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I.R.C. Section 2518 and the Law of Disclaimers

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Abstract

The Tax Reform Act of 19761 introduced code section 2518,2 which created definitive standards for a disclaimer to be valid for Federal Tax purposes.

KEYWORDS: disclaimers, law, IRC

I.R.C. Section 2518 and the Law of Disclaimers

The Tax Reform Act of 1976[1] introduced code section 2518,[2] which created definitive standards for a disclaimer to be valid for Federal Tax purposes. As a result of its recent passage, lack of interpretive regulations and absence of court interpretation,[3] its application in many areas is unclear; consequently, much uncertainty surrounds the law of disclaimers. In an attempt to show the virtues, uncertainties and shortcomings of section 2518, this article will analyze section 2518 on two different planes: (1) whether it carries out the intent of Congress and (2) whether it can be improved to enhance the use of disclaimers as an estate planning tool (a somewhat idealistic notion).

To discuss section 2518 meaningfully the reader must understand the use of disclaimers as an estate planning tool, the common law of disclaimers and the events which led to the enactment of section 2518. Therefore, the article begins with several sections designed to acquaint the reader with these areas. The remainder of the article is devoted to a discussion of section 2518's effectiveness and suggestions to enhance its effectiveness.

1. DISCLAIMERS AS AN ESTATE PLANNING TOOL

A disclaimer is the refusal to accept the ownership of property or rights with respect to property.[4] The major importance of disclaimers is the flexibility they provide for estate planning. Disclaimers can be used to correct errors in an estate plan after it would ordinarily be too late

1. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 STAT. 1893, added I.R.C. Sec. 2518.

2. I.R.C. Sec. 2518 (hereinafter referred to as 2518).

3. *But see* Ingham v. Hubbell, 462 F. Supp. 59 (S.D. Iowa 1978). In Hubbell, the court was asked to decide a class action under the declaratory judgement act. The issue was whether the plaintiff's disclaimer of a portion of a contingent interest was a qualified disclaimer. The case was dismissed for lack of an actual controversy.

4. WAYS AND MEANS COMMITTEE REPORT accompanying HR 14844 H.R. REP. No. 94-1380, 94th Cong., 2d Sess. 65 (1976) (hereinafter cited as WAYS AND MEANS COMMITTEE REPORT).

(for example after the testator's death), adjust the estate plan to account for changed circumstances, avoid the creditors of a beneficiary and allow post mortem estate planning. The following examples will demonstrate the use of disclaimers as a method of achieving tax savings; assume each of the following disclaimers are qualified.

A disclaimer may be used to save gift tax.[5] A devises Whiteacre to B. B has no need for Whiteacre and would prefer it to pass to his son C. If B accepts Whiteacre and transfers it to C for less than adequate and full consideration in money or money's worth, B has made a taxable gift to C.[6] Whereas, if B disclaims Whiteacre which thereby passes to C, no gift tax will be imposed on B.[7] There is no gift from B to C because B will be treated as never having owned Whiteacre.[8]

A disclaimer may be used to save estate tax.[9] A devises Whiteacre to B who is terminally ill. B would prefer to give Whiteacre to his son C in a manner that will not have any tax ramifications. If B accepts Whiteacre and then dies, Whiteacre will be included in B's gross estate.[10] If B disclaims Whiteacre, which thereby passes to C, there will be no inclusion in B's gross estate, because B will again be treated as never having owned Whiteacre.[11]

A disclaimer may be used to prevent an overfunding or an underfunding of a marital bequest for purposes of achieving the maxi-

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5. I.R.C. Sec. 2518 (a); WAYS AND MEANS COMMITTEE REPORT AT 65.

6. I.R.C. Secs. 2501 and 2511; Treas. Reg. Sec. 25.2511-1(c), T.D. 6334, 1958-2 C.B. 643. *See* Hardenbergh v. Comm'r, 198 F.2d 63 (8th Cir.), aff'd. 17 T.C. 166 *cert. denied,* 344 U.S. 836 (1952); Bishop v. United States, 338 F. Supp. 1336 (N.D. Miss. 1970), aff'd per curiam, 26 AFTR 2d 1653 (5th Cir. 1972); Krakoff v. United States, 313 F. Supp. 1089 (S.D. Ohio 1970), aff'd. 439 F. 2d 1023 (6th Cir. 1971); William L. Maxwell v. Comm'r, 17 T.C. 1589 (1952).

7. I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65.

8. "(a) General Rule - For purposes of this subtitle, if a person makes a qualified disclaimer with respect to any interest in property, this subtitle shall apply with respect to such interest as if the interest had never been tranferred by such person." I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65.

9. I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65. For purposes of estate tax, I.R.C. Sec. 2045 says 2518 applies.

10. "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." I.R.C. Sec. 2033; Treas. Reg. Sec. 20.2033-1.

11. Brown v. Rautzahn, 63 F. 2d 914 (6th Cir. 1933), *cert. denied,* 290 U.S. 641 (1933); I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65.

mum marital deduction.[12] If an amount greater than the maximum marital deduction allowable[13] passes to the surviving spouse, the excess will be taxed in the estate of each spouse.[14] If the surviving spouse disclaims the excess[15] over the maximum marital deduction allowable, the disclaimed property will not be included in the surviving spouse's gross estate.[16] If an amount less than the maximum marital deduction allowable is provided for the surviving spouse, a disclaimer by another can increase the property passing to the spouse and allow use of the full marital deduction.[17] In much the same way, a disclaimer by one heir can be used to increase an estate's charitable deduction.[18] Thus, a disclaimer can be an important post mortem estate planning tool.

A disclaimer will prevent the imposition of a generation skipping tax.[19] A devises to his son B a life estate in Whiteacre with remainder to B's son C. Assuming that the value of the property at B's death is greater than $250,000, a generation skipping tax will be imposed at

12. I.R.C. Secs. 2518(a) and 2056; WAYS AND MEANS COMMITTEE REPORT at 65. In the following discussion it is assumed that achieving the maximum marital deduction allowable is desired. For the law prior to 2518 *see generally* I.R.C. Sec. 2056 (d) and Treas. Reg. Sec. 20.2056(d)-1 (1958).

13. The maximum marital deduction allowable is the greater of $250,000 or 50% of the decedent's adjusted gross estate as defined in I.R.C. Sec. 2056(c)(2), less the I.R.C. Sec. 2056(c)(1)(B) adjustment.

14. It will be included in both estates as an I.R.C. Sec. 2033 inclusion, since the decedent owned the property at death. This property is not subject to the marital deduction since it exceeds the maximum deduction allowable. When the spouse receives the property under the marital bequest, it will be included in the surviving spouse's gross estate under I.R.C. Sec. 2033 when the survivor dies. However, the double taxation may be reduced by I.R.C. Sec. 2013.

15. The issue of partial disclaimers will be discussed later in this article as part of an analysis of the Tax Reform Act of 1976. *See* text accompanying notes 74-87.

16. I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65. The possibiltiy of a surviving spouse disclaiming an interest in a marital trust and taking a portion of the disclaimed interest under a non marital trust will be discussed later in this article. For purposes of this example assume the property passes to the issue of the surviving spouse.

17. *Id.*

18. *Id.* For an excellent discussion and example of disclaimers with respect to charitable deductions, *see* Newman and Kalter, *The Need For Disclaimer Legislation-An Analysis of The Background and Current Law,* 28 TAX LAW 571, 577 (1975).

