3-1-1993

Timely Disclaimers and Taxable Transfers

Grayson M.P. McCouch

Follow this and additional works at: http://repository.law.miami.edu/umlr

Recommended Citation
Available at: http://repository.law.miami.edu/umlr/vol47/iss4/4

This Essay is brought to you for free and open access by Institutional Repository. It has been accepted for inclusion in University of Miami Law Review by an authorized administrator of Institutional Repository. For more information, please contact library@law.miami.edu.
ESSAY

Timely Disclaimers and Taxable Transfers

GRAYSON M.P. MCCOUCH*

I. INTRODUCTION

This essay focuses on issues raised by two recent appellate court decisions involving the federal transfer tax treatment of disclaimers. A brother and sister disclaimed their remainder interests in a family trust created by their grandfather, causing their shares of the trust corpus to pass to their respective issue. The Eleventh Circuit held that the brother's disclaimer constituted a taxable gift. The Eighth Circuit initially reached the same conclusion concerning the sister's disclaimer, but on rehearing held that the sister's disclaimer was not a taxable gift. The Supreme Court has granted certiorari to review the Eighth Circuit's decision.

The Eighth Circuit's decision rests on a misreading of applicable law and sows the seeds of confusion concerning the federal transfer tax treatment of disclaimers. The decision merits reversal both because it is wrong and, more importantly, because it threatens to breed litigation and disrupt the administration of federal transfer taxes. As long-term family trusts established in the early part of this

* Associate Professor, University of Miami School of Law. The author would like to thank John Gaubatz for his helpful comments and Ruth Parlin for her resourcefulness in locating government documents.

2. Ordway, 908 F.2d at 896.
3. Irvine v. United States, 936 F.2d 343, 348 (8th Cir. 1991), on reh'g, 981 F.2d 991, 996 (8th Cir. 1992) (en banc).
century terminate, remainder beneficiaries will undoubtedly seek to shift valuable interests to younger-generation beneficiaries free of gift tax. In its eagerness to salvage one flawed estate plan, the Eighth Circuit has sidestepped Supreme Court precedent and turned the tax concept of a "transfer" on its head.

II. THE ORWAY TRUST CASES

In 1917, Lucius P. Ordway created an irrevocable inter vivos trust (the "Ordway Trust"), naming his wife Jessie and their five children as concurrent life income beneficiaries. On the death of the last surviving income beneficiary, the trust corpus was to be paid in equal shares to Lucius's grandchildren, with the issue of any deceased grandchild taking that grandchild's share.

The Ordway Trust terminated with the death of Katharine, Lucius's last surviving child, on June 27, 1979. At Katharine's death, the trust corpus became distributable in thirteen equal shares to Lucius's twelve living grandchildren and the issue of a deceased grandchild. Within two months after Katharine's death, two of the grandchildren, Sally Ordway Irvine and her brother John G. Ordway, Jr., filed partial disclaimers of their respective interests in the trust corpus.

The state disclaimer statute in force in 1979 permitted a disclaimer of a future interest "at any time after the creation of the interest, but . . . not later than six months after the event which would cause [the disclaimant] to become finally ascertained [as a beneficiary]..." 

5. Irvine, 981 F.2d at 992-93.
6. See id. Under the trust agreement, Jessie was to receive a $14,000 annuity for life, and the remaining net income was to be divided among the five children in equal shares. After the death of a child survived by a spouse or issue, the child's share of net income was to be paid to the child's spouse (until remarriage) and "children." On termination of the trust at the death of the last survivor of Jessie and the five children, the corpus was to be distributed "in equal shares to each of [Lucius's] grand children per capita and not per sturpes [sic]. If any of [Lucius's] grand children shall then have died leaving issue, said children [sic] shall be entitled to equal portions of the share of said deceased grand child." Ordway Trust Agreement dated January 16, 1917.
7. Irvine, 981 F.2d at 993.
8. Sally disclaimed an undivided 31.25% portion of her share of the trust corpus on August 21, 1979. See id. at 993. John disclaimed an undivided 11.52% portion of his share of the trust corpus on August 23, 1979. See Ordway v. United States, 908 F.2d 890, 892 (11th Cir. 1990), cert. denied, 111 S. Ct. 2916 (1991). Several other grandchildren also disclaimed their respective shares of the trust corpus in whole or in part. See In re Ordway Trust, No. 365266 (Ramsey County, Minn. Dist. Ct. Sept. 6, 1979) (order confirming validity and effect of disclaimers under state law). At least one of these disclaimers has given rise to federal tax litigation. See Johnson v. United States, No. 89-8192CV (S.D. Fla. Jan 26, 1993) (order closing case for administrative purposes only); Johnson v. United States, No. 89-CV-265 (D. Minn. Sept. 1, 1989) (order staying proceedings).
and his interest to become indefeasibly fixed both in quality and quantity. In an uncontested proceeding, a state court confirmed the validity of the two grandchildren's disclaimers under the state disclaimer statute. As a result of the disclaimers, each grandchild's disclaimed interest in the trust corpus became payable to the grandchild's issue as if the grandchild had died immediately before Katharine.

Sally and John disclosed their disclaimers on their third-quarter 1979 gift tax returns, taking the position that the disclaimers had no federal gift tax consequences. On audit the government determined that the disclaimers constituted indirect gifts and assessed gift taxes, which the grandchildren paid. After disallowance of their refund claims, Sally's personal representatives and John brought separate refund actions in federal district courts. In 1989, both district courts granted summary judgment for the taxpayers. On appeal, the Eleventh Circuit reversed the district court's decision in Ordway v. United States, and the Eighth Circuit initially followed suit in Irvine v. United States. Subsequently, however, the Eighth Circuit vacated its panel decision and affirmed the district court's decision en banc, thereby creating a split between the circuits and prompting the Supreme Court to grant certiorari.

III. THE FEDERAL TRANSFER TAX CONTEXT

The Ordway Trust cases graphically illustrate the importance of determining the federal transfer tax consequences of a disclaimer separately from its characterization under state property law. A disclaimer is an affirmative refusal to accept a donative transfer of an interest in property. State disclaimer statutes typically treat a disclaimed interest as passing directly from the original transferor to the ultimate takers, as if the disclaimant had died immediately before the

10. See In re Ordway Trust, No. 365266 (Ramsey County, Minn. Dist. Ct. Sept. 6, 1979). The government conceded the validity of the disclaimers under the Minnesota disclaimer statute in both tax refund suits. See Irvine, 981 F.2d at 993; Ordway, 908 F.2d at 892.
12. Irvine, 981 F.2d at 993; Ordway, 908 F.2d at 892.
15. 936 F.2d 343 (8th Cir. 1991).
16. Irvine v. United States, 981 F.2d 991 (8th Cir. 1992) (en banc).
original transfer. In accordance with the legal fiction of the disclai-
mant’s death, state property law generally treats the disclai-
mant as never having owned or transferred the disclaimed interest.

A transaction characterized as a valid disclaimer under state law
may nevertheless constitute a transfer for federal transfer tax pur-
poses. The gift tax reaches any “transfer of property by gift,” includ-
ing the release of an unrestricted power to acquire ownership of
property as well as a direct or indirect transfer of a beneficial interest
in owned property. For example, a parent’s interest-free loan to a
child may be recharacterized for tax purposes as a gift of the foregone
interest by the parent coupled with deemed payments of interest at a
market rate by the child. Similarly, the gift tax concept of a transfer
is sufficiently expansive to treat a disclai-
mant as constructively receiv-
ing the disclaimed interest from the original transferor and then mak-
ing a second transfer to the ultimate takers. Accordingly, the
provisions recognizing tax-free disclaimers carve out limited excep-
tions to the general rule of taxability.

The current gift tax provisions concerning disclaimers reflect the
historical development of an independent federal standard. Section

---

contrast, the applicable state disclaimer statute in the Ordway Trust cases treated the
disclaimers as relating back to Katharine’s death in 1979 rather than to the creation of the
trust in 1917. See Minn. Stat. § 501.211, subd. 5 (1978).

19. On the definition and operation of disclaimers under state property law generally, see 6

20. See I.R.C. §§ 2501(a)(1) (gift tax imposed on “transfer of property by gift”), 2511(a)
gift tax applies “whether the transfer is in trust or otherwise, whether the gift is direct or
indirect”), 2514(b) (exercise or release of general power of appointment created after October
21, 1942 treated as transfer of underlying property); Treas. Reg. § 25.2511-1(c)(1) (gift subject
to tax includes “any transaction in which an interest in property is gratuitously passed or
conferred upon another, regardless of the means or device employed”). Unless otherwise
indicated, all I.R.C. and Treas. Reg. references are to the Internal Revenue Code of 1986, as
amended through August 1993 and Treasury Regulations as amended in 1986, respectively.
See also H.R. Rep. No. 708, 72d Cong., 1st Sess., at 27-28 (1932), reprinted in 1939-1 C.B.
(Part 2) 496, 524.


“unquestionably encompasses an indirect transfer, effected by means of a disclaimer, of a
contingent future interest in a trust”). For an excellent discussion of the transfer tax treatment
of disclaimers, see John H. Martin, Perspectives on Federal Disclaimer Legislation, 46 U. Chi.

23. See I.R.C. § 2518(a); Treas. Reg. §§ 20.2041-3(d)(6), 20.2055-2(c), 20.2056(d),
25.2511-1(c), 25.2514-3(c)(5)-(6). One commentator perceptively describes a disclaimer as “a
transfer that is not treated as a transfer for tax purposes.” Mitchell M. Gans, Disclaimers,
Inst. on Fed. Tax’n, § 52.01, at 52-1 (1988).
2518 of the Internal Revenue Code applies to any disclaimer of an interest created by a transfer made after 1976.\textsuperscript{24} In the case of an interest created by a pre-1977 transfer, however, the current gift tax treatment of a disclaimer is governed by a regulation originally promulgated in 1958 and effective for gifts made after 1954 (the "Regulation").\textsuperscript{25} To escape treatment as a transfer for gift tax purposes, the Regulation requires that a disclaimer be effective under state law and be made "within a reasonable time after knowledge of the existence of the transfer" and before any acceptance of ownership.\textsuperscript{26} Thus, the Regulation not only incorporates the standards of state law but also superimposes independent federal requirements of timeliness and non-acceptance.\textsuperscript{27}

\textsuperscript{24} See Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009(b), 90 Stat. 1520, 1893 (enacting section 2518); id. § 2009(e)(2) (effective date). Section 2518 currently provides that a disclaimer is not treated as a transfer for federal transfer tax purposes if it is made in writing and delivered not later than nine months after the transfer creating the interest (or, if later, the day the disclaimant reaches age 21); in addition, the disclaimant must not have accepted the disclaimed property or any of its benefits, and the disclaimed property must pass as a result of the disclaimer to a person other than the disclaimant or the transferor's spouse. I.R.C. § 2518.


\textsuperscript{26} The Regulation currently provides:

The gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax. . . In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution) a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law. There can be no refusal of ownership of property after its acceptance. In the absence of the facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.

Treas. Reg. § 25.2511-1(c).

\textsuperscript{27} In Jewett v. Commissioner, 455 U.S. 305, 316 (1982), the Supreme Court stated: "The Regulation explicitly imposes two requirements: (1) the disclaimer must be effective as a matter of local law; and (2) the disclaimer must be made within a reasonable time. If timeliness were governed solely by local law, the second requirement would be redundant. While it is possible that local law may require a disclaimer to be timely to be effective, such a requirement would not absolve the taxpayer from the separate timeliness requirement imposed by the federal Regulation." In Fuller v. Commissioner, 37 T.C. 147 (1961), the Tax Court held that a widow's attempted disclaimer in 1956 of an income interest in a testamentary trