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COMMENT

INTERNAL REVENUE CODE SECTION 2518
DISCLAIMERS AND THE 1981 ECONOMIC
RECOVERY TAX ACT: CONTINUED UNEQUAL
TREATMENT OF TAXPAYERS

I. INTRODUCTION

One of the purposes of estate planning is to decrease or eliminate federal and state taxes by distributing family wealth to meet family members' needs. Disclaimers can play an important role in estate distributions particularly where the beneficiaries' circumstances have changed since the formulation of the original estate plan. A disclaimer is a refusal to accept ownership of either a testamentary or inter vivos gift or an intestate share. The disclaimed property is treated as if it had never been transferred to the person making the disclaimer. Instead, it is considered to pass directly from the original transferor to the person entitled to receive the property as a result of the disclaimer. Consequently, there is no federal gift tax levied on a property transfer that results from a qualified disclaimer.

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3. See Note, supra note 1, at 46-47; Schwartz, supra note 1.


6. See I.R.C. § 2518 (1976). The net tax savings to beneficiaries may also in-
A hypothetical situation illustrates the usefulness of a disclaimer in the area of postmortem estate planning. Suppose testator T dies in 1982 and is survived by two sons, B and C, and B's children. T leaves equal shares in certain income producing property to B and C. Additional property is left in trust to B with the trustee authorized to pay the income to B and B's children. At B's death, the remaining trust assets are to be distributed to B's children. B, a successful doctor with sufficient assets for security and comfort, desires to limit his estate and decrease his income taxes. B would prefer that his property interests, inherited from T, pass to his children and his brother C, who became incompetent immediately following T's death. If B's inherited property interests can be validly disclaimed, he can successfully reduce his estate size, avoid a generation-skipping tax, minimize the family's income taxes, and equalize the family estates.

7. A disclaimant's property usually passes under the particular state's laws of succession. Accordingly, B's disclaimed property interests in the trust will pass to his children. See infra notes 154-57 and accompanying text.

8. It must be assumed that a clause in the testator's will provides that in the event B disclaims his interest in the nontrust assets, they are to pass to C. Otherwise, they would pass to B's children. See infra notes 154-61 and accompanying text.


10. A trust established for the benefit of two or more generations below the grantor is considered a "generation-skipping" trust. I.R.C. § 2613(b) (1976). Upon its termination, a transfer tax is imposed. I.R.C. § 2601 (1976). A "taxable termination" is defined as a termination by means of death, lapse of time, exercise or nonexercise, or otherwise, of an interest in a generation-skipping trust of a younger generation beneficiary. I.R.C. § 2613(b). A "younger generation beneficiary" is a beneficiary in any generation below that of the grantor. I.R.C. § 2613(c). In the hypothetical, B is not deemed to have an interest, therefore, there is no taxable termination for purposes of section 2613(b) and no tax is imposed. If he waits to let the interest pass to his children at death, however, a generation-skipping tax will be imposed. I.R.C. § 2613(b).

The right to refuse an offered gift was recognized in early common law. People v. Flanagan, 331 Ill. 203, 207-08, 162 N.E. 848, 849-50 (1928); Burritt v. Silliman, 13 N.Y. 93 (1855); 60 A.L.R. 305 (1928).

11. Assume the children are in a lower tax bracket than B. If the property passes to the children, the current income will be taxed at their lower income tax rate.
The tax implications of disclaiming property interests, however, have not always been definitively ascertainable. Analysis of the original version of Internal Revenue Code section 2518 shows that state law has controlled disclaimer evaluation. Therefore, disclaimants have received varying treatment according to their place of domicile.

12. C, now incompetent, will not receive earnings which will increase his estate. B is in a highly lucrative profession and his estate size will most likely increase. By using a disclaimer, B is able to help meet C's support needs and distribute the family wealth so that its respective estates are closer in size.

13. Section 2518 was enacted in 1976 and provided as follows:
   (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 transferred to such person.
   (b) Qualified disclaimer defined
   For purposes of subsection (a), the term "qualified disclaimer" means an 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 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 to a person other than the person making the disclaimer (without any direction on the part of the person making the disclaimer).
   (c) Other rules
   For purposes of subsection (a)—
   (1) Disclaimer of undivided portion of interest. A disclaimer with respect to an undivided portion of interest which meets the requirements of the preceding sentence shall be treated as a qualified disclaimer of such portion of the interest.
   (2) Power. A power with respect to property shall be treated as an interest in such property.


Before the 1981 amendment, the section had been amended in 1978, altering subsection (b)(4) to read, "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." Revenue Act of 1978, Pub. L. No. 95-600, § 702(m), (2), 92 Stat. 2763 (codified as amended at I.R.C. § 2518(b)(4) (Supp. IV 1980)).

14. See infra notes 20-31 and accompanying text.
Examination of the 1981 amendment, subsection 2518(c)(3), discloses that deference to state law has been virtually abandoned. The amendment has, thereby, achieved uniformity in the application of disclaimers. The issue of unfair treatment of taxpayers, however, has not been entirely resolved. The IRS interpretation of section 2518 generates inconsistencies within the statute which confer less favorable treatment upon certain taxpayers. In addition, the amendment fails to address differences between state and federal law concerning determination of the proper post-disclaimer transferee.

This comment focuses on whether I.R.C. section 2518 has abrogated deference to state law in disclaimer application and abolished the unequal treatment of taxpayers. It concludes that the unfair treatment of taxpayers persists after the 1981 amendment to section 2518 and suggests that these inequities may be eliminated by the following: (1) alteration of the proposed IRS interpretation of section 2518; (2) designation of testator post-disclaimer transferees; and (3) passage of state legislation parallel to that of the federal statute.

II. COMMON LAW INCONSISTENCIES

Problems in utilizing disclaimers arise only where state and federal law are inconsistent. These inconsistencies are a product of the common law, and, therefore, examination of their development is pertinent in order to lay the new law's foundation.

