date the ISO stock was transferred to the employee (I.R.C. § 422A(a)(1) (1986)) will only cause the employee to recognize ordinary income to the extent of gain realized. I.R.C. § 421(b) (1986); Treas. Reg. § 1.421-8(b)(1) (1986).

them to distinguish between the question of fulfillment of the lifetime payment requirement and the question of aggregation. It will allow them to apply a clearly articulated test to both.[224]

VI. CONCLUSION

Section 2039 was enacted to include in a decedent's gross estate the value of benefits paid to a survivor under a joint and survivor annuity.[225] The aggregation rule responded to the Treasury's fear that clever taxpayers and their employers would avoid the reach of section 2039 by splitting a joint and survivor annuity into two single life annuities, both of which would fail to meet the requirements of the section.[226] When they excluded qualified plans from the aggregation rule, the Treasury and the Service appeared to follow the rather attractive rationale that a benefit not subject to federal estate taxation should not be used to make another benefit subject to such taxation.

The repeal of the qualified plan exclusion destroys the applicability of that rationale and requires a re-examination of the aggregation rule. This re-examination reveals that much of the confusion resulted from an unwillingness to distinguish between fulfillment of the lifetime payment requirement of section 2039 and the issue of aggregation.

The re-examination of this area of the law yields a different analytical approach to both the aggregation rule and the lifetime payment requirement. The new approach reconciles the congressional purpose in enacting section 2039 with the Service's current administration of the aggregation rule. It results in continuing to exclude qualified plans from aggregation. Because it is fully articulated, it also provides a framework for determining whether other types of benefits should be subject to aggregation. It thus brings order to a

224. Although the benefits that would not be subject to aggregation under the proposed test are, in some cases, payable by the same type of plans whose proceeds were excluded from the gross estate until 1984, two factors bear comment. First, the reason for excluding the listed benefits from the aggregation rule is grounded on the inability to use them to thwart the purpose of § 2039 and not their inclusion or exclusion from the gross estate. Second, not all benefits previously subject to the § 2039(c) exclusion have been listed. Thus, benefits provided under plans adopted by § 170(b)(1)(A)(ii) or (vi) organizations ("exempt organization plans") previously covered by the § 2039(c) exclusion are not part of the list.

As previously explained, the reason such benefits were subject to the § 2039(c) exclusion was that Congress reasoned that since such plans were subject to the same non-discrimination requirements applicable to qualified plans they should also enjoy the estate tax benefit of qualified plans. However, exempt organization plans are not subject to all of the restrictions applicable to qualified plans, and, in particular, are not subject to the restrictions on the form in which benefits can be paid. *See* I.R.C. § 415(k)(1)(A) (1986). Theoretically, then, such plans could be structured so as to avoid the impact of § 2039. Application of the aggregation rule would prevent such avoidance, and should therefore occur.

225. *See supra* note 23 and accompanying text.

226. *See supra* note 84.

complicated area of the law and provides a policy-based mechanism for determining the reach of a rule whose purpose and application are an integral part of the federal estate tax system.

The Treasury and the Service should act promptly to amend existing regulations and published rulings to clarify the scope of the aggregation rule and the lifetime payment requirement and to make it clear that the repeal of the estate tax exclusion for qualified plans will not result in the estate taxation of other, previously untaxed, non-qualified death benefits. If the Treasury does not so act, perhaps Congress should step into the breach. Congress did not intend that the coalescence between death and taxes be complete. Inadvertence should not make it so.