19. I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65. *See* section 2614(c) and S. Rep. No. 94-1236, 94th Cong. 2d Sess. 607 (1976).

that time.[20] If B disclaims his life estate, no generation skipping tax will be imposed because B will be treated as never having owned a life estate in Whiteacre.[21]

A disclaimer may shift the income tax consequences of a trust.[22] A devises to B, a wealthy individual with a large income, the power to designate who shall be the recipient of an income interest in the trust res (the power excludes designation of the grantor's spouse). B will be taxed on the income of the trust because he has the power, exercisable solely by himself, to vest the income in himself.[23] If B disclaims his power he will not be taxed on the income.[24] Assuming B disclaims and the income is payable to B's son C (an individual with very little income) income tax will be saved as a result of the graduated tax rates.

2. COMMON LAW

It is important to understand the common law history of disclaimers because, prior to the enactment of section 2518, the federal income, estate and gift tax consequences of a disclaimer were dependent upon state law.[25] In this period, many states lacked disclaimer statutes and were dependent upon their own common law. Moreover, the disclaimer statutes that had been enacted[26] lacked sufficient uniformity to provide

20. *See generally* I.R.C. Secs. 2601-2614.

21. I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65. I.R.C. Sec. 2614(c) says for the effect of a qualified disclaimer see Sec. 2518.

22. I.R.C. Sec. 2518(a); WAYS AND MEANS COMMITTEE REPORT at 65.

23. I.R.C. Sec. 678(a)(1); Treas. Reg. Sec. 1.678 (a) -1 (1956).

24. I.R.C. Sec. 2518(c)(2) treats a power with respect to property as an interest in such property. I.R.C. Sec. 2518(a) will treat B as never having the power if he disclaims it. In Gallagher v. Smith, 223 F. 2d 218 (10th Cir. 1954), rev'g. 119 F. Supp. 360 (D.C. Pa. 1953) a widow disclaimed a portion of her interest in a trust. The court held she was only taxable on the income of the portion she retained.

25. Brown v. Routzahn, 63 F. 2d 914 (6th Cir. 1933); Kenaith v. Comm'r, 480 F. 2d 57 (8th Cir. 1973), rev'g. 58 T.C. 352 (1972); Estate of Rolin v. Comm'r, 68 T.C. 919 (1977), aff'd. 588 F. 2d 368 (2nd Cir. 1978); Jewett v. Comm'r, 70 T.C. 430 (1978); Treas. Reg. Secs. 25.2511-1 (c), T.D. 6334, 1958-2 C.B. 643; 20.2041-3 (d)(6) (1958); WAYS AND MEANS COMMITTEE REPORT at 65.

26. ARIZ. REV. STAT. Sec. 14-2801 (1973); CAL. PROB. CODE Sec. 190.1 (Deering 1972); COLO. REV. STAT. Sec. 15-11-801 (1963); CONN. GEN. STAT. Sec. 45-300 (1972); FLA. STAT. Sec. 732.801 (1977); HAW. REV. STAT. Sec. 538-1 (repealed 1974 and Uniform Probate Code was adopted 560:2-801); IDAHO CODE SEC. 15-2—801 (1971) repealed 1973 by ch. 173 Sec. 1 S.L. 1978; ILL. ANN. STAT. ch. 110 ½, Sec. 2-7

a standard law of disclaimers at the federal level.[27] Therefore, federal courts were frequently using common law rules in deciding controversies involving disclaimers. The next portion of this article will briefly outline the pertinent points of the common law: that is, who may disclaim, what may be disclaimed and when to disclaim.

A beneficiary under a will was permitted to disclaim his interest,[28] whereas, an heir was not permitted to disclaim an intestate share because it passed by operation of law.[29] A disclaimed interest in property was treated as if it was never made.[30] Therefore, a disclaimer became an effective way to avoid the claims of creditors and/or to reduce taxes.[31]

One issue which arose at common law involved the question of whether a disclaimer of part, but not all, of an interest in property was valid. The courts took varied positions. Some courts would not recog-

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(Smith-Hurd 1976); IND. CODE Sec. 29-1-6 (1971); IOWA CODE ANN. Sec. 633.704 (West 1972); KAN. STAT. Sec. 59-2291 (1968); MICH. COMP. LAWS ANN. Secs. 554.501-520 (1972); N.Y. EST., POWERS & TRUSTS LAW Sec. 4-1.3 (Consol. 1966); OHIO REV. CODE ANN. Sec. 1339.60 (Page 1976); OKLA. STAT. ANN. tit. 84 Sec. 22 (West 1973); R.I. GEN. LAWS ANN. Sec. 34-5-1 (1956); S.D. COMPILED LAWS ANN. Sec. 43-29 (1968); TEX. PROB. CODE ANN. art. 37A (Vernon 1971); WASH. REV. CODE ANN. Secs. 11.86.03-05 (1973); W. VA. CODE Sec. 42-4-3 (1959). The above listing of state disclaimer statutes is intended to be illustrative and is not exhaustive.

27. *Id.*

28. For a collection of cases illustrating this point, *see* 6 BOWE-PARKER, PAGE ON WILLS; 39, n.1 (sec. 49.2) [hereinafter cited as PAGE ON WILLS]; *See also*, Newman and Kalter, *Disclaimers of Future Interests: Continuing Problems and Suggested Solutions*, 49 NOTRE DAME LAW 827 (1974).

29. For a collection of cases illustrating this point, *see* PAGE ON WILLS 36, n. 1 (sec. 49.1); *see* In re Meyer's estate, 107 Cal. App. 2d 799, 238 P. 2d 597 (2nd Dist. 1951); Watson v. Watson, 13 Conn. 83 (1839); Payton v. Monroe, 110 Ga. 262, 34 S.E. 305 (1899); Estate of Bliven, 236 N.W. 2d 366 (Iowa 1975); Central Fibre Products Co. v. Lorenz, 66 N.W. 2d 30 (Iowa 1954); Seeley v. Seeley, 45 N.W. 2d 881 (Iowa 1951).

30. For a collection of cases illustrating this point, *see* PAGE ON WILLS 41, n. 1 (sec. 49.4).

31. If fraud, collusion or estoppel is involved, the court will treat the disclaimer as a conveyance. In re Kalt's Estate, 16 Cal. 2d 807, 108 P. 2d 401 (1940); Goodman v. Jannsen, 234 Iowa 925, 14 N.W. 2d 647 (1944); Coomes v. Finegan, 233 Iowa 448, 7 N.W. 2d 729 (1943); Schoonover v. Osborne, 193 Iowa 474, 187 N.W. 20 (1922); In re Hodge's Estate, 20 Tenn. App. 411, 99 S.W. 2d 561 (1936). However, the motive of the disclaimant is irrelevant. Keniath v. Comm'r, 480 F. 2d 57 (6th Cir. 1973); Camp v. United States, 16 AFTR 2d 6154 (M.D. Ga. 1965).

nize a partial disclaimer,[32] while other courts would recognize a partial disclaimer if the gift was severable.[33] No court, however, permitted a partial disclaimer of a nonseverable gift absent a statute.[34] Even before section 2518 was enacted, many states changed the common law by statutes which allowed the partial disclaimer of an interest in property.[35]

At common law, the right to disclaim was not personal to the devisee unless the testator evidenced a contrary intent.[36] This meant that the representatives of a deceased devisee could disclaim in the name of the devisee.[37] The power of a representative to disclaim is a significant estate planning tool and will be discussed in more detail later in the article.

To be effective, a disclaimer must have been made within a reasonable time.[38] On its face, this requirement seemed logical and understandable; however, the reasonable time requirement became an unworkable standard for determining the federal tax consequences of a disclaimer.[39] The primary problem in using such a standard was the fact that it had to be applied on a case by case basis.[40] Prior to the

32. For a collection of cases illustrating this point, *see* PAGE ON WILLS 51, n. 1 (sec. 49.10).

33. *Id.* at 52, n. 4 (Sec. 49.10).

34. *Id.* at 51, n. 3 (Sec. 49.10).

35. *See* note 27 *supra*.

36. For a collection of cases illustrating this point, *see* PAGE ON WILLS 42, n. 1 (Sec. 49.5).

37. *See* Perkins v. Phinney, 7 AFTR 2d 1753 (D.C. Tex. 1967); Estate of Rolin v. Comm'r, 68 T.C. 919 (1977); Estate of Dreyer v. Comm'r, 68 T.C. 275 (1976) acq. 1978-12 I.R.B. 6; Estate of Hoenig v. Comm'r, 66 T.C. 471 (1976) acq. 1978-12 I.R.B. 6.

38. For a collection of cases illustrating this point, *see* PAGE ON WILLS 46, 46-47 nn. 5-9 (sec. 49.8). There was both a common law requirement of reasonable time and a federal law requirement of reasonable time. However, in many cases they were treated as a single standard. *See* Keniath v. Comm'r, 480 F. 2d at 61; Estate of Rolin v. Comm'r, 68 T.C. at 927; Estate of Dreyer v. Comm'r, 68 T.C. at 291; *Contra*, Jewett v. Comm'r, 70 T.C. at 436.

39. WAYS AND MEANS COMMITTEE REPORT at 66-67. Notes 39-50, *infra.*, illustrate many of the difficulties in determining whether a disclaimer was made within a reasonable time.

40. *See* Estate of Dreyer v. Comm'r, 68 T.C. 275 (1977). Therein the court held: "What is the reasonable time varies with the circumstances of each case. The time may be very long if injury to others will not result." *Id.* at 293.

enactment of section 2518, it was nearly impossible to decide with certainty whether a disclaimer was made within a reasonable time. This uncertainty was displayed in *Brown v. Routzahn*[41] and the many cases that followed. In *Brown,* the plaintiff (Brown) disclaimed an interest in the property of his deceased wife eight years after her death but prior to settlement and distribution of her estate. The circuit court held that the disclaimer was effective for federal tax purposes because Ohio law did not require a donee to accept or reject a gift within a specified time; therefore, a rejection made prior to distribution was held valid. *Brown* is the first case to recognize that a disclaimer is not a transfer for tax purposes. After *Brown,* regulations were added requiring that disclaimers be made within a reasonable time period after receiving knowledge of the existence of the transfer.[42]

In *Estate of Rolin v. Commissioner,*[43] the decedent created a revocable trust on April 28, 1958. He died on September 30, 1968, and his spouse, the beneficiary of an interest in the trust, died on January 31, 1969. The executors of the deceased spouse disclaimed her interest eleven years after its creation, but within eight months of its becoming indefeasibly fixed. The timeliness of the disclaimer was at issue. The court held that a reasonable time commences when the interest is indefeasibily fixed both in quality and quantity which, in this case, occurred at Mr. Rolin's death. Thus eight months was held to be a reasonable time.[44]

In *Kenaith v. Commissioner,*[45] the disclaimant had a vested remainder subject to devestiture. The disclaimer was made nineteen years after the creation of the interest but only six months after the death of the life beneficiary. The court was faced with the difficult question of determining when the period of reasonable time commences. The Tax Court[46] held that a reasonable time should be inter-

41. 63 F. 2d 914 (6th Cir. 1933).

42. Treas. Reg. Secs. 25.2511-1(c) (1958), 20.2041-3(d)(6) (1958).

43. 68 T.C. 919 (1977).

44. *Id.* at 927. Accord, In re Estate of Mixter, 372 N.Y.S. 2d 296, 83 Misc. 2d 290 (N.Y. County Sur. Ct. 1975). In Rolin, the court was dealing with the disclaimer of a general power of appointment. *See* Treas. Reg. Sec. 20.2041-3(d)(6) (1958), which requires the disclaimer of a general power of appointment to be valid under local law and to be made within a reasonable time after learning of its existence.

45. 480 F. 2d 57 (8th Cir. 1973).

46. 58 T.C. 352 (1972).

a federal standard;[47] nineteen years was held not to be a reasonable time. The Eighth Circuit reversed the tax court saying:

> In determining 'reasonable time' and the related issue of when the reasonable time commences, we perforce, absent a federal statute or regulation defining reasonable time, must look to the law of the states. We are not conclusively bound by the state law, but this is the only field to probe for legal decisions and discussions on the phrase 'reasonable time' as used in the context of making valid disclaimers.[48]

After examining many authorities the court concluded that, when a vested interest subject to divestiture is involved, the reasonable time period commences after the death of the life beneficiary; not at the time the interest was created.[49] The result in *Keniath* was that a disclaimer made nineteen years after the creation of the interest, but six months after the death of the life beneficiary, was within a reasonable time. At that point, it became clear that allowing local law to dictate what a "reasonable time" is presented an inadequate method of determining the federal tax consequences of a disclaimer.

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47. The Tax Court relied on Fuller v. Comm'r, 37 T.C. 147 (1961) which held a disclaimer 25 years after the creation of the interest was not within a reasonable time. These tax court decisions create a federal standard, which measures a reasonable time from the creation of the interest whether the interest is a present interest or a future interest, and whether it is vested or contingent.

48. 480 F. 2d at 61.

49.

> We hold that under the prevailing common law and in particular, the jurisdiction of the state of Minnesota the holder of a vested remainder subject to divestiture has a reasonable time within which to renounce or disclaim the remainder interest after the death of the life beneficiary and that an unequivocal disclaimer filed with six months thereof is made within a reasonable time.

Id. at 64. *Contra,* Jewett v. Comm'r, 70 T.C. 430 (1978). In Jewett the court disagreed with Keniath and held that state law does not necessarily provide an adequate guide to the resolution of the federal tax question presented. The court measured the time from the creation of the interest, rather than from the time the interest became indefeasibly fixed, and concluded 33 years was not reasonable. The court relied on Keniath v. Comm'r, 58 T.C. 352 (1972); Estate of Hoenig v. Comm'r, 66 T.C. 471 (1976); Fuller v. Comm'r, 37 T.C. 147 (1961); Treas. Reg. Sec. 25.2511-1 (c) (1958). *See also,* Estate of Halbach v. Comm'r, 71 T.C. 141 (1978).

3. THE ADVENT OF 2518

As a result of the confusion and uncertainty surrounding the law of disclaimers in the years following the Eighth Circuit's decision in *Keniath,* considerable discussion of ways to clarify the law surfaced.[50] It was suggested that the law of disclaimers be federalized and specific disclaimer requirements be imposed.[51] The widespread dissatisfaction with the pre 1977 state of the law brought about the enactment of section 2518.[52]

A disclaimer of an interest in property created after 1976 will be effective for federal tax purposes only if it is a qualified disclaimer, which is defined as:

> [A]n irrevocable and unqualified refusal by a person to accept an interest in property but only if-
> (1) such refusal is in writing,
> (2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of-
> (A) the day on which the transfer creating the interest in such a person is made, or
> (B) the day on which such person attains age 21,
> (3) such person has not accepted the interest or any of its benefits, and
> (4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either-
> (A) to the spouse of the decedent, or
> (B) to a person other than the person making the disclaimer.[53]

If the recipient of an interest in property makes a qualified disclaimer,

50. 49 NOTRE DAME LAW at 837 (1974); COMMITTEE ON ESTATE AND GIFT TAXES, TAX SECTION RECOMMENDATIONS No. 1974-2, 27 Tax Law 818 (1974).

51. *Id.* WAYS AND MEANS COMMITTEE REPORT at 66.

52. *Id.* The dissatisfaction stemmed from the fact that prior to 2518 disclaimers were handled under many different code sections and in many different regulations and were dependent upon local law. *See* Treas. Regs. Secs. 25.2511-1(c), 20.2041-3(d)(6), 20.2056(d)-1(a) (1958).

53. I.R.C. Sec. 2518(b).

the property will be considered as having never been transferred to such person.[54]

The intent of Congress in enacting section 2518 was the creation of a federal standard for disclaimers, thus ending reliance upon state law in determining the federal tax consequences of a disclaimer.[55] Therefore, it was hoped that section 2518 would create a safe harbor. However, section 2518 (b) (4) (A) and (B) requires that the interest must pass to a person other than the disclaimant or the spouse of the decedent[56] (the decedent being the testamentary transferor). The absence of a federal rule or regulation determining who will receive the disclaimed property[57] prevents section 2518 from acting as a safe harbor, for the courts are now forced to look to local law in making this determination. Consequently, if local law does not recognize the disclaimer, section 2518 (b) (4) cannot be satisfied. This can be illustrated by the following example. In state X an intestate share could not be disclaimed. B, an heir of A, satisfying all the requirements of section 2518 (except b(4) because the disclaimer was not recognized under state law) disclaimed his intestate share. If section 2518 is to act as a safe harbor, B's disclaimer should be a qualified disclaimer. It would appear B's disclaimer is not, because the property, as a result of the disclaimer not being effective under state law, did not pass to someone other than the disclaimant. Therefore, the only way to be certain a

54. I.R.C. Sec. 2518(a).

55. "If the requirements of the provision are satisfied, a refusal to accept property is to be given an effect for federal estate and gift tax purposes even if the local law does not technically characterize the refusal as a disclaimer." WAYS AND MEANS COMMITTEE REPORT at 67. For a critical analysis of 2518 *see* Frimmer, *Using Disclaimers in Post Mortem Estate Planning: 1976 Law Leaves Unresolved Issues,* 48 J. OF TAX. 322 (1978).

56. I.R.C. Sec. 2518(b)(4). A peculiar result is reached when a power is disclaimed. Section 2518(c)(2) treats a power with respect to property as an interest in such property. Equating the power with an interest seems to indicate that powers may be disclaimed. A problem is encountered when we apply 2518(b)(4) to the disclaimer of a power. As a result of the disclaimer, the power is generally dissolved and consequently does not pass to a person other than the disclaimant. It would appear that section 2518(b)(4) was not intended to be literally applied to disclaimers of powers. *See* Frimmer, 48 J. OF TAX 322 (1978).

57. There are no federal rules or regulations which deal with who the recipient of the property will be after the property has been disclaimed. Therefore, local law must be consulted.

disclaimer will be a qualified disclaimer is to satisfy both state and federal requirements.[58]

To rectify section 2518's apparent reliance upon state law and, in turn, to fulfill the intent of Congress, section 2518 should be amended to read: As a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer as if the disclaimant predeceased the transferor.[59] Although the proposed amendment would be reliant upon state law to determine the taker, it would not be dependent upon the state's recognition of the disclaimer.

The most significant change brought about by section 2518 was the establishment of a definitive time in which to disclaim.[60] Section 2518 changes the common law requirement (that a disclaimer be made within a reasonable time) to a nine month period, adding much needed certainty to the law of disclaimers. The only remaining question concerns the determination of when this nine month period commences. The Conference Report[61] states the nine month period commences with reference to each taxable transfer.[62] Therefore, the disclaimant has nine months after the taxable transfer in which to disclaim.

If the transfer is considered made when it is treated as a completed transfer for gift tax purposes,[63] with respect to inter vivos transfers, or upon the decedent's death, with respect to testamentary transfers, the use of disclaimers will be seriously impaired. The above

58. The above example assumes that an intestate share can be disclaimed under Sec. 2518. This issue is discussed later in this article. In many cases, satisfying both state and federal law will not create a hardship; however, in other cases, due to an unreasonably strict state statute, it may prevent a disclaimer from being qualified only because of the state law which governs.

59. *See* 49 NOTRE DAME LAW 839. The Uniform Probate Code also treats the disclaimant as predeceasing the transferor. *See* Uniform Probate Code Sec. 2-801(c). The mechanics of such a standard would entail the conveyance, by the disclaimant, to the person who would receive the property as a result of the disclaimant being treated as predeceasing the transferor. This would divest the disclaimant of title under state law and vest title in the one who was treated as receiving it for tax purposes.

60. I.R.C. Sec. 2518(b)(2).

61. CONFERENCE REPORT ACCOMPANYING HR 14844 H.R. REP. NO. 94-1515, 94th Cong., 2d Sess. 623-24 (1976).

62. "The conferees intend to make it clear that the 9-month period for making a disclaimer is to be determined in reference to each taxable transfer." *Id.* at 623.

63. A gift is complete for gift tax purposes when the transferor has reqlinquished dominion and control over the property. Treas. Reg. Sec. 25.2511-2(b) (1958).

definition of transfer will make the disclaimer of certain interests in property almost impossible. One such interest in property is created by the exercise of a special power of appointment. Where a donee is given a special power the gift (or devise) is a taxable transfer; the donee has nine months from that date in which to disclaim for it to be considered "qualified". If the donee chooses not to disclaim and subsequently exercises the power, the appointee's disclaimer, for it to be qualified, must be made within nine months of the transfer of the power to the donee. The nine months do not begin when the power is exercised since the exercise of a special power is not a taxable transfer;[64] consequently, the transfer creating the appointee's interest is the transfer of the power to the donee. In many cases, the donee of the power may refrain from exercising it for a period in excess of nine months. In such cases, the appointee will be precluded from making a qualified disclaimer insofar as he is unaware of his interest until it is too late.

In addition to making the qualified disclaimer of some interests impossible, Congress' definition of transfer - taxable transfer - would allow some "qualified" disclaimers to be made many years after the interest was created. If we assume that a special power of appointment can reach the hands of the holder of the power without the occurrence of a taxable transfer (which can easily happen where the holder acquired it for full and adequate consideration in money or money's worth, for example, section 2516), when will the nine month period begin for the appointee under the special power? This question can best be answered in the negative. We know it does not begin when the holder acquired the power since that was not a "transfer". We know it

64. The exercise of a special power of appointment is not a transfer (completed transfer for gift tax purposes). *See* I.R.C. Sec. 2514, and Self v. United States, 142 F. Supp. 939 (Ct. Cl. 1956). The death of B with a special power of appointment is not a taxable transfer. *See* I.R.C. Sec. 2041; Clauson v. Vaughan, 147 F. 2d 84 (1st Cir. 1945); Janes v. Reynolds, 57 F. Supp. 609 (D. Minn. 1944). The reason the exercise of a special power of appointment is not a transfer is because powers of appointment are not interests in property. The following cases, although prior to I.R.C. Sec. 2041, are useful to demonstrate that a power of appointment (general or special) is not an interest in property. Helvering v. Safe Deposit & Trust Co., 316 U.S. 56 (1942), rev'g. 121 F. 2d 307, aff'd. 42 BTA 145; United States v Field, 255 U.S. 257 (1921). The exercise of a general power of appointment is a transfer because of I.R.C. Sec. 2514 and a general power of appointment is included in a decedent's gross estate because of I.R.C. Sec. 2041 (not I.R.C. Sec. 2033).

does not begin when the power was exercised since the exercise of a special power is not a "transfer". Insofar as no other events occurred, we must conclude that the period never commenced; basic logic tells us that a period which never commenced can never end. Therefore, in certain situations, the appointee can disclaim many years later (assuming he has not accepted the interest or its benefits) and have it qualify.

The result in the above discussion would be vastly different if the donee is given a general power as opposed to a special power. Since the exercise of a general power is a taxable transfer,[65] the appointee will have nine months from the exercise of the power in which to disclaim. Thus, an appointee under a general power will always have nine months to disclaim;[66] whereas, the appointee under a special power (especially if it is a testamentary power) will rarely have such an opportunity.

The obvious question that arises regarding the commencement of the nine month period, is whether a disclaimer of property passing by the exercise of a special power should be treated differently than a disclaimer of property passing by the exercise of a general power. If we focus upon the disclaimant's right to disclaim, there is no justification for such a distinction. The appointees under both a general and a special power are similarly situated: they have no way of knowing if they will be appointed, when they will be appointed or what they will receive if apppointed. In each case, their ownership arises as a result of the exercise of the power. Therefore, it is of little concern to the appointee

65. *See* I.R.C. Secs. 2514 and 2041. *See also* Treas. Reg. Sec. 25.2514-1(a)(1) (1958). Section 2514 treats the exercise (or lapse) of a general power of appointment as a gift. Section 2041 includes in the decedents gross estate property subject to a general power of appointment. Note there is no code section which treats the exercise or lapse of a special power of appointment as a gift. Similarly, there is no code section which causes the property subject to a special power of appointment to be included in the holder's gross estate unless the exercise of the special power is used to create another power.

66. CONFERENCE REPORT ACCOMPANYING HR. 14844 H.R. REP NO. 94-1515, 94th Cong., 2d Sess. 623-24 (1976). The report gives the following example:

> [I]n the case of a general power of appointment where the other requirements are satisfied, the person who would be the holder of the general power will have a nine month period after the creation of the power in which to disclaim. The person to whom the property would pass by reason of the exercise or lapse of the power would have a nine month period after a taxable exercise, etc., by the holder of the power in which to disclaim.

what type of power the holder exercised.

The sole distinction between a general and a special power is with respect to the federal taxation of the holder of the power. The holder of a general power is taxed upon its exercise; the holder of a special power is not.[67] The imposition of a transfer tax upon the holder of the power is an inadequate basis to justify disallowing the disclaimer by an appointee under a special power (if made within nine months of the exercise of the power), since the tax is unrelated to the rights of the appointee. Therefore, it is unreasonable to require the disclaimer, by an appointee under a special power, be made within nine months of the transfer creating the power (which may be prior to the exercise of the power), when an appointee under a general power is permitted to disclaim nine months after the exercise of the power. To remedy this unwarranted distinction, as well as to cure the situation where no tranfer occurs, section 2518 should be amended or regulations promulgated defining transfer in a manner which treats the appointee under a geneal and a special power similarly in all cases. Florida Statutes Section 732.801 provides an excellent example of when an interest must be disclaimed to assure that the recipient of any interest in property has a fair opportunity to disclaim:

> (5) Time for filing disclaimer—A disclaimer shall be filed at any time after the creation of the interest, but in any event within 9 months after the event giving rise to the right to disclaim, including the death of the decedent; or, if the disclaimant is not finally ascertained as a beneficiary of his interest has not become indefeasibly fixed both in quality and quantity at the death of the decedent, then the disclaimer shall be recorded not later than 6 months after the event that would cause him to become finally ascertained and his interest to become indefeasibly fixed both in quality and quantity.[68]

The requirement that the disclaimant not accept any interest in the disclaimed property provides an adequate safeguard to prevent any abuse that may arise as a result of allowing additional interests to be disclaimed.

Many of the difficult questions raised by *Keniath* and *Dreyer* are answered by section 2518, the most important of which is that contin-

67. *See* I.R.C. Secs. 2514 and 2041. Treas. Reg. Sec. 25.2514-1(a)(1) (1958).
68. FLA. STAT. Sec. 732.801(5) (1977).

gent interests and vested interests subject to divestiture must be disclaimed within nine months of the transfer creating the interest.[69] However, section 2518 leaves many unanswered questions. It is not clear if the right to disclaim is personal to the disclaimant or may be exercised by his representatives after his death. The power of a representative to disclaim in the name of the decedent can be very significant where the recipient of an interest in property dies before he becomes aware of such interest or before he has accepted the property or its benefits. If a representative is permitted to disclaim, the property will not be taxed in the decedent's gross estate.[70] If a representative is not permitted to disclaim, the property will be taxed both when it is tranferred to the decedent (gift or estate tax) and also upon the decedent's death.[71] Thus, to enhance the use of disclaimers as an estate planning tool, regulations should be issued which make it clear that the right to disclaim is not personal. In the absence of such regualtions, it would appear that the right to disclaim is not personal since section 2518 does not address this question, and furthermore, common law permitted it.

Another unresolved question is whether section 2518 changes the common law by allowing the disclaimer of an intestate share. It would appear that if section 2518 (a) is taken literally— ". . . disclaimer with respect to any interest in property . . ." - a disclaimer of an intestate share would be allowed. However, the congressional intent was to federalize the law of disclaimers, not to expand the common law; hopefully, regulations will be issued clarifying this point.

Similarly, it is unclear whether the disclaimer of an interest in jointly held property will be effective for federal tax purposes. If the right of each joint tenant vests at the creation of the tenancy (which is a question of local law), a jointly held interest in property may not be disclaimed for federal tax purposes, even if it is a valid disclaimer under local law, since the disclaimant has accepted the interest in property or its benefits.[72]

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69. I.R.C. Sec. 2518(b)(2).

70. *See* I.R.C. Secs. 2033 and 2518(a).

71. For cases in which representatives of a decedent were permitted to disclaim the decedent's interest in property; *see* Estate of Rolin v. Comm'r, 68 T.C. 919; Estate of Dreyer v. Comm'r, 68 T.C. 275; Perkins v. Phinney, 7 AFTR 2d 1752; Estate of Hoenig v. Comm'r, 66 T.C. 471; *Contra,* Uniform Probate Code Sec. 2-801(a). However, the double taxation may be reduced by I.R.C. Sec. 2013.

72. I.R.C. Sec. 2518(b)(3). *See* Ltr. Rul. 7911005. In the ruling, the service said

Section 2518 changes the common law by allowing the partial disclaimer of certain interests in property. There is a conflict between section 2518 (a) and section 2518 (c) (1) as to what may be partially disclaimed. Section 2518 (a) appears to permit the partial disclaimer of any interest in property; whereas, section 2518 (c) (1) only allows the disclaimer of "an undivided portion of an interest". Consequently, it is uncertain what interests may be partially disclaimed.[73] However, it appears that the congressional intent was only to allow the partial disclaimer of an undivided portion of an interest.[74]

The meaning of "an undivided portion of an interest" is unclear.[75] Consequently, a devisee is faced with the dilemma of whether the disclaimer of any of the following interests will be a qualified disclaimer: a fractional interest in property (an undivided one half interest), a portion of a devise ($25,000 of a $50,000 devise or five acres of a ten acre tract) or a carve out of an interest (a life estate or a remainder from a fee). It is disturbing that Congress used the term without any further elaboration.[76] This term, however, has been used in other code sections[77] and interpreted in the regulations.[78] It has been intepreted as: "A person owns an 'undivided interest' in all substanial rights to a pat-

that if a joint tenant is vested with an undivided interest in the property at the creation of the joint tenancy (a matter of local law), the disclaimant has accepted an interest in the property or its benefits and the disclaimer will not be effective. This ruling, however, is based on law existing prior to section 2518's effective date. The conclusion reached seems to apply to section 2518 as well, insofar as both section 2518 and the prior law have the same requirement that the disclaimer must be made prior to acceptance. *See also* Krakoff v. United States, 313 F. Supp. 1089 (S.D. Ohio 1970); Bishop v. United States, 338 F. Supp. 1336 (N.D. Miss. 1970), for the nonacceptance requirement which presumably remains unchanged by section 2518. In Letter Ruling 7922018, the service ruled that a widow, who was the sole beneficiary and executrix under decedent's will, did not accept its benefits where she segregated decedent's property and income from it and admitted the will to probate for the sole purpose of her qualification as independent executrix.

73. *See* I.R.C. Sec. 2518(c)(1); Frimmer, 48 J. OF TAX. 322.

74. THE WAYS AND MEANS COMMITTEE REPORT at 67 says: "Under the bill, a disclaimer with respect to an undivided portion of an interest is to be treated as a qualified disclaimer of the portion of the interest if the requirements are satisfied as to the undivided portion of an interest."

75. *See* Frimmer, 48 J. OF TAX. 322 (1978).

76. *Id.*

77. I.R.C. Secs. 170(f)(3) an 1235(a).

78. Treas. Reg. Secs. 1.170A-7(b)(1) (1972); 1.1235-2(c) (1965).

ent when he owns the same fractional share of each and every substantial right to the patent".[79] The above interpretation of an undivided interest clearly allows partial disclaimers when a fractional interest is involved.[80]

Another and more expansive meaning given to an undivided portion of an interest is illustrated by an example in the regulations where a taxpayer owns 100 acres of land and makes a contribution of 50 acres to a charity.[81] Based on this contribution, the regulations conclude that the donor contributed an undivided portion of his entire interest and a deduction would be allowed. If we apply the service's interpretation of an "undivided portion of an entire interest" (as used in the above regulation interpreting section 170 (f) (3) (B) (ii)) to section 2518, we find that the service should, and in all likelihood will, recognize that there is little difference for federal tax purposes between a fractional disclaimer (one half undivided interest) and a disclaimer of a portion of a devise (five acres of a ten acre tract or $25,000 of a $50,000 devise).[82] Consequently, they both will be considered disclaimers of an undivided portion of an interest. If the service rejects the application of the above regulation (which is highly unlikely) as an interpretation of section 2518(c)(1), and attempts to narrowly define "undivided portion of an interest," the use of disclaimers to prevent the overfunding of a marital bequest will be seriously impaired.[83]

No interpretation of an undivided portion of an interest has ever encompassed the "carve out" of an interest. The carve out type of disclaimer can be distinguished from the other types of disclaimers previously discussed because of is effect on the disclaimant's estate. If a

79. Eickmeyer v. Comm'r, 580 F. 2d 395 (10th Cir. 1978). Eickmeyer applied I.R.C. Sec. 1235(a) as interpreted by Treas. Reg. Sec. 1.1235-2(c) (1957). Treas. Reg. Sec. 1.170A-7(b)(1) (1972).

80. *See* Frimmer, 48 J. OF TAX. at 324 (1978).

81. Treas. Reg. Sec. 1.170A-7(b)(1) (1972).

82. Both types of disclaimers are similar insofar as the disclaimed property will be excluded from the disclaimant's gross estate (I.R.C. Sec. 2033) and the retained property will be included (I.R.C. Sec. 2033). The following example demonstrates their similarities. A is devised Whiteacre, a ten acre tract of land. If A disclaims an undivided one half interest, the disclaimed property will not be included in his gross estate at his death; the undivided one half he retained will be included in his gross estate. If A disclaims five of the ten acres, the disclaimed five acres will not be included in his gross estate at his death; the five acres he retained will be included in his gross estate.

83. *See* the text accompanying notes 13-18 *supra*.

remainder is disclaimed from a fee, all the property (not just that which is disclaimed) will be excluded from the disclaimant's gross estate, since the retained interest is nondescendable.[84] Conversely, where a fractional disclaimer or a disclaimer of a portion of a devise is made, only the disclaimed property will be excluded from the disclaimant's gross estate, because the retained interest is descendable.[85] The forego- ing distinction indicates a possible justification for Congress' use of the term undivided portion of an interest as opposed to some other term i.e. to prevent the carve out of an interest from being a qualified disclaimer. Therefore, it would appear, although it is still uncertain, that such a disclaimer cannot be a qualified disclaimer. In the interest of clarity, regulations should be promulgated which specifically define the interests that may be partially disclaimed. Florida Statutes Section 732.801 provides an excellent delineation of those interests that may be partially disclaimed:

> (d) An 'interest in property' that may be disclaimed shall include:
> 1. The whole of any property, real or personal, legal or equitable, present or future interest, or any fractional part, share or portion of property or specific assets thereof.
> 2. Any estate in the property.
> 3. Any power to appoint, consume, apply, or expend property, or any other right, power, privilege, or immunity relating to it.[86]

The most important and possibly the most interesting issue raised by section 2518 is the federal tax consequences of a disclaimer which is valid under state law but is not a qualified disclaimer as defined by section 2518. It should be noted that state law, in certain situations, may be used as a basis for imposing a federal tax[87] and/or to define

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84. I.R.C. Sec. 2033. In Ltr. Rul. 7922018, a widow disclaimed the remainder of a fee. The widow asked for a ruling as to whether such a disclaimer could be a qualified disclaimer. The service declined to rule on this question since the I.R.S. does not rule on issues that cannot be reasonably resolved before the issuance of regulations. An interesting question raised is whether the disclaimer of a remainder of a fee will cause inclusion under I.R.C. Sec. 2036. It seems clear that it may cause a transfer, not ordinarily a generation skipping transfer, to become one.

85. I.R.C. Sec. 2033.

86. FLA. STAT. Sec. 732.801(1)(d)1-3 (1977).

87. *See, e.g.,* I.R.C. Sec. 2053(a) where the amount of the deductions allowed are " . . . allowable by the laws of the jurisdiction, whether within or without the

one's rights or interests with respect to property for purposes of applying a federal tax.[88] In this discussion, we will focus on the former. Consider the following situation: B dies intestate with A his only heir; A orally disclaims his entire intestate share. With regard to this example, state law allows oral disclaimers; whereas, it is not a qualified disclaimer under section 2518. What is the federal tax effect of A's disclaimer? There are only two possible ways to answer this question (neither of which is entirely satisfactory): (1) to give conclusive effect to state law or (2) to give conclusive effect to federal law. If state law is conclusive, the effectiveness of section 2518 will be thwarted since the purpose of section 2518 was to eliminate the dependence upon state law in determining the federal tax consequences of a disclaimer.[89] If federal law is conclusive, A will be taxed on the transfer of property he never owned; A never owned the property because state law determines the ownership of property and rights with respect to property.[90]

The beginning point to the solution of this question is *Burnet v. Harmel*.[91] In *Harmel,* the respondent, the owner of Texas oil lands, executed oil and gas leases of the lands. On his income tax return, he treated the gain from the leases as capital gain because the law of Texas considered an oil and gas lease a sale. The commissioner argued that regardless of its characterization under state law, the lease was not a sale; therefore, the higher tax rate applicable to ordinary gain applied. Holding that federal law controls the federal tax consequences of the lease, the court set forth the relationship between state and federal law saying

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United States, under which the estate is being administered".