At common law, the states were allowed to determine the validity of a disclaimer. State property law determined when

15. The 1981 amendment to § 2518 provides as follows:
(c) Other rules.—For purposes of subsection (a)—
(3) Certain transfers treated as disclaimers.—For purposes of subsection (a), a written transfer of the transferor's entire interest in the property—
(A) which meets requirements similar to the requirements of paragraphs (2) and (3) of subsection (b), and
(B) which is to a person or persons who would have received the property had the transferor made a qualified disclaimer (within the meaning of subsection (b)), shall be treated as a qualified disclaimer.
16. See infra note 118 and accompanying text.
a property interest vested\textsuperscript{18} and, consequently, when it had been accepted. State probate law controlled the postmortem passage of property and designated the person to whom the interest would pass.\textsuperscript{19} The issue of whether a disclaimer was a taxable event hinged upon whether the disclaimant held title to the property interest before the purported disclaimer. If state law deemed property title to have vested in the disclaimant the post-disclaimer transfer would then result in a gift tax. Otherwise, no tax consequences would arise.

Of course, state laws varied. Differences existed with respect to the vesting of intestate and testate shares\textsuperscript{20} and partial interests.\textsuperscript{21} It was unclear whether joint ownership interests,\textsuperscript{22} life insurance and annuity contract proceeds, and beneficial interests combined with fiduciary obligations could be proper disclaimer subjects.\textsuperscript{23} To add to the confusion, no definitive period for a timely disclaimer was established.\textsuperscript{24}

The resulting unequal treatment of taxpayers at common law is best illustrated by two cases. In Brown v. Routzhan,\textsuperscript{25}

\begin{itemize}
\item \textsuperscript{18} See Wartin, Perspective on Federal Disclaimer Legislation, 46 U. Chi. L. Rev. 323-25 (1979).
\item \textsuperscript{19} Id. See, e.g., Cal. Prob. Code §§ 200-59.2 (West 1956).
\item \textsuperscript{20} Compare Hardenberg v. Commissioner, 198 F.2d 63 (8th Cir. 1952), cert. denied, 334 U.S. 846 (1952) (attempted renunciation of intestacy interest was held to be a taxable transfer) with Brown v. Routzhan, 63 F.2d 914 (6th Cir. 1933) (renunciation of a testamentary transfer was upheld even though the disclaimant had delayed eight years in renouncing his interest).
\item \textsuperscript{21} See Commissioner v. Macaulay's Estate, 150 F.2d 847 (2d Cir. 1945) (upholding a renunciation of $400,000 out of a $1,000,000 bequest and allowing a charitable deduction for the amount disclaimed which passed to charities according to the terms of the residuary clause); Brown v. Routzhan, 63 F.2d 914 (6th Cir. 1933) (the court treated a one-third interest in a life estate as a severable interest); Perrine v. United States, 423 F. Supp. 1217, 1220 (N.D. Iowa 1976) (electing under a will does not estop a surviving spouse from disclaiming an interest under one of the provisions).
\item \textsuperscript{22} Other states take an all or nothing approach. "The 'all or nothing' concept is based on the theory that a will must be accepted as a whole and liabilities must be accepted with benefits." Note, supra note 1, at 52 (citing Nusz v. Nusz, 155 Kan. 699, 127 P.2d 441 (1942)).
\item \textsuperscript{23} See Note, supra note 1, at 52 (citing Krakoff v. United States, 493 F.2d 1023 (6th Cir. 1971) (involving joint bank accounts for which the survivor had signed cards and stock certificates for which she had endorsed dividend checks)).
\item \textsuperscript{24} See Comment, supra note 1, at 225-27; Frimmer, supra note 2, at 829-33.
\item \textsuperscript{25} Treas. Reg. § 25.2511-1(c) (1973); see Keinath v. Commissioner, 480 F.2d 57 (8th Cir. 1973); Ewing v. Rountree, 228 F. Supp. 137 (D. Tenn. 1964); In re Wilson's Estate, 298 N.Y. 393, 83 N.E.2d 852 (1949).
\end{itemize}
the Sixth Circuit confirmed that state law was controlling in the determination of a valid disclaimer. The court allowed for renunciation of a testamentary share despite the delay of eight years. In contrast, intestate shares were not subject to disclaimers. In *Hardenberg v. Commissioner*, the Eighth Circuit applied the state’s descent and distribution statute and concluded that title to intestate property vested in the heirs immediately at the decedent’s death. As a result, the heirs could not divest themselves of the interest without incurring a federal gift tax.

In addition to these common law inequities, no specific disclaimer time period was prescribed. The greatest controversy arose in the case of *Keinath v. Commissioner*. The Eighth Circuit held that disclaimer of a remainder interest made at the expiration of the life estate was timely under both federal and state law, despite the lapse of nineteen years since the estate’s creation. The court decided that the tolling period for a remainder interest did not begin to run until the interest became indefeasibly vested.

