How to Look a Gift Horse in the Mouth - Disclaimers under California Law and the Tax Reform Act of 1976

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HOW TO LOOK A GIFT HORSE IN THE MOUTH—DISCLAIMERS UNDER CALIFORNIA LAW AND THE TAX REFORM ACT OF 1976

INTRODUCTION

Every lawyer who writes or probates wills is familiar with disclaimers. They are an effective estate planning tool which serve to minimize taxes, especially at the federal level. The failure to use them when appropriate may amount to legal malpractice. Though this would seem to imply some certainty in regard to their use, the law of disclaimers has been changing rapidly in the last few years. This rapidly changing law has left many traps for the unwary, which periodic legislative efforts have attempted to solve.

The 1972 California statute on disclaimers represented one such legislative attempt. Prior to 1977, state law determined the effectiveness of a disclaimer for federal tax purposes. Consequently, the statute's clarification of such problems as what types of interests were disclaimable, the form of a disclaimer, the time period for making one, and the effect of a disclaimer on the devolution of property, marked a major step forward.

More recently, the Tax Reform Act of 1976 emerged as the

1. A disclaimer is basically the refusal to accept a gift conferred either inter vivos or by will. Newman, Substantive and Tax Aspects of Disclaimers and Renunciations, 7 Inst. Est. Plan. ¶ 73.500 (1973).
2. Id.
3. See Lecture by Prof. Jerry Kasner at Univ. of Santa Clara School of Law (Fall 1976).
5. See Cal. Prob. Code § 190(a) (West Supp. 1977). The types of interests which are potentially disclaimable include interests acquired through intestate succession, by will, by gift, and through survivorship in a joint tenancy. The common law prohibited disclaiming an interest acquired through intestate succession because an heir could not prevent passage of title to himself. There has also been controversy over whether a partial disclaimer (one in which part of the interest was disclaimed and part was accepted) is valid. See Newman & Kalter, The Need for Disclaimer Legislation—An Analysis of the Background and Current Law, 28 Tax Law. 571, 586, 580 (1975).
6. For the form of an effective disclaimer, see Cal. Prob. Code §§ 190(c), 190.1, 190.4 (West Supp. 1977). The Code also settles the issue as to the survivorship of the right to disclaim by allowing a disclaimer by the personal representative of a decedent. Id. § 190.2.
7. See id. § 190.3. The issue of the proper time within which to make a valid disclaimer has caused more problems in the area of disclaimers than any other issue.
8. See id. § 190.6. Under common law the effect of a disclaimer was to treat the transfer as if it had never been made. The recent trend has been to analogize the disclaimer to a lapsed legacy in which the beneficiary predeceases the donor. Either theory usually results in the interest passing through the residuary estate. There is a

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federal solution to the problems surrounding the use of disclaimers. It specified certain requirements for an effective disclaimer for federal tax purposes which appear to be more limited than the California statute. However, it does not deal with many aspects of disclaimers, which presumably should be governed by state law.

This comment will begin by outlining the possible advantageous uses of disclaimers for state and federal estate planning purposes. Following this outline, it will examine the federal law on disclaimers before the Tax Reform Act of 1976, state law as exemplified by the California statute, and the federal law under the Tax Reform Act of 1976, to point out the potential problem areas regarding the use of disclaimers. Finally, it will indicate various aspects of these problem areas which need to be clarified or corrected.

**ADVANTAGES OF USING DISCLAIMERS**

Although disclaimers may have some value in the area of inter vivos gifts their basic use is in the area of post-mortem estate planning. They may be needed because there was no pre-death planning, or if there was, because that planning was inadequate or obsolete due to changes in circumstances in the federal or state law. Increasingly, they are used in good pre-death estate planning to provide certain post-mortem elections which will still result in the passage of property according to the testator's intent. In either instance, the proper use of disclaimers can result in considerable federal or state gift, estate, income, and inheritance tax savings.

**Gift Tax**

In a situation where a disclaimer results in the passing of an interest to a beneficiary to whom the disclaimant otherwise wishes to make a gift of the interest, there is a potential gift tax savings. This transaction is treated as if the disclaimant never received the interest rather than as a taxable transfer of possibility that it will pass by intestate succession, however, if there is no residuary clause or if the anti-lapse clause does not reach the interest under the common law theory. See Newman & Kalter, supra note 5, at 592.

10. Johnson, Disclaimers as an Estate Planning Tool, 19 PRAC. LAW. No. 8, at 27 (Dec. 1973); Newman, supra note 1, at ¶ 73.500-.505.
11. Id.
that interest to the second beneficiary. For example, suppose John receives a bequest under a will which will go to his daugh-
ter Mary if he doesn’t take the interest. If he would like to gift
the bequest to her anyway, he may simply disclaim the interest
which will then pass to Mary. By disclaiming, John avoids the
gift tax he would have incurred had he accepted the gift and
then given it to Mary. Thus, as was stated in a California
case, the right to disclaim is essentially the same as a general
power of appointment without any of the incidents of taxation
that go along with the exercise of such a power.

Estate Tax

If the effect of the disclaimer is essentially the same as the
estate planning desires of the disclaimant and he has no use for
the property, a disclaimer can potentially result in saving es-
tate taxes upon his death since the disclaimed property will not
pass through his estate. In the previous example, if John in-
tends to will his bequest to Mary anyway and he doesn’t want
or need it, he may disclaim the interest, and again it will pass
directly to Mary. This disclaimer would save his estate the
estate tax it would have to pay on the interest had he held it
at his death.

Additionally, disclaimers can play a key role in the advan-
tageous use of several specific statutory provisions, resulting in
estate tax savings to either the estate making the bequest or
the one disclaiming it.

The marital deduction. There is a potential for increasing
the estate tax marital deduction by disclaiming interests which
will then pass to a spouse and qualify for the deduction. For
example, a husband’s will might provide for several specific bequests of the income from property to each of his children, with the remainder to his wife. As a result of these bequests, the wife receives less under the will than she is eligible for as a marital deduction. If her children disclaimed part of their income interests, the property would pass directly to their mother, increasing the marital deduction and saving estate taxes on the husband’s estate. Conversely, if the wife receives more under a will than the amount which qualifies for the deduction and she does not need the additional interest, she may, by means of a disclaimer, be able to save taxes on her estate. For example, if she had received the previously mentioned income interest and one of her children the remainder, she could disclaim the interest, allowing it to go directly to the child without having the interest pass through her estate.

Similarly, if a marital deduction trust was created to qualify for the estate tax marital deduction, disclaimers can play a key role if the trust is defective and does not qualify. In this event, if the trustee disclaims all his powers with respect to the trust property and the beneficiary disclaims an interest in it, the trust property would probably pass into the residue of the husband’s estate and thus to the wife where it could qualify for the marital deduction. The defect would thereby be avoided.

455, § 2002(a), 90 Stat. 1520 (amending I.R.C. § 2056(c)(1)). In California, a community property state, the marital deduction only applies to separate property; thus it is of more limited value. I.R.C. § 2056(c)(2)(B).

When utilizing the marital deduction, it should be noted that the amount deducted will in theory be taxed in the surviving spouse’s estate. Thus, the optimum deduction may not be the maximum deduction possible. Several factors should go into determining the optimum deduction, among which are the surviving spouse’s age and the size of the potential estate. The wise use of disclaimers can result in the optimum deduction at the first spouse’s death. See Int. Rev. Code of 1954, ch. 736, § 2056(d)(2), 68A Stat. 392 (current version at I.R.C. §§ 2045, 2518).

16. This provision required that the person disclaim before the date prescribed for filing the estate tax return in order to be effective.

17. See id. § 2056(d)(1).

18. Frequently this type of trust is used for the surviving spouse’s share of the estate. However, it must be carefully drafted in order to qualify as a qualified interest for the marital deduction. See I.R.C. § 2056(b).

19. A potential problem in this area was created by the Tax Reform Act of 1976. Prior to the Act it was common to have “A-B trusts” where the widow would disclaim anything which did not qualify for the marital deduction which would then go into the B trust giving her an income interest with a remainder to the children. There was a question whether this disclaimer would be disqualified under I.R.C. § 2518(b)(4), which required that the interest pass to a person other than the person making the disclaimer. As a result, the proposed (as of May 11, 1977) Technical Corrections Bill of 1977 (H.R. 6715) would amend § 2518(b)(4) to read “as a result of such refusal, the
DISCLAIMERS

The charitable deduction. The estate tax charitable deduction can also be increased by disclaiming an interest which then passes to a qualifying charity. For example, if the testator's will directed that the income from certain property be paid to A for life, with the remainder to a recognized charity, this would not ordinarily qualify for the estate tax charitable deduction. However, if A disclaimed his interest, it would pass directly to the charity, thereby qualifying for the charitable deduction and reducing the amount of estate tax paid by the testator's estate. These estate tax savings would make more money available for the other beneficiaries of the estate.

General power of appointment. As a general rule, a decedent's gross estate includes the value of all property over which he held a general power of appointment. Thus, if a trust created by S provided that the income be paid to A for life, with a power in A to appoint the remainder by will and A died, the entire value of the property would be includable in A's estate. However, it is now possible to disclaim a general power of appointment over property and yet retain another interest in it, without having the entire value of the property included in the disclaimant's estate. Consequently, A's disclaimer of the general power of appointment over the above trust property, would result in considerable estate tax savings.

Generation-skipping transfers. Under the new generation-skipping transfer taxes, the creation of life estates with re-
remainder interests for members of subsequent generations may no longer skip exposure to estate taxes at the death of the life tenant(s). As a result, such interests should also be examined for potential tax savings through the use of disclaimers. Before the Tax Reform Act of 1976, the decedent in his will could transfer property to A for life, then to B for life, with remainder to C. In this event, estate tax is paid at the decedent’s death, but is avoided at each of the other levels. Now the transfers from A to B and B to C are taxable events, and the tax will be computed as if they had transferred the interest. A and B could avoid the imposition of this tax by disclaiming their interests in the arrangement.

**Income Tax**

There are also potential income tax savings possible through the effective use of disclaimers. By disclaiming an income producing interest in favor of someone in a lower income tax bracket, there will be an income tax savings. Thus, a transfer could provide that the income from a trust be paid to John but in the event that he disclaims it, to Mary. If John is in the 60% income tax bracket and Mary is only in the 20% bracket and the interest produces $10,000 income per year, Mary will get to keep $4000 more than John would. Similarly, if an individual has a power which he alone can exercise to vest the corpus or income of a trust in himself, he is treated as the owner of the trust for income tax purposes and must pay income tax on the income from the trust. However, this does not apply if he disclaims the power within a reasonable time after becoming aware of its existence.

**Inheritance Tax**

In general, the California inheritance tax parallels the fed-

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27. See I.R.C. §§ 2601-2622.
28. The only limitation on this scheme was the rule against perpetuities.
30. See id. § 2614(e).
31. Id. § 678.
32. Id. § 678(d). This time test appears to be different from the one for the estate and gift tax provisions under the Tax Reform Act of 1976, which now specifies nine months after the creation of the interest without any reference to the knowledge of the existence of the transfer. Since these are separate provisions of the Code they do not serve as precedent for each other and the time test for § 678(d) may be different from the estate and gift tax provisions.
eral estate tax law. One potentially important exception where disclaimers might be helpful is in the area of will contests. Under federal estate tax law, the tax is based on where the money actually goes. However, under California law the inheritance tax is based on the terms of the will admitted to probate. Thus, the terms of a compromise settlement of a will contest might include the requirement of a disclaimer to help minimize the tax consequences. For example, the will leaves $X to A and the residue to the Hope charity and Hope contests the will. If a compromise is worked out so that A receives $Y, there will still be a state inheritance tax based on $X. However, if A disclaims $Y, the federal estate tax on $Y will be saved.

There are a number of other areas where disclaimers are potentially useful but they are less settled. These include the possibility of disclaiming interests in joint tenancies, life insurance policies or trustee powers. In attempting to disclaim these interests, the taxpayer runs the risk that the disclaimer may not be upheld by a court or recognized by the state or federal taxing authorities.

In order to be effective, any attempted disclaimer must meet the requirements of the prevailing law. Meeting these requirements can generate many problems for the unwary planner. To help avoid these problems, it is important to understand the federal law as it existed before the Tax Reform Act of 1976.

**DISCLAIMERS UNDER FEDERAL LAW PRIOR TO 1977**

Before the Tax Reform Act of 1976, disclaimers were mentioned, but not defined, in five sections of the Internal Revenue Code and their accompanying regulations. The most com-
plete set of requirements for an effective disclaimer were spelled out in Regulation 25.2511-1(c). It set out three essential elements. First, the disclaimer had to be unequivocal and executed before the property was accepted. Second, it had to be in compliance with local law. Finally, it had to be “made within a reasonable time after knowledge of the existence of the transfer.”

**Reasonable Time**

Of these requirements, the final one was the greatest source of uncertainty. It was litigated in *Keinath v. Commissioner*, a case which highlights many of the difficulties encountered in using disclaimers. The case involved a disclai-

mendant who had a vested remainder in one-half of a trust, subject to divestment if he predeceased the life of tenant. He dis-

claimed this interest six months after the death of the life tenant, but nineteen years after the creation of the remainder. A state court determined that the disclaimer was effective under local law, but both the court of appeals and the tax court held that this determination was only a necessary not a sufficient condition for federal tax relief. The treasury regulation was held to call for a two part test—that the disclaimer be valid under local law and be made within a reasonable time after the disclaimant learned of the transfer. Based on this test, the tax court found the disclaimer invalid for federal tax purposes, concluding that the remainder was vested from the time of the creation of the trust and 19 years was not a reasona-

ble time period for disclaiming.

The Eighth Circuit reversed. It confronted two issues: what was the length of a reasonable time period for a disclaimer and when did that time period begin to run. The court con-

cluded that six months was a reasonable time period but nine-

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42. Id.
43. Id.
44. Id.
45. 480 F.2d 57 (8th Cir. 1973), rev'g 58 T.C. 352 (1972).
46. Id. at 60.
47. 480 F.2d at 61.
49. 58 T.C. at 359.
50. Id. at 358-59.
51. 480 F.2d 57 (8th Cir. 1973).
teen years was not. However, in contrast to the tax court, the court of appeals found that the time period did not begin to run until the remainder was no longer subject to divestment, which in this case occurred at the death of the life tenant. It is worth noting that the court seemed to suggest a third possible approach to answering the question of when the reasonable time period for disclaiming began:

Central to this case is the interpretation or denotation of the word "transfer" in the regulation. Is the transfer made at the time the trust is established or when the remainderman comes into possession and control? In other words, is the reasonable time period calculated from the date the remainderman has the right of possession or control of the property or when the trust is established?

This language implies that perhaps the time of possession as opposed to the time of creation of the interest or the time of absolute vesting should begin the reasonable time period for disclaiming. In the wake of Keinath, considerable confusion still remains as to the point at which the time period for disclaiming begins to run.

Insurance Proceeds

In addition to the requirements for an effective disclaimer, another problem area under the federal law was whether insurance proceeds could be disclaimed. One commentator suggests that this should be possible if the insured reserved the right to change the beneficiary. He draws support for this conclusion from an example found in the marital deduction section of the regulations which provides: "For example, if proceeds of insurance are payable to the surviving spouse and she refuses them so that they consequently pass to an alternate beneficiary designated by the decedent, the proceeds are considered as having passed from the decedent to the alternate beneficiary." Presumably, however, the disclaimer would also

52. Id. at 62.
53. Id. at 64.
54. Id. at 61.
55. See Newman & Kalter, supra note 5, at 588; Newman, supra note 1, at 73.503.1.
56. Id.
57. Treas. Reg. § 20.2056(d)-1(a) (1958). The interest of a beneficiary in an insurance contract where the insured reserved the right to change the beneficiary has been considered analogous to that of a legatee under a will since it is only an expectancy until the death of the insured. See Newman & Kalter, supra note 5, at 588.
have to be effective under local law and there is no clear common law right to disclaim an interest in insurance proceeds. A few jurisdictions have by statute included life insurance benefits as disclaimable interests but California is not one of them.\(^{58}\)

**Joint Tenancy**

Similar uncertainty surrounds the issue of whether a surviving joint tenant\(^{59}\) can disclaim property acquired by survivorship.\(^{60}\) It has been argued that there should be a right to disclaim on the theory that acceptance is required before a deed of property is effective. However, under this theory, such a disclaimer would have to be made at the initial conveyance of the property in joint tenancy. This is so because the survivor, in a validly created joint tenancy, does not take from the deceased co-owner but by operation of law.\(^{61}\) Nevertheless, courts have generally denied any form of joint tenancy disclaimer\(^{62}\) unless the survivor first learned of the interest after the death of the creator of the interest or unless there is statutory authority for it.\(^{63}\)

Even with the passage of the Tax Reform Act of 1976, the prior law on disclaimers remains important. First, the requirements for an effective disclaimer outlined above still apply to pre-1977 transfers.\(^{64}\) Second, the new law makes no provision for what types of interests can be disclaimed. Thus, the problems surrounding the ability to disclaim insurance proceeds or property conveyed in joint tenancy still persist. In any event, pre-1977 law will presumably control all the issues left open by the new Act.

As noted earlier, state statutes have always played an important role in determining the effectiveness of a disclaimer. In particular, they governed what types of property interests

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58. See Newman & Kalter, *supra* note 5, at 588 & n.69. The states that have included life insurance benefits by statute are Connecticut, Florida, Hawaii, and Nebraska.

59. A joint tenancy is an estate arising by a purchase or grant to two or more persons. The major incidence in joint tenancy is the right of survivorship by which the entire tenancy on the death of any tenant remains to the survivors and finally to the last survivor. *BLACK'S LAW DICTIONARY* 1634 (4th ed. 1968).


64. See text accompanying notes 39-54, *supra*. 
might be disclaimed. As a result, any comprehensive estate plan which seeks to utilize disclaimers must take into account the demands of local law. This aspect of disclaimer law will be examined, using California law as a backdrop.

**DISCLAIMERS UNDER CALIFORNIA LAW**

In 1972 the California legislature codified the law on disclaimers in California Probate Code section 190. Under section 190, a wide range of interests are disclaimable, including whole or fractional parts of any property—real, personal, legal or equitable. One can disclaim any power to appoint, consume, apply or extend property or any other right, power, privilege or immunity relating to property. Potential disclaimants include those who take an interest by intestate succession, devise, legacy or bequest, succession to a disclaimed interest, an election to take against a will, as beneficiary of a trust, pursuant to a power of appointment or an inter vivos gift. There is also a section for the survival of a disclaimer in the event that a beneficiary under a will dies before receiving an interest. This provision will prevent the interest from being taxed in both estates.

**Disclaimed Interests**

Unless otherwise specifically provided in the creating instrument, the disclaimed interest is treated as a lapsed interest—as if the disclaimant had predeceased the person creating the interest. Under the California anti-lapse statute, a lapsed testamentary disposition fails unless a substitute is mentioned

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Many of the § 190 provisions are patterned after the Model Acts to Provide for Disclaimer of Succession to Real and Personal Property for Testamentary Instruments and Nontestamentary Instruments. For a copy of the model act and commentary on its provisions, see 4 REAL. PROP. PROB. & TR. J. 658 (1969).

66. See CAL. PROB. CODE § 190(b) (West Supp. 1977).

67. See id.

According to one commentator the only inconsistency between the new probate code section and prior case law was the right of an intestate heir to disclaim. See Selected 1972 California Legislation, 4 PAC. L.J. 246, 248 (1973).

68. See CAL. PROB. CODE § 190(a) (West Supp. 1977).

69. See id. § 190.2.

70. The right to do this for federal tax purposes was litigated in Estate of Hoenig, 66 T.C. 471 (1976). The husband died 11 days after his wife who had willed her estate to him. By having the husband’s estate disclaim the interest left to him by the wife, it passed directly to the daughter and saved over $100,000 in taxes.

71. CAL. PROB. CODE § 190.6 (West Supp. 1977).
in the instrument or the estate is left to any kindred of the
testator with surviving lineal descendants. In either case it
appears that they should take the disclaimed interest.72 If the
gift fails, it falls into the residue.73 If there is no residuary clause
or it is a non-class residuary gift which is disclaimed, the gift
passes by intestate succession.74 Thus, these sections appear to
determine the eventual taker of the disclaimed interest. Since
the identity of the eventual taker is critical to the decision
whether or not to disclaim an interest, it would seem that in-
struments should be carefully drafted to specify what should
happen in the event of a disclaimer.75

Reasonable Time

The Probate Code deals with the reasonable time problem
by establishing a presumption as to what is reasonable.76 A
disclaimer is conclusively presumed to have been filed within
a reasonable time if it is filed within nine months of the death
of the creator of the interest by will77 or of the person dying
intestate,78 within nine months after the interest created by an
inter vivos trust becomes indefeasibly vested,79 and in all other
cases, within nine months after the first knowledge of the inter-
est is obtained by the disclaimant.80

In 1976, the legislature amended section 190, adding that
the presumption of filing within a reasonable time is also met
if the disclaimer is filed “within nine months after the interest
becomes indefeasibly vested.” Apparently then, the California
legislature has adopted the reasonable time standard utilized
by the appellate court in Keinath.81

If the requirements for this presumption are not met under
any of the various statutory tests, the disclaimant has the bur-
den of establishing that the disclaimer was filed within a rea-
sonable time after he acquired knowledge of the interest.82

72. Id. § 92 (West 1970).
73. 7 B. Witkin, Summary of California Law §§ 224-225, at 5735-37 (8th ed.
1974).
74. Id.
75. Continuing Education of the Bar, California Will Drafting § 14.23 (1965).
77. Id. § 190.3(a)(1).
78. Id. § 190.3(a)(2).
79. Id. § 190.3(a)(3).
80. Id. § 190.3(a)(4).
Section 190 also provides that a disclaimer is conclusively presumed not filed within a reasonable time if more than one year has elapsed from the date of death or the date of transfer of the inter vivos gift, whether outright or in trust, and the interest has been acquired by a bona fide purchaser.83

The foregoing statutory framework appears to establish the point at which the reasonable time period begins to run for a disclaimer to be effective under local law. However, the expiration of nine months from the starting point of any of the statutory tests does not end the “reasonable time period” inquiry. After nine months, the statute merely shifts the burden to the disclaimant to establish that the disclaimer was filed within a reasonable time after he acquired knowledge of the interest.

The fact that the nine month limit could elapse before a person acquires any knowledge of the interest might raise problems in the area of powers of appointment.84 Frequently a person does not know that he has a power until long after its creation particularly in an inter vivos trust.85 The statute says that interests resulting from the exercise or nonexercise of a testamentary or nontestamentary power of appointment shall be deemed created by the donee of the power.86 However, this stops short of the situation in which the donee himself wishes to disclaim the power. Since a disclaimer is neither an exercise nor a nonexercise of a power, it appears that the donee will be bound by the nine month time period, running from the date of the creation of the interest.

Form of Disclaimer

The statute also specifies the form for an effective disclaimer. It must be a signed,87 written instrument88 filed with the superior court if the interest is created by death, with the trustee if an inter vivos trust, and with the person creating the interest in all other cases.89 If the interest involves real property, the disclaimer must be acknowledged and proved and may

83. Id. § 190.1(iv).
84. See CAL. PROB. CODE § 190.3(b) (West Supp. 1977).
86. CAL. PROB. CODE §§ 190.3(a)(1), 190.3(a)(3) (West Supp. 1977).
87. Id. § 190.3(c)(1), (2). A bona fide purchaser (BFP) is a purchaser or encumbrancer for value.
88. See CAL. PROB. CODE § 190.3(b) (West Supp. 1977).
89. Id. § 190(c).
be certified and recorded in the same manner and with the same effect as grants of real property.\(^9\)

**Taxation of Disclaimed Interests**

Prior to the enactment of section 190, California Revenue and Taxation Code section 13409\(^9\) provided that, in the event of a disclaimer, the interest would be taxed as if there had been no disclaimer. Although this was an unusual statute,\(^9\) it was upheld by the courts.\(^9\) The section was amended at the same time that Probate Code section 190 was passed and now the inheritance tax is imposed based on the actual recipient of the interest.\(^9\) Since the California tax rate is based on the relationship of the recipient to the decedent, this can affect the tax rate and other possible deductions.\(^9\) However, the new section 13409 only applies to disclaimed interests and does not affect the outcome of will contests mentioned above.\(^9\)

**Transfers Covered**

The effective date of the statute provides for the disclaimer of interests created before the date of the statute.\(^9\) This is different from the new federal law since the new federal disclaimer statute\(^9\) only applies to interests created after the effective date of the section.

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90. *Id.*
92. *See* Annot., 27 A.L.R.3d 1354, 1360 (1969). California is cited as subscribing to the minority view that renunciation does [did] not free a person from inheritance tax on the theory that the tax accrues immediately upon the testator's death. *Id.*
95. *Id.* §§ 13307-13309, 13404-13406 (estate tax), 15110-15112, 15205-15207 (gift tax) (West 1970). This is not the case for federal estate and gift taxes where the relationship has no bearing on the tax rate. *See* I.R.C. § 2001.
96. *See* notes 15-18 and accompanying text *supra*.
   Any interest created prior to the effective date of this chapter which has not been accepted, may be disclaimed on or after August 16, 1972, in the manner provided herein; provided, however, that no interest which has arisen prior to the effective date of this chapter in any person other than the beneficiary, shall be destroyed or diminished by any action of the disclaimant taken pursuant to this chapter.
   *In re* Estate of Cooke, 57 Cal. App. 3d 595, 602, 129 Cal. Rptr. 354, 359 (1976), held that "person" includes the government and not just creditors and purchasers. Since the decedent in this case died before the effective date of the statute and the right to inheritance tax vests at the date of death, the tax was computed under § 13409 of the old Revenue and Taxation Code, despite the disclaimer.
Problem Areas