88. *See* the cases cited in note 91 *infra.* In these situations, state law is only used for the purpose of determining whether the federal law has been satisfied. The distinction between the uses of state law can be shown by using section 2518; the first use is where a state disclaimer statute conflicts with a federal law (2518), and the second is where section 2518 requires the determination under state law as to where the property passes as a result of the disclaimer.

89. *See* WAYS AND MEANS COMMITTEE REPORT at 67.

90. *See* Aquilino v. United States, 363 U.S. 509 (1960); Leyth v. Hoey, 305 U.S. 188 (1938); Wentworth v. Comm'r, 510 F. 2d 883 (6th Cir. 1975); Estate of Peyton v. Comm'r, 323 F. 2d 438 (8th Cir. 1963); Estate of Polster v. Comm'r, 274 F. 2d 358 (4th Cir. 1960); Estate of McNichol v. Comm'r, 265 F. 2d 667 (6th Cir.) *cert. denied,* 361 U.S. 829 (1959).

91. 287 U.S. 103 (1932).

> Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution to tax income. The exertion of that power is not subject to State control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose is to be interpreted so as to give a uniform application to a nation-wide scheme of taxation . . . State law may control only when the operation of the Federal taxing act, by express language or necessary implication, makes its operation dependent upon State law.[92]

The Supreme Court reiterated this point in *Morgan v. Commissioner.*[93] In *Morgan,* state law characterized a power of appointment as a special power; the service argued it was a general power. The court held that, notwithstanding its charcterization under state law, the power was general within the meaning of the revenue act.[94]

The holdings of *Harmel* and *Morgan* can be summarized into the following rules:

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92. *Id.* at 110. The Supreme Court went on to apply the law to the facts of the case, saying:

> But section 208 neither says nor implies that the determination of 'gain from the sale or exchange of capital assets' is to be controlled by state law. For purposes of applying this section to the particular payments now under consideration, the act of Congress has its own criteria, irrespective of any particular characterization of the payments under local law [citation omitted]. The state law creates legal interests, but the federal statute determines when and how they should be taxed.

But see United States v. White, 311 F. 2d 399 (10th Cir. 1962) and the service's disagreement and nonacquiesence in Rev. Rul. 63-120 1963-1 C.B. 141.

93. 309 U.S. 78 (1940).

94.

> State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed. Out duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by the state law.

Id. at 80-81.

Many later cases have applied the rules enunciated in Morgan and Harmel to varied situations. *See,* United States v. Mitchell, 403 U.S. 190 (1971) (liability of spouse for income tax in community property state); Maytag v. United States, 493 F. 2d 995 (10th Cir. 1974) (whether a power of appointment was general or special); Kean v. Comm'r, 469 F. 2d 1183 (9th Cir. 1972) (shareholder's status for subchapter S election); Estate of Miller v. Comm'r, 58 T.C. 699 (1972) (income earned by estate during administration).

(1) If federal law does not expressly or impliedly depend upon the characterization of an interest in property or a transaction under state law, its characterization under state law is not controlling for federal tax purposes.

(2) If federal law does expressly or impliedly depend upon the characterization of an interest in property or a transaction under state law, its characterization under state law is controlling for federal tax purposes.

Depending upon which rule is applicable, state disclaimer statutes may or may not control the federal tax consequences of a disclaimer. In *Doll v. Commissioner,*[95] the court set forth several tests which have been used to determine whether Congress intended state law to control. They are: (1) whether the purposes of the taxing act would be avoided or defeated by applying state law, (2) whether the language or necessary implication of the revenue statutory provision so requires, and (3) whether through such application a uniform nationwide scheme of taxation would be thwarted.[96] If we apply these tests to section 2518, we find that Congress did not expressly or impliedly intend for state disclaimer statutes to control.[97] Therefore, regardless of whether a dis-

95. 149 F. 2d 239 (8th Cir.) *cert. denied,* 326 U.S. 725 (1945).

96. *Id.* at 242. The tests have been developed through case law. *See* Estate of Putman v. Comm'r, 324 U.S. 393 (1945); Rogers v. Helvering, 320 U.S. 410 (1943); Helvering v. Stuart, 317 U.S. 151, 161 (1942); United States v. Pelzer, 312 U.S. 399, 402 (1941); Helvering v. Horst, 311 U.S. 112 (1940); Estate of Sanford v. Comm'r, 308 U.S. 39 (1939); Thomas v. Perkins, 301 U.S. 655 (1937);

97. It may be helpful to refer back to the text accompanying notes 51-59. *See* Estate of Halbach v. Comm'r 71 T.C. 141 (1978). In Halbach, the petitioner contended that because the decedent's disclaimer of her remainder interest was both timely and effective under New York law, such interest should not be included in her gross estate. The Service conceding the fact that the disclaimer was valid under state law, but took issue with the timeliness of the disclaimer for federal tax purposes. The court held that the disclaimer was not timely for federal tax purposes saying:

> Herein, we have no authority or desire to quarrel with the state court's decision that the disclaimer was timely for probate purposes. The issue before that court was the validity and effect of the renunciation in relation to a determination of in which party legal title to the property would vest. That court had no need to take into account, as this court must, the Congressional desire to impose a tax on the transfer of a property interest. Therefore, what is a reasonable time for probate purposes, any time prior to the vesting of title in the party renouncing the interest, is not necessarily reasonable for our purposes, determining whether a transfer of the property interest has occurred.

claimer satisfies state law, its federal tax consequences are determined solely upon its satisfaction of the requirements of section 2518.[98] In resolution of the situation presently under consideration, A's disclaimer, although valid under state law, will not be a disclaimer for federal tax purposes.

State law, however, may play a role in determining whether the federal requirements for a disclaimer have been satisfied. The operation of section 2518, as previously discussed, is in some ways dependent upon state law (recall the discussion of 2518 (b)(4)). The application of state law in this situation raises the problem of whether a federal court hearing a federal tax case is bound by a state court interpretation of state law. In *Commissioner v. Estate of Bosch,*[99] the Supreme Court was faced with this very issue. The Supreme Court held that a federal court applying state law is not bound by a state court decision unless it is the decision of the highest state court.[100]

5. REVENUE ACT OF 1978

A 1978 amendment to section 2518 made it possible for property to pass to a decedent's spouse as a result of a disclaimer even if the surviving spouse was the disclaimant.[101] This amendment is important because it allows a surviving spouse to disclaim an interest in a marital trust and take the property under a non-marital trust assuming the de-

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98. This is not to say that state law will not have to be consulted. It may be used to determine one's property rights if such a determination is necessary. This point is discussed, *infra,* at notes 100 and 101.

99. 387 U.S. 456 (1967). For a more detailed analysis of Bosch *see* Sobeloff, *Tax Effect of State Court Decisions—The Impact of Bosch*, 21 TAX LAW 507 (Spring 1968).

100.

> This is not a diversity case but the same principle may be applied for the same reasons, viz., the underlying substantive rule involved is based on state law and the state's highest court is the best authority on its own law. If there be no decision by that court then federal authorities must apply what they find to be the state law after giving 'proper regard' to relevant rulings of other courts of the state. In this respect, it may be said to be, in effect, sitting as a state court.

387 U.S. at 465.

101. Tax Reform Act of 1978, Pub. L. 95-600, 92 Stat. 2934 (1978), Sec. 702 (M) amended I.R.C. Sec. 2518(b)(4) (hereinafter referred to as Tax Reform Act of 1978).

cedent's will is set up properly.[102] A spouse will only make such a disclaimer when the marital bequest exceeds the optimal marital deduction i.e. an overfunding has occurred.[103] The spouse will disclaim the excess; thus raising the issue of whether it was the disclaimer of an undivided portion of an interest[104] (except in the very rare case where the total marital bequest will be disclaimed because the optimal marital deduction is zero). Consequently, the interpretation given to an undivided portion of an interest will determine the effectiveness of the amendment.

The benefits to be derived by such a disclaimer are achieving the optimal marital deduction and excluding the disclaimed property from the disclaimant's gross estate. In theory, such a disclaimer is an effective post mortem estate plainning device, but before a spouse makes such a disclaimer, he or she will have to be convinced that it is a beneficial course of action. These benefits become apparent when the spouse realizes that the property interests he or she will receive in a properly

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102. The decedent's will must contain a marital bequest (one which qualifies for the marital deduction) and a non-marital bequest (one which does not qualify for the marital deduction and does not cause the property to be included in the spouse's gross estate), with the decedent's spouse named as the beneficiary under each trust. The non-marital bequest should be drafted in a manner so as to give the spouse all the incidents of ownership consistent with its exclusion from the spouse's gross estate (*see* footnote 104 *infra*). In addition, it would be wise to include in the decedent's will a clause which provides that any property disclaimed shall pass to the non-marital trust (*see* appendix A).

103. The optimal marital deduction is not necessarily the maximum marital deduction allowable (for example, where the decedent's adjusted gross estate is less than $425,000). The reason the spouse will not disclaim, unless the marital bequest exceeds the optimal marital deduction, is because when considering the value of tax deferral, the estate tax burden will be at a minimum when the optimal deduction is used; consequently, nothing will be achieved by such a disclaimer aside from increasing the burden of estate taxes.

104. Congress intended the amendment to apply to partial disclaimers where the spouse disclaims property passing under a marital trust. *See* The Staff of the Joint Committee on Taxation, 96th Cong. 1st Sess., LEGISLATIVE HISTORY OF THE TAX REFORM ACT OF 1978 at 443 (1979) where it states:

> The Congress believes that, where the decedent's spouse refuses to accept all or a portion of his or her interest in property passing from the decedent and, as a result of such refusal, the property passes to a trust in which the spouse has an income or other interest, such disclaimer should be recognized as a qualified disclaimer.

drafted non-marital trust are substantially equivalent to those disclaimed.[105] Therefore, once the spouse understands the situation, there is no logical reason why he or she will refuse to disclaim.

The following example demonstrates the importance of this amendment. B (A's spouse) dies, his will created a marital trust and a non-marital trust. A is the beneficiary of each trust. Due to an error in the marital deduction formula clause in B's will, the marital trust was overfunded. The optimal martial deduction for B's estate is $500,000 (one half of B's gross estate of $1,000,000); $600,000 was devised to the marital trust. B's will provided that any property that is disclaimed shall become part of the non-marital trust (see appendix A for the form of such a clause).[106] A disclaims $100,000 of the $600,000 marital trust. As a result of A's disclaimer the property passes to the non-marital trust (pursuant to the clause in decedent's will). Prior to the 1978 amendment it was unclear whether A's disclaimer was a qualifed disclaimer since the disclaimed property did not pass to a person other than the disclaimant. This amendment would treat A's disclaimer as a qualified disclaimer, thus allowing the optimal marital deduction and excluding the disclaimed property from A's gross estate.

Carrying the above example one step further, assume A has an estate of $100,000 at her death. If A does not disclaim and dies ten years after B (not having disposed of any of the property), A's gross estate will be $700,000 ($100,000 of A's property plus $600,000 from the marital trust); if A disclaims the $100,000 excess, A's gross estate will be $600,000 ($100,000 of A's property plus $500,000 from the marital trust). If we assume A has no deductions, credits, or adjust-

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105. The property interests the spouse receives under a marital and a non-marital trust are not all that different in substance. The spouse can receive, under a non-marital trust, the following: a life estate, a special power of appointment, a five and five general power of appointment, a general power of appointment subject to an ascertainable standard, and a trustee can be given the power to invade the corpus for the spouse's comfort or maintenance.

106. Rev. Rul. 76-156, 1976-1 C.B. 292 seems to allow such a clause to determine the taker of the disclaimed property. This ruling dealt with an issue which arises where the decedent's will gives the disclaimant a special power to appoint his disclaimed interest. The service ruled that a disclaimer coupled with a power to appoint is not a disclaimer but is a taxable gift. The service implied that where the decedent's will disposes of the disclaimed property in an ascertainable manner, the disclaimer will then be recognized. *See* Newman and Kalter, *Disclaimers By Surviving Spouse* 181 N.Y.L.J. 1 (Jan. 15, 1979).

ments to her gross estate, an additional $100,000 will be taxed on A's death if she does not disclaim. The tax rate on the additional $100,000 in A's estate is 37%; the value of the disclaimer is $37,000 in this case. A $37,000 tax savings should not be treated lightly.

6. CONCLUSION

The enactment of section 2518, as demonstrated above, changed the common law in many respects. It improved the prior law by creating a definitive period in which to disclaim i.e. nine months, requiring a writing, and most importantly, creating uniform rules governing the law of disclaimers. Although it was not the intent of Congress to greatly expand the interests that may be disclaimed, section 2518, although unclear, appears to permit the disclaimer of both an intestate share and also some partial interests in property. Hopefully, regulations will be able to clear up this uncertainty in a manner that will enhance the uses of disclaimers. Section 2518's shortcomings are its dependence upon state law and its disallowance of the disclaimer of certain interests because of its definition of transfer. To cure the above shortcomings section 2518 should be amended.

It is obvious that section 2518 is a long way from being perfect. It is a beginning and, as this article has demonstrated, section 2518, if liberally construed and properly amended, can be made into an effective law of disclaimers.

Donald J. Jaret

APPENDIX A

The following disclaimer forms were taken from P-H Wills forms 3875 New Forms and Ideas.

FORM FOR A DISCLAIMER "QUALIFIED" UNDER THE TAX REFORM ACT OF 1976

I, ______________, beneficiary under the will of ______________, deceased, do hereby unqualifiedly and unconditionally and completely disclaim, reject and refuse to accept the legacy/devise made to me in the Last Will and Testament of said ______________, who died on the _____ day of _________, 19 __, said Last Will and Testament having been resident of ______________ City/County, State/Commonwealth of ______________. I have received and retain no interest in the property I herein disclaim and this disclaimer is completely irrevocable, regardless of any occurrences either pior to or subsequent to its execution.

Signed ______________,
The ____ day of ______,
19__.

FORM FOR A STANDARD DISCLAIMER CLAUSE

If any devisee and/or legatee named in this Will should renounce and disclaim in whole or in part, any property I have herein devised and/or bequeathed to him or to her, then in that event I give, devise and bequeath the property so renounced and disclaimed to __________.