The preceding decisions failed to alleviate the confusion. The distinction made by Brown and Hardenberg between intestate and testate shares had no logical basis, and the courts failed to clearly define disclaimer “timeliness.” Moreover, the Eighth Circuit in *Keinath* did not establish an unequivocal future interest tolling period, even though it decided when that tolling period would begin to run. Perhaps the most innovative implication of the *Keinath* court was that

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26. A disclaimant was allowed to renounce his outright one-third interest in his deceased wife’s property approximately eight years after her death. The district court held that the husband’s acceptance of the income from the property and his delay in rejecting its benefits precluded his renunciation. 63 F.2d at 916. The Sixth Circuit reversed holding that the right to accept or reject the testamentary gift could be exercised as long as the decedent’s estate was in administration. Id. at 917.
27. Id. at 916.
28. 198 F.2d 63 (8th Cir. 1952), cert. denied, 344 U.S. 836 (1952).
29. Id. at 68.
30. 480 F.2d 57 (8th Cir. 1973), rev’d, 58 T.C. 352 (1972).
31. The court’s holding that the tolling of the period does not begin to run until the interest becomes indefeasibly vested was contrary to the IRS position that the period should begin to run upon creation of the interest. Since in this case the interest had become indefeasibly vested at the death of the life tenant, petitioner had made an effective disclaimer. 480 F.2d at 64.
32. Id. at 62.
33. Id. at 64. The court concluded that six months was “timely” once the tolling period began to run but that nineteen years was not.
federal law had a role to play in the determination of a disclaimer's validity. I.R.C. section 2518 was enacted in response to the common law inconsistencies to establish a uniform federal standard for judging disclaimer effectiveness.

III. I.R.C. Section 2518

I.R.C. section 2518, part of the Tax Reform Act of 1976, was enacted to eliminate submission to the vagaries of state law. Congress was unsuccessful in achieving this goal, however, because the language of the 1976 statute mandated application of state law. The Economic Recovery Tax Act of 1981 amended section 2518 and rendered state law irrelevant in effective disclaimer determination by providing a method for transferring disclaimed property to an alternate transferee.

A. Original Section 2518 Requirements Still Applicable

Section 2518 defines a "qualified disclaimer" as an "irrevocable and unqualified refusal to accept an interest in property" that satisfies the following four conditions: (1) The refusal must be in writing; (2) the refusal must be received by the person transferring the property, or his legal representative, no later than nine months after creation of the interest or after the disclaimant reaches age twenty-one; (3) no interest or benefits in the transferred property may have been accepted prior to the disclaimer; and (4) as a result of the disclaimer, the interest must pass either to the testator's surviving spouse or to a person other than the disclaimant.

34. Id. at 61. The Eighth Circuit agreed with the Tax Court that a disclaimer should not be assessed solely on the basis of its validity under local law.
38. Id. at (b)(1).
39. Id. at (b)(2).
40. Id. at (b)(3).
41. Revenue Act of 1978, Pub. L. No. 95-600, § 702(m)(2) 92 Stat. 2763, amended § 2518 (b)(4) to permit the interest disclaimed by the surviving spouse to pass to the surviving spouse. The amendment allows disclaimed, overfunded marital deduction bequests to pass to the family or bypass trust even though the spouse is also a beneficiary of that trust. See Letter Ruling 7928054 (4-16-79) (disclaimer of the above type was ruled a "qualified disclaimer").
without any disclaimant direction.\textsuperscript{42}

The proposed IRS regulations,\textsuperscript{43} issued in 1980, elaborate on the above requirements. The disclaimer writing must identify the disclaimed property interest and be signed either by the disclaimant or his legal representative.\textsuperscript{44} Further, the regulations repeat the Committee Report guideline that the nine-month disclaimer period is to be determined with reference to each taxable transfer.\textsuperscript{45}

Acceptance of property interests can be either express or implied.\textsuperscript{46} The payment of property taxes for instance, can be deemed an implied acceptance.\textsuperscript{47} An agreement to have the disclaimed property pass to the disclaimant's designee and receipt of consideration for making the disclaimer may also be deemed an implied acceptance.\textsuperscript{48} For example, a disclaimant may renounce an interest in a house but be allowed to live in it rent free for life.\textsuperscript{49} The disclaimer may, in the alternative, be conditioned on the receipt of the interest by the disclaimant's designee.\textsuperscript{50} Both situations would result in an implied property acceptance by the purported disclaimant. The exercise of a power of appointment may also be regarded as an acceptance. Actions taken by a person in the exercise of his fiduciary powers to maintain and preserve the disclaimed property, however, will not result in an acceptance.\textsuperscript{51}

The most important section 2518 requirement is contained in subsection (b)(4), which states that the interest must "pass without direction on the part of the disclaim-

\textsuperscript{42} I.R.C. § 2518(c)(4) (1976).
\textsuperscript{43} Proposed Treas. Reg. § 25.2518 (1980). Comments on the proposed regulations were heard on November 18, 1980. These comments attacked the IRS position. The final regulations may reflect changes which are of concern to the estate planning community. See American Bankers Association, Request for opportunity to testify at public hearing, (10-15-80); Michael D. Carrico, Comments on the proposed regulations (10-29-80); Paul N. Frimmer, Outline of oral comments on the proposed regulations under § 2518, (10-30-80); Robert A. Parr, Written comments on the proposed regulations pertaining to a qualified disclaimer, (9-19-80). The above comments and outlines may be obtained from the Commissioner of the Internal Revenue Service and are also on file with Santa Clara Law Review.
\textsuperscript{44} § 25.2518-2(b)(1).
\textsuperscript{45} Id. at (c)(2).
\textsuperscript{46} Id. at (d)(1)(i).
\textsuperscript{47} Id. at (d)(1)(iii) example 3.
\textsuperscript{48} Id. at (d)(1)(i).
\textsuperscript{49} Id. at (d)(1)(iii) example 2.
\textsuperscript{50} Id. at (d)(1)(i).
\textsuperscript{51} Id.
ant."  

First, the property interest must not remain in the disclaimant's possession or control. Otherwise, the "pass" requirement will not have been met. Second, the disclaimant cannot designate who will take the property in his or her stead. In the introductory hypothetical situation, if B were to specify that his interest must pass to his children, B would violate the "without direction" requirement and the disclaimer would fail.

The federal statute, as originally enacted, failed to supply a mechanism for subsequent disposition of disclaimed property. The statute on its face did not direct how the interest would pass and to whom. In the hypothetical situation, B wanted to disclaim his respective interests to obtain beneficial tax results. How would the effectiveness of B's disclaimer be determined?