Although the statute on disclaimers went a long way toward clarifying the law in California, there are still a number of problem areas. First, the right to disclaim insurance proceeds and interests under joint tenancies remains unsettled under the revised law. Several proposals which would have specifically included such interests among those disclaimable were not adopted.99

A second problem area surrounds the ability of a trustee to disclaim part of his powers over a trust.100 In view of the tax ramifications of trustee powers,101 it has been suggested that trusts should be permitted to contain clauses providing for the partial disclaimer of any trust provisions which the trustee considers burdensome, unnecessary or unwise.102 Despite the beneficial results which could flow from this type of partial disclaimer, section 190 makes no specific mention of trustees. Therefore, it seems that trustees will continue to be governed by the common law rule which provides that they may disclaim all their powers but not those covering only a portion of a trust.103

A third problem area involves the rights of creditors when a disclaimer is used to defeat their interests. For example, a beneficiary, knowing that his interest will merely go to pay his creditors, may disclaim the interest and allow it to pass to someone else. Since the statute states that the disclaimer shall relate back104 for all purposes to the date of the creation of the interest,105 it would appear that the creditor’s claim would be defeated since this would imply that the debtor never had a right to the interest. However, there is language in In re Estate of Kalt106 which might generate a different result. The Kalt court concluded that the fiction of “relation back” should not

99. Uniform Disclaimer of Transfers under Non Testamentary Instruments Act § 1; Newman & Kalter, supra note 5, at 588; see notes 27-32 and accompanying text supra.
100. Johnson, supra note 10, at 27.
102. Continuing Education of the Bar, Drafting California Revocable Inter Vivos Trusts § 6.21 (1972).
103. 2 O. Scott, Trusts § 102.4 (3d ed. 1967).
104. The doctrine of “relation back” is simply a fiction by which an act done or a right arising is deemed to have been done or to have accrued at an antecedent time in order to preserve the rights as of the earlier date or otherwise to avoid injustice. 36A Words and Phrases 407 (West 1962).
106. 16 Cal. 2d 807, 108 P.2d 401 (1940).
be used to defeat the claims of creditors. The court reached this conclusion by comparing the right to disclaim an interest in property to the creation of a general power of appointment. The court then noted that the debtor in effect is forced to exercise this power in favor of himself if he exercises it at all and must accept the property subject to it even against his will. By analogy then, the disclaimant should also be forced to accept the property which would come to him as a beneficiary were it not for the disclaimer.

The conflict between the “relation back” theory and the Kalt reasoning indicates that creditors should seek additional protection from the potential adverse results of a disclaimer. One possible protection for the creditor is the provision in section 190 for a written waiver of the right to disclaim, executed by the potential disclaimant which, when filed, is binding on him. A creditor could condition the entering of the obligation on the execution of such a waiver by the debtor. Alternatively, it is not beyond reason that a court could create a fictional “waiver” for the protection of creditors when disclaimers are used to generate fraudulent conveyances to defeat the interest of the creditors.

With the examination of California and pre-1977 federal law complete, it becomes important to examine the impact of the Tax Reform Act of 1976 on the structure of disclaimer law. As noted earlier, this basic structure mandated three requirements for a qualified disclaimer: it had to be unequivocal and executed before the property was accepted; it had to comply with local law; and it had to be made within a reasonable time after knowledge of the existence of the transfer.

**Disclaimers Under the Tax Reform Act of 1976**

Prior to the Tax Reform Act of 1976 there was a great deal of criticism of the law of disclaimers for federal tax pur-

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107. *Id.* at 812, 108 P.2d at 403.
108. *Id.*
110. Fraudulent conveyance is defined as a conveyance or transfer of property the object of which is to defraud a creditor, or hinder or delay him, or to put such property beyond his reach. The conveyance is made with the intent to avoid some duty or debt due by or incumbent on the person making the transfer. *Black's Law Dictionary* 790 (4th ed. 1968).
111. See notes 20-22 and accompanying text supra.
poses. The major issues mentioned were the uncertainty of a disclaimer's validity and the inequity in the area since the effectiveness of the disclaimers depended on local law. This led to fifty standards for an effective disclaimer under the federal tax laws. Some states, such as California, enacted statutes to help clarify the requirements for effectiveness under local law, but this provided only a partial solution to the problem.

This was amply illustrated by the Keinath case, which pointed out that effectiveness of a disclaimer under local law was a necessary but not a sufficient condition for effectiveness of a disclaimer for federal tax purposes. The rationale of Keinath clearly implies that an area exists where federal law determines the effectiveness of disclaimers. The Tax Reform Act of 1976 entered this area by adding sections 2518 and 2045 (cross-reference provision to section 2518) to the estate and gift tax title of the Internal Revenue Code.

Section 2518

Section 2518 provides that a disclaimer to qualify for federal tax purposes must satisfy four conditions. First, the refusal to accept the interest in property must be in writing. Second, this refusal must be received by the transferor of the interest, his legal representative, or the holder of the legal title to the property not later than nine months after the day on which the transfer creating the interest is made. Third, the person must not accept the interest or any of its benefits prior to making the disclaimer. Finally, as a result of the refusal to accept the property, the interest must pass to a person other than the person making the disclaimer. These conditions raise the issue of whether or not they nullify the former requirement that a disclaimer be effective under local law. It is possible that a

114. 480 F.2d 57 (8th Cir. 1973); see note 47 and accompanying text supra.
117. Id. § 2518(b)(2).
118. Id. § 2518(b)(3).
119. Id. § 2518(b)(4).
Disclaimer could meet the requirements of section 2518 and not meet the requirements of the state involved.

Disclaimable Interests

For example, one of the biggest problems of the prior law was its failure to outline what types of interests could be disclaimed. Section 2518 does not solve this problem, it merely says “an interest in property” can be disclaimed. It also provides that an undivided portion of an interest can be disclaimed and that a power with respect to property is a disclaimable interest. Beyond this there is no listing of the types of interests which are disclaimable. This raises a question regarding whether the interest must be disclaimable under local law to be a disclaimable interest under federal tax law or, whether it need only be an interest in property under local law. Since the law was supposed to help make the disclaimer uniform throughout the United States, the latter interpretation would be more useful. However, this could lead to the anomalous result of a property interest being disclaimed for federal tax purposes which cannot be disclaimed under local law. The promulgation of a clear treasury regulation would help clarify this point.

120. Id. § 2518(c)(1).
121. Id. § 2518(c)(2).
122. If it merely needs to be a property interest under local law, joint tenancies and insurance benefits might be disclaimable for federal tax purposes even though not disclaimable under state law. See notes 55-63, 99-104 and accompanying text supra.
123. A statement in the House report suggests that the federal law is intended to operate independently of state law. If the requirements of the provision are satisfied, a refusal to accept property is to be given effect for Federal estate and gift tax purposes even if the applicable local law does not technically characterize the refusal as a “disclaimer” or if the person refusing the property was considered to have been the owner of the legal title to the property before refusing acceptance of the property.

House Report, supra note 113, at 67. However, since the disclaimer is only effective if the interest passes to a person other than the person making the disclaimer, I.R.C. § 2518(b)(4), it would seem that the disclaimer must be effective under state law. The American Bar Association’s disclaimer proposal deals with the problem and states: DISCLAIMERS INEFFECTIVE UNDER LOCAL LAW—A disclaimer of property which is ineffective under governing law shall be given effect for the purpose of this section if the property is transferred, within the time herein prescribed for delivery of a disclaimer, to the person or persons who would have been entitled thereto had the disclaimant predeceased the prior holder of the property.

This statement might provide guidance for the regulations or for a technical amendment. See J. McCord, 1976 Estate and Gift Tax Reform 253-54 (1977).
Execution of Disclaimers

Another area where federal and state law could conceivably conflict is in the requirements for execution of a qualified disclaimer. Section 2518 specifies that the disclaimer must be in writing and must be received by the transferor, his legal representative or the holder of the legal title to the property. In comparison, the California statute calls for filing with the court if the interest is created at death, the trustee of an inter vivos trust, or the person creating the interest in all other cases. It is possible that the notification could be effective under one rule but not the other. For example, the disclaimerant could notify the executor but not the court. This would imply a disclaimer effective under federal law but not state law. Perhaps the easiest solution to this problem would be to change the California statute so that it parallels the federal law.

Reasonable Time Period

As outlined earlier in Keinath, perhaps the most uncertain aspect of the pre-1977 federal law on disclaimers was when the reasonable time period for making a disclaimer began to run. In the Tax Reform Act of 1976, the House Ways and Means Committee wanted to establish a uniform standard of time within which a disclaimer must be made. Keinath was mentioned by the committee with a tone of disapproval because of the nineteen year period from the date of death to the date of disclaimer. The Committee’s solution in section 2518 was to define a reasonable time to be nine months from “the date on which the transfer creating the interest in such person is made.” Arguably, this does not define a workable starting point for the reasonable time period, since it does not deal with interests which may not vest until long after the actual creation of the interest. For example, a revocable trust might be established where an interest is created but may be withdrawn at

124. I.R.C. § 2518(b)(1), (2).
126. 480 F.2d 57 (8th Cir. 1973).
128. This comment seems to ignore some of the subtleties of the Keinath decision. It concentrates on the 19 years rather than the problem of when to start the reasonable time period. It also seems to stress the importance of local law rather than the fact that Keinath established a federal time standard (in addition to requiring effectiveness under local law). See notes 45-54 and accompanying text supra.
129. I.R.C. § 2518(b)(2).
any time. It seems unreasonable to assume that the beneficiary in this instance should be forced to disclaim what amounts to a mere expectancy within nine months of the establishment of the trust.

The Joint Explanatory Statement of the Committee of Conference attempted to clarify the section by stating that the nine month period is to be determined in reference to each taxable transfer. Presumably, this would be a transfer subject to an estate, gift or generation skipping tax. This standard would cover the revocable trust since there is no liability for gift tax until an interest vests in a beneficiary. However, it generates problems with respect to remainder interests, since this standard makes no allowance for the point at which actual knowledge of these interests is acquired by the beneficiary. Even if such knowledge was not acquired until years after the transfer, remainder interests are apparently not disclaimable more than nine months after their creation, since this is generally a taxable event.

Since California has now adopted the more liberal Keinath standard as part of its statutory reasonable time requirement, it appears that some disclaimers, particularly of remainder interests, will be valid under state law but not under the more stringent federal standard.

Generation-skipping transfers. The Tax Reform Act of 1976 may have created an exception to this with respect to generation-skipping transfers which do impose a tax when subsequent interests vest in enjoyment. For example, John, in his will, leaves a life estate to his daughter Mary, a subsequent life estate to his granddaughter Susie and the remainder interest to any living great grandchildren at Susie's death. Under the generation-skipping tax the transfers from Mary to Susie and from Susie to the grandchildren will be subject to the

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132. Remainder interests created by a will are taxed with the original estate, not at the time they vest in possession. I.R.C. § 2031.
133. See note 26 and accompanying text supra.
generation-skipping tax. Thus, it would seem that Susie's interest could be disclaimed at Mary's death so that the interest would go directly to the grandchildren without being taxed as a transfer from Susie to the grandchildren. This seems permissible under the new law since "any taxable distribution or taxable termination" is defined to be a generation-skipping transfer. Consequently, under the Conference Committee's interpretation it would seem that an interest could be disclaimed at the termination of a prior life estate since that would be a taxable transfer, avoiding the requirement that the interest be disclaimed nine months after the death of its creator (John in the example).

However, an alternative theory is available. This would be that the creation of the interest occurs in the will of the original decedent and therefore, any disclaimers must be filed within nine months of his death. There is language in the House Ways and Means Committee report which might support this view, since it states: "A beneficiary under a generation-skipping trust is permitted to disclaim his interest in that trust within the same time period and the same manner as would any beneficiary of an outright gift or bequest."

In the wake of these interpretations, it seems obvious that the disclaimer of generation-skipping interests will be a major area of uncertainty under the new law, since either view could reasonably prevail.

Powers of appointment. The Conference Committee's report also provided that a recipient of a general power of appointment would have nine months to disclaim. No mention was made of the problem of lack of knowledge which could lead to the difficulties discussed above. As a result, these interests could generate similar problems concerning the reasonable time period and its starting point.

Transfers involving minors. An exception to the nine month disclaimer period arises when a minor is the recipient of the interest. Such a person is given nine months after attaining the age of twenty one. It is difficult to reconcile why this type of incompetency receives an exception but others such

135. See I.R.C. § 2611(a).
136. See House Conference Report, supra note 130, at 4118, 4262 app. A.
138. House Conference Report, supra note 130, at 4118, 4262 app. A.
139. See notes 85-86 and accompanying text supra.
as absence from the United States or mental incompetency do not. Such a long delay would seem to create a great deal of uncertainty in transfers involving minors. For example, the federal law by its terms would arguably prohibit the guardian of a minor from making a qualified disclaimer, despite the fact that other types of guardians may do so. This might also cause some conflict with state law since under California law a guardian can disclaim for a minor.\textsuperscript{141} If he does not, would the minor still have the right to disclaim when he reaches age twenty-one? If the guardian disclaims would this be effective for federal law purposes since it is effective under state law? The answer seems to depend on the resolution of the previously mentioned problem involving the conflict between state law and the federal tax law.

\textit{Transfers Covered}

The effective date for the new federal law provides for its application to all transfers creating an interest in the person disclaiming made after December 31, 1976.\textsuperscript{142} Thus, the prior law mentioned above will still apply to all interests created before that time. It should also be used along with the legislative history of the Tax Reform Act of 1976 to clarify some of the obvious problems with the new statute.

\textbf{CONCLUSION}

The value of disclaimers as an estate planning tool has long been recognized. However, the uncertainty surrounding their use served to detract from their obvious utility. Recent legislative efforts have endeavored to make this area of the law more dependable.

Despite these efforts, there are still a number of problem areas such as what types of interests can be disclaimed and when the reasonable time period to execute a disclaimer begins to run.\textsuperscript{143} Indeed, the Tax Reform Act of 1976 may have created

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\item[143.] The definite nine month period of the federal legislation should decrease the importance of the California section on time, \textit{Cal. Prob. Code} § 190.3(b) (West Supp. 1977), since avoiding the federal tax is often the major aim of a disclaimer.

This might not be so true of a smaller estate, since the Tax Reform Act of 1976 increased the exemption for the estate tax. Before, any estate over $60,000 was subject to the federal estate tax. By 1981 any estate over $175,625 will be subject to the federal estate tax. \textit{Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001, 90 Stat. 1520} (codified
\end{enumerate}
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yet another difficulty. It was designed to establish a uniform disclaimer law throughout the states. However, it is unclear whether the previous requirement that a disclaimer be effective under the state law still applies and what the effect will be when there is a conflict between the state and federal disclaimer laws. This is a major issue which needs to be resolved.

Since the disclaimer is such a useful and indispensable tool for proper estate planning and management, it is hoped that regulations under the new federal tax law can be issued to help clarify some of these areas in order to avoid costly litigation.

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at I.R.C. § 2010). Thus, saving California death taxes may become an important issue also.