The proposed section 2518 regulations indicated that state law would continue to govern disclaimer validity. "If a disclaimer is not effective under local law to divest ownership of the disclaimed property in the disclaimant and to vest it in another, the disclaimer is not a qualified disclaimer under section 2518." This appeared to be the only logical conclusion in spite of congressional intent to the contrary.

The federal statute was devoid of any language directing the subsequent property transfer. In comparison, most states
have statutes that specifically provide for the devolution of validly disclaimed property. Under state law, the interest will shift only if the disclaimer is authorized by the state’s statutory scheme or common law. If the disclaimer is not so authorized, the property is deemed to have been vested in the disclaimant. Any subsequent disposition will be considered a transfer by the disclaimant independent of the disclaimer. Consequently, the purported disclaimant would have incurred a federal gift tax. If the purported disclaimant, B, were domiciled in a jurisdiction which did not permit disclaimer of intestate shares, the interest would have vested immediately in B. The transfer of property interests from B to his children would be taxable. On the other hand, if the particular jurisdiction allowed intestate share disclaimers, the interest would have passed to B’s children without a gift tax imposition.

The foregoing examples demonstrate that deference to state law endured through the original enactment of section 2518 and, consequently, the common law’s unequal treatment of taxpayers persisted. Congress has recently enacted an amendment to section 2518, via the Economic Recovery Tax Act of 1981, which may change this result.

B. The 1981 Amendment: Subsection 2518(c)(3)

The basic motive behind adding section 2518(c)(3) was to...
achieve a uniform federal standard of disclaimer application. 68
Section 2518 now permits a disclaimant to transfer the property to certain designated transferees without otherwise violating the statute. 69 In effect, the amendment disregards state law for purposes of determining disclaimer validity.

Section 2518(c)(3) permits the shifting of a property interest to "the person or persons who would have received the property had the person made a qualified disclaimer within the meaning of subsection (b)." 70 The disclaimant is no longer deemed to retain possession or control of the interest and the "passing" requirement can now be satisfied without looking to state law for guidance. 71 The amendment mandates further, that the property is to be transferred to a statute determined taker, which leaves no possibility for the disclaimant to choose the taker. The disclaimant merely performs a ministerial function in the transfer, and the interest passes "without direction on the part of the disclaimant." 72 The Senate report further indicates that the disclaimant can direct the property interest to the person who would have taken under local law without being deemed to have accepted the property. 73

By providing for a shifting of disclaimed property, Congress abrogated deference to state law with regard to the devolution of property interests. A disclaimant can now perfect

68. The Senate Report states:

Prior to the enactment of section 2518, the effect of a disclaimer, for Federal estate and gift tax purposes, depended on its validity under applicable local law. When Congress enacted section 2518, it intended a uniform Federal standard so that a disclaimer would be valid for Federal estate and gift tax purposes whether or not valid under local law.

Under section 2518, however, because the disclaimer must be effective to divest the disclaimant of ownership, and pass the interest without direction on the part of the person making the disclaimer, the dis-claimer must still satisfy local law. Because applicable law varies from State to State, there is still no uniformity.

The committee believes that a disclaimant should be able to perfect an otherwise valid disclaimer by directing that the interest pass to the person who would have received the property had the refusal been effective under local law.


70. Id.
71. Id.
an otherwise valid disclaimer by transferring the disclaimed interest to the substituted taker designated by the statute. The statute, however, is still not completely devoid of inconsistencies and uncertainties.

IV. AMENDED SECTION 2518 INCONSISTENCIES AND UNCERTAINTIES

Although subsection 2518(c)(3) has finally set aside deference to state law, it has not entirely resolved the issue of unequal treatment of taxpayers. The IRS interpretation of the statute and the uncertainty surrounding the determination of the proper transferee may still lead to possible divergent treatment of disclaimants.

A. Statute Inconsistencies

State law is no longer responsible for the unequal treatment of disclaimants. The IRS has interpreted section 2518, however, in a manner that confers less favorable treatment upon certain taxpayers depending upon their status. Discrepancies exist with respect to a fiduciary-beneficiary disclaimant, a partial interest disclaimant, or a power of appointment recipient.

1. Fiduciary-Beneficiary Disclaimants

The IRS states that for federal tax purposes a beneficial interest in a trust may be disclaimed so long as discretionary powers to direct the enjoyment of the disclaimed property interest are not retained. This restriction applies whether the fiduciary-beneficiary relationship is in relation to one trust or whether the fiduciary obligation is in relation to a trust in which the disclaimed beneficial interest passes. For instance, B disclaims his beneficial interest in Whiteacre, which then falls into a residuary trust. If B has the power to invade, encroach, or allocate the residuary trust income or corpus, he is deemed to have accepted the interest and the disclaimer is

74. Proposed Treas. Reg. § 2518 (1980). The proposed regulations, specifically those mentioned in the text, have been under attack by several commentators. See supra note 43.
76. Id.
The above result is inconsistent with the 1978 technical amendment to section 2518(b)(4) which allows qualification of a disclaimed interest passing to the surviving spouse under both a "marital" and "nonmarital" trust. The "nonmarital" trust frequently provides that: (1) the surviving spouse be the initial trustee; (2) the spouse receive income for life; and (3) the trustee distribute the corpus to the spouse for her support and maintenance or that the spouse be able to withdraw up to the greater of five percent of the corpus or $5,000 dollars in any calendar year. The IRS will not allow a surviving spouse holding an interest in such a trust to disclaim a portion of the "marital" trust which would fall into the "nonmarital" trust, unless the surviving spouse also renounces her trusteeship and the right to withdraw the annual amount. Despite congressional intent to the contrary, many spouses will not be able to "take advantage of section 2518(b)(4)(A) without [a] disclaimer of important interests under the 'nonmarital' trust."

One commentator has argued that the regulations reach incorrect results. Disclaimer of a beneficial interest in property or in a trust should not preclude that individual from acting as a fiduciary, even if the individual has the power to direct the disposition of the disclaimed property or interest in his fiduciary capacity. The commentator supports his conclusion by pointing to legislative history and to the statute itself. There is no language in the legislative history which can be construed to prohibit direction by a fiduciary. He argues

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77. Id.
79. The "marital trust" consists of the surviving spouse's interest in community and separate property which interest is held in trust for the surviving spouse's benefit. The surviving spouse has the freedom to appoint these assets as she or he chooses. The decedent's estate obtains a marital deduction in an amount equal to the value of the assets.
80. "Nonmarital" signifies a trust which is set up for the benefit of both the surviving spouse and the couple's children. It is also commonly referred to as a "family trust."
81. I.R.C. § 2041 and attendant regulations.
82. Carrico, supra note 43, at § 3.
84. Id.
that section 2518’s "without direction" requirement can be interpreted as relating to the direction "within the disclaimer itself, and not a direction which arises after the disclaimer." The IRS rulings have, nevertheless, corroborated the regulations. One taxpayer who resigned as trustee in her children’s trust was permitted to disclaim her interest in a marital trust even though she had been the trustee of a living revocable trust in the same property and had received benefits therefrom. Another individual renounced his beneficial interests in a testamentary trust as well as all executor and trustee discretionary powers. The IRS, in effect, will differentiate between fiduciaries to the extent that beneficial interests are also involved. The ability to continue to perform fiduciary obligations will depend largely on the beneficial status of the fiduciary in a particular trust.

Under California law, trustee powers might not be a proper disclaimer subject. California Civil Code section 2258 mandates the trustee to obey the trust declarations. This suggests an all or nothing approach: A trustee cannot renounce only part of his duties unless the trust instrument so provides. All powers, whether discretionary or purely administrative, must be disclaimed. This effectively amounts to a trustee resignation. Thus, the options available to a fiduciary-beneficiary under the California Civil Code are either to resign completely as the trustee of the trust or to incur a gift tax. It appears from this that validity of a disclaimer of a beneficial interest paired with fiduciary obligations may still be dependent on the particular state’s law. This leads to divergent treatment of taxpayers.

2. Partial Interest Disclaimers

In determining whether a disclaimer of less than an entire interest qualifies, a distinction is made between nontrust and trust assets. For nontrust assets, a beneficial income interest in property is treated as one interest and a beneficial interest in the corpus as another. For trust assets, all income and

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85. Id.
86. Letter Ruling 8134216 (6-1-81).
87. Letter Ruling 8143053 (7-29-81).
89. Id.
DISCLAIMERS

Corpus interests are a single collective interest.90

When a disclaimant who holds more than one piece of the same type of property attempts to disclaim less than his collective interest, the validity of the disclaimer depends on whether the property is held in trust. For example, if beneficiary B is devised two pieces of income producing property, he can disclaim the income from one piece of property and continue to receive income from the other. But if instead the properties are held in trust for B's benefit, he cannot disclaim income from one piece of trust property while keeping the income from the other.91

This distinction is most significant when a beneficiary is given a combination of interests or powers92 over the corpus. Four interests or powers can be included in the combination: (1) A testamentary power of appointment over the corpus; (2) a power to withdraw a stated percentage of the corpus annually; (3) a power limited by any standard; and (4) a right to receive additional corpus at the trustee's discretion.93 The examples in the proposed section 2518(3)(c) regulations indicate that when a combination of interests is involved, all powers must be disclaimed in order to have an effective disclaimer.94 Thus, if B is a permissible appointee under the trustee's discretionary power of invasion and B also has a general testamentary power of appointment over the corpus, both interests are treated collectively as one and B must disclaim both.95

This regulation, which requires disclaimer of all corpus interests, is contrary to an earlier IRS ruling.96 A beneficiary was permitted to disclaim a limited testamentary power of appointment even though he retained the right to receive discretionary distributions of trust income and principal.97 Commentators have argued that this former position is correct.98

91. Id.
92. The term "power" is synonymous with "interest." Section 2518 (c)(2) provides that "a power with respect to property shall be treated as an interest in such property." I.R.C. § 2518(c)(2) (1976).
93. See I.R.C. § 2041 and attendant regulations.
95. Id. at example 11.
96. Letter Ruling 7803065 (10-31-77).
97. Id.
98. See American Bar Association, supra note 43, at 23-26; Frimmer, supra note 43, at § C(1).
They have attacked the proposed regulations on the grounds that section 2518(c)(2) provides that "a power with respect to property shall be treated as an interest in such property" and that section 2518(b) allows an interest in property to be disclaimed. The regulation dealing with powers of appointment clearly indicates that a power constitutes a separate property interest.

Nevertheless, the IRS position presently controls. The validity of a partial interest disclaimer depends on whether an identical interest in property is held in trust for or given outright to a beneficiary. This distinction, much like the common law distinction accorded testate and intestate shares, has no logical basis and should be discarded.

3. Power of Appointment Beneficiaries

The IRS also distinguishes between the takers of a special and general power of appointment. In both cases, the donees of the power must disclaim within nine months of the power's creation. For appointees and takers in default of a general power of appointment the period for making the disclaimer begins to run after the holder has exercised the power or upon its lapse. The permissible appointees and takers in default of a special power of appointment are given less favorable treatment. They are regarded as contingent beneficiaries and their disclaimer period begins to run upon creation of the special power of appointment.

The dissimilar treatment of the permissible appointee of general and special powers of appointment can produce harsh results. A special power of appointment can be exercised in favor of anyone except the holder of the power, his estate, his creditors, and his estate's creditors. In the case of a very broad power, a permissible appointee may not even be in exis-
tence at the time the power is granted. For example, a donee may be granted a power to appoint to her children's spouses. If the children are not married and do not become married within the nine month statutory disclaimer period following award of the power to the donee, the future spouses would be unable to disclaim. But a different result follows if the donee is also a permissible appointee; the power could then be deemed a general power of appointment.\textsuperscript{109} The future spouses of the donee's children or the takers in default do not have to disclaim until the donee either appoints to the spouses or until the interest passes to the takers in default upon lapse.\textsuperscript{110} The permissible appointees of a general power of appointment are, in effect, granted the right to disclaim although the permissible appointees of a special power are not.

The above situations demonstrate that while deference to state law has been abrogated, the unequal treatment of taxpayers still persists. Section 2518 not only fails to completely resolve this problem, but actually creates new issues and uncertainties regarding the determination of the proper transferee.

B. Statute Uncertainties

1. Determining the Transferee

Under subsection 2518(c)(3), an interest in property may be validly disclaimed for federal tax purposes if the disclaimer is made with respect to the entire interest prior to acceptance of the interest.\textsuperscript{111} As long as the requirements of subsection (b)(2) and (3)\textsuperscript{112} are met, the disclaimer will be upheld whether or not state standards have been satisfied.\textsuperscript{113} Subsection 2518(c)(3) allows an individual to make a valid disclaimer of intestate shares even in jurisdictions where such a disclaimer is not authorized. It is still unclear, however, who should receive the disclaimed interest.

The legislative history indicates that Congress intended to defer to state law: "State disclaimer rules will be used to

\textsuperscript{109} The nonholders would then get preferential treatment. Proposed Treas. Reg. § 25.2518-2(c).
\textsuperscript{110} Proposed Treas. Reg. § 25.2518-2(c).
\textsuperscript{112} I.R.C. § 2518(b)(2)-(3) (1976).
determine the transferee.\textsuperscript{114} To reiterate, section 2518(c)(3) will only validate a disclaimer if the property is transferred to the "persons who would have received the property had the disclaimer been qualified under the meaning of subsection (b)."\textsuperscript{115} In order to qualify under subsection (b), the dis-claimer must be valid under local law.\textsuperscript{116} In this respect, de-ference to state law persists.

When federal and state law both authorize the disclaimer, no problems will arise. The property passes under the state's succession law. In California, for example, the interest "shall descend, go, be distributed, or continue to be held as if the beneficiary disclaiming had predeceased the person creating the interest," unless a will or another dispositive instrument provides otherwise.\textsuperscript{117}

When state law invalidates the disclaimer, determination of the transferee is unclear. This uncertainty might arise when a person purports to disclaim an intestate share, a joint own-ership interest, life insurance and annuity proceeds, or where state and federal disclaimer time limits do not coincide. State statutes do not generally provide for property devolution in the event that the disclaimer fails.\textsuperscript{118} The property is simply deemed to have been vested in the disclaimant amounting to an acceptance on his part. Any subsequent disposition will give rise to tax consequences. The foregoing interests, previously the cause of uncertainty as to disclaimer validity,\textsuperscript{119} are now the cause of uncertainty in determining the post-disclaimer transferee.

2. \textit{Joint Ownership}

The proposed section 2518 regulations state that an interest in joint tenancy or tenancy by the entirety can be effec-tively disclaimed if: (1) Made with respect to the entire prop-erty interest; (2) made within nine months of creation of the tenancy; and (3) the disclaimer covers the disclaimant's prop-

\textsuperscript{115} I.R.C. § 2518(c)(3).
\textsuperscript{116} I.R.C. § 2518(b)(4) (1976). See supra notes 52-65 and accompanying text.
\textsuperscript{117} CAL. PROB. CODE § 190.6 (West Supp. 1982). See infra notes 159-61 and accompanying text for a discussion of the effect of the code section.
\textsuperscript{118} See, e.g., id. at §§ 190-190.10.
\textsuperscript{119} See supra notes 20-24 and accompanying text.
property interest, not just the right of survivorship. An exception is made with respect to joint tenancy bank accounts. Since bank accounts are revocable in nature, the interest does not vest until the joint tenant's death. Consequently, a disclaimer can be made within nine months of the contributing joint tenant's death rather than within nine months of the joint interest creation.

While the proposed regulations do not address the situation in which the contributing joint tenant is the disclaimant, several letter rulings indicate that the IRS would not support such a disclaimer. In one instance, the disclaimant had created two joint bank accounts during the decedent transferee's lifetime. The IRS disallowed the disclaimer because the disclaimant had been the sole contributor. In so ruling, the IRS stated that the disclaimer would be valid under section 2518 if made by the donee or the transferee of the interest.

There exists very little case law authority supporting disclaimer of joint tenancy property. The few existing cases reach contrary results. In California, a joint tenancy vests title in the joint tenants immediately upon creation of the interest. This is similar to the vesting of intestate property. The California Probate Code provides for disclaimer of intestate shares, but it does not specifically refer to joint tenan-

121. Id.
122. Id.
123. Letter Ruling 8130069 (4-21-81).
124. Id. See also Letter Ruling 8124118 (3-29-81) in which the IRS allowed a husband to disclaim his deceased spouse's one-half interest in a joint bank account instituted nine months prior to the deceased joint tenant's death. The joint tenancy bank account was revocable and did not become irrevocable until the joint tenant's death. The IRS assumed that joint tenancies were community property in California and that such interests were disclaimable under state law.
125. See Krakoff v. United States, 313 F. Supp. 1089 (S.D. Ohio 1970) aff'd, 439 F.2d 1023 (6th Cir. 1971) (Both husband and wife signed signature cards on the bank accounts and made occasional deposits and withdrawals. The disclaimer was disallowed because the surviving joint tenant had had knowledge of the joint tenancy since its creation). Cf. Hershey v. Bowers, 7 Ohio St. 2d 4, 218 N.E. 2d 455 (1966) (The court permitted the surviving joint tenant's disclaimer subsequent to the other joint tenant's death because the surviving joint tenant did not know about the joint tenancy until after the death).
126. CAL. CIV. CODE § 683 (West 1972). See Hardenberg v. Commissioner, 198 F.2d 63 (8th Cir. 1952), cert. denied, 344 U.S. 836 (1952); Neil v. Ross, 101 F.2d 153 (9th Cir. 1939) (the legal effect of a joint tenancy is to vest title to property in the joint tenants); Maxwell v. Commissioner, 17 T.C. 1589 (1952); Lauritzen, supra note 61, at 568-69.
Thus, the statute may be construed as precluding joint tenancy disclaimers. To whom will the property in this case be directed?

It has been argued that joint tenancies should be disclaimed interests because they are analogous to a testamentary transfer. At least one state views a joint tenancy interest as being merely a contractual right because the non-contributing tenant in that state has no equitable interests until the death of the first joint tenant. In keeping with those views, "the joint tenancy property should be excepted from the 'acceptance' provision until the death of the first joint tenant." In any event, a spouse's ability to make a valid disclaimer is very limited. Joint tenancies should be proper subjects of a disclaimer, however, because the creation of the interest is basically indistinguishable from a gift.

3. Life Insurance and Annuity Proceeds

Prior to a 1982 amendment, because the California Probate Code made no specific provision for disclaimer of life insurance or annuity proceeds, it was doubtful whether such a disclaimer would be effective under California law. The proposed IRS regulations specifically allow disclaimers of such interests if the disclaimant refrains from exercising sufficient control over the proceeds. For example, the primary beneficiary may, under federal law, validly direct the insurance or annuity company to hold the proceeds at interest during the disclaimant's lifetime and to pay the principal upon the

127. CAL. PROB. CODE § 190 (West Supp. 1982). Assembly Bill No. 769 recently amended the probate code to allow disclaimer of five additional interests, among which are included joint tenancies and life insurance and annuity proceeds. 1982 CAL. LEGIS. SERV. ch. 41 (to be codified at CAL. PROB. CODE § 190). However, since the old code is more representative of most state statutes, it will be used as an illustration of inconsistencies prevalent between state and federal law.

128. See Frimmer, supra note 2, at 831-32; and note 43, at § B(21).

129. KAN. STAT. ANN. § 58-501 (1976); see Note, supra note 1, at 60 nn.167-69.


132. One commentator states, "[t]he initial creation of joint tenancy by the person in favor of another may be the subject of a disclaimer because the transfer is nothing more than a gift." Frimmer, supra note 2, at 831. See Note, supra note 1, at 60 nn.168-69.

133. See supra note 127. See also Frimmer, supra note 2, at 829-31, Comment, supra note 1, at 226.

disclaimant’s death to the disclaimant’s designee. When this inconsistency between federal and state law arises, to whom will the property pass? Again, commentators contend that an insurance contract closely resembles a testamentary transfer and should be treated accordingly.

4. Time Limitations

Inconsistencies between federal and state law concerning disclaimer time limitations may also lead to uncertainties in the determination of the subsequent transferee. For federal tax purposes, an effective disclaimer must be made no later than nine months after creation of the interest or after the disclaimant has obtained age twenty-one. The IRS construes the disclaimer period for gift tax purpose to begin running when the transfer becomes complete. For testamentary transfers, the disclaimer period begins to run at the date of the testator’s death. When there is a transfer of income for life with succeeding interests to other persons, both the life tenant and the succeeding takers, whether their interests are vested or contingent, must disclaim within nine months of the original taxable transfer.

In contrast, the California legislature established a “reasonable time requirement” of nine months after the death of the person creating the interest or, in the case of inter vivos trusts, within nine months after the interest becomes indefeasibly vested. Contingent remaindermen do not have to disclaim until the preceding tenant’s death. The new federal law, therefore, preempts the California statute, because the federal law determines the maximum limit for a valid disclaimer and the state time limit exceeds the federal. In states where the time limit is shorter than the federal limit, however, the disclaimer could be valid for federal tax purposes but ineffective under state law. This conflict again leads to the ques-


138. *Id.* at (c)(2).

139. *Id.*


141. *Id.*
tion of who will be the transferee.

Federal and state law also clash over the federal exception to the nine month time limitation which is given to minors. Federal law gives minors the opportunity to disclaim an interest in property within nine months after reaching age twenty-one unless the minor retains a property ownership interest. The problem of ascertaining the property transferee arises when the minor's disclaimer meets the federal standard but does not comply with state law. For example, when D is age ten, a trust is set up for his benefit. D is given the power to compel the trustee to make distributions for his support, comfort, maintenance, and welfare. At age nineteen, D presents the trustee with his college bill. Upon reaching age twenty-one, D chooses to disclaim his interest in the trust. The delay between the time of interest creation and the disclaimer may constitute an unreasonable length of time in California and the disclaimer may consequently fail. If this is not considered an acceptance for federal tax purposes, determining the alternate taker becomes an issue.

The foregoing examples are typical of the differences that exist between federal and state law. Where a disclaimer, sanctioned under federal law, is not authorized under the state's disclaimer statute, problems in determining the substitute transferee will arise because states do not make provisions for ineffective disclaimers. Since Congress has deferred to state law in determining the substitute transferee, questions remain as to whom the property interests will pass: To the disclaimant's estate, to alternate beneficiaries under life insurance policies or annuity contracts, or to the decedent transferor's estate? The interpretation of section 2518's language, passage of new disclaimer legislation, and careful estate planning may provide solutions to the remaining inconsistencies and uncertainties of section 2518.

143. CAL. PROB. CODE § 190.3 (West Supp. 1982).
144. See Proposed Treas. Reg. § 25.2518-2(d)(iii) example 6. The example indicates that the disclaimer would also fail for federal tax purposes. I.R.C. § 2518(c)(3), however, disregards local law in determining the validity of a disclaimer. As long as the minor disclaims within nine months after reaching age twenty-one, therefore, the federal statute should be satisfied.
V. SECTION 2518 CLARIFICATION

The dissimilar treatment of taxpayers according to their place of domicile has not been totally removed by the 1981 amendment to section 2518. Inconsistencies within the statute, largely due to IRS interpretation, and the uncertainty of substitute transferee determination may still lead to varying tax consequences for individuals under similar circumstances. These differences, however, may be substantially eliminated through alteration of the proposed IRS regulations, state legislation, and estate planning.

A. The IRS Interpretation of Section 2518

The statute's inconsistencies are not a direct result of the language itself, but rather are due to IRS interpretations. Commentators have attacked the proposed regulations on the basis that neither the legislative history nor the statute itself supports these illogical interpretations.\textsuperscript{146} The legislative history cannot be construed to include fiduciaries under the disclaimer rules.\textsuperscript{146} The distinction between trust and nontrust assets is most acute with respect to the corpus of a trust since different powers over the corpus can be conferred upon a beneficiary.\textsuperscript{147} This distinction is unsound, because the statute itself treats powers as separate property interests.\textsuperscript{146} The distinction between permissible appointees of general and special powers of appointment is not only unsound, but also unfair. Requiring special power appointees to disclaim within nine months of creation of the power while allowing general power appointees to disclaim within nine months after exercise or lapse of the power is undoubtedly unequal treatment.\textsuperscript{146} Both powers can be very broad and the effect is to produce harsh tax results.\textsuperscript{146} An equitable solution would be to allow both sets of nonholders to disclaim within nine months of either exercise or lapse of the power.

Hearings on the proposed regulations have been held at which comments similar to those discussed above have been

\textsuperscript{145} See supra notes 83-85, 98-101, 108-09 and accompanying text.
\textsuperscript{146} See supra notes 83-85 and accompanying text.
\textsuperscript{147} See supra notes 92-95 and accompanying text.
\textsuperscript{148} I.R.C. § 2518(c)(2) (1976).
\textsuperscript{149} See supra notes 103-10 and accompanying text.
\textsuperscript{150} See supra notes 108-10 and accompanying text.
heard. The proposed regulations have been severely criticized. The final regulations may, therefore, reflect changes which give taxpayers more equitable treatment. If this in fact is the case, the only problem left for resolution is the determination of a transferee.

B. Determining the Transferee

Congress has placed upon the states the responsibility of determining the proper post-disclaimer transferee. The language of section 2518(c)(3) furnishes a clue to fixing the proper substitute taker. A disclaimer will be enforced if the property is transferred to the individual who would have received the property had the disclaimer been effective under state law. For all practical purposes, a disclaimer is to pass under the state's regular disclaimer provisions. In California, for example, the interest will pass as "if the disclaimant had predeceased the person creating the interest." The interest will pass according to the lapsed gifts and anti-lapse statutes. These statutes direct either that the interest pass to the disclaimant's lineal descendants or, in the alternative, that the gift falls into the residuum and go to the residuary legatee or devisee. If the testator's will does not contain a residuary clause, the testator dies intestate as to that gift and it passes to the testator's heirs. The possibility of a will contest further complicates matters. In order to avoid this confusion, the property interest should be delivered to the testator's estate by the disclaimant so that it can ultimately pass to the proper transferee.

Most states' disclaimer statutes are similar to California's; they apply only in the event that the transferor has not made provisions to account for disclaimed property. The transferor can himself name the substitute taker to avoid the problem of who is to receive a disclaimed property interest.

151. See supra notes 114-16 and accompanying text.
153. CAL. PROB. CODE § 190.6 (West Supp. 1982).
155. Id.
156. Id.
157. Id.
158. CAL. PROB. CODE § 190.6 (West Supp. 1982).
Legislators may also be instrumental in reducing the transferee determination uncertainty. Section 2518 now specifically permits disclaimers of certain property interests which have been questionable in the past.\textsuperscript{159} States may, consequently, be encouraged to adopt legislation conforming to the federal standard. Recently adopted California legislation, for example, expressly enumerates five additional interests which may be disclaimed,\textsuperscript{160} including, among others, joint tenancies and proceeds from life insurance and annuity contracts. All interests disclaimable under federal law can also be disclaimed in California.\textsuperscript{161} Since the California statute now largely parallels the federal standard, the uncertainties created by conflicting state and federal disclaimer validity standards have been substantially eliminated.

VI. Conclusion

The Economic Recovery Act of 1981 has decisely abrogated the original section 2518 deference to state disclaimer law. Section 2518(c)(3) provides a method of disclaiming property irrespective of its characterization under state law. The new subsection, however, has failed entirely to resolve the unequal treatment of taxpayers. Inconsistencies within the statute itself, due largely to IRS interpretation, continue to accord disclaimants dissimilar treatment. These inconsistencies have been the subject of much controversy and the final regulations may incorporate changes that will treat disclaimants more equitably.

Subsection 2518(c)(3) has created new uncertainties which surround post-disclaimer transferee determination. This determination, to be made at the state level, may lead to various interpretations of who is to be deemed the ultimate transferee. Estate planners should, consequently, anticipate the possibility of a disclaimer to avoid potential property devolution problems by incorporating provisions in wills for post-disclaimer transferees. In addition, the enactment of section 2518(c)(3) may give impetus to serious consideration of adopt-

\textsuperscript{159} See Proposed Treas. Reg. § 25.2518-2(c) (1980) (providing for disclaimers of joint tenancies); id. at 4 (providing for a disclaimer of life insurance and annuity proceeds).


\textsuperscript{161} Id.
ing legislation parallel to the federal standard which would eliminate the question of who is the proper post-disclaimer transferee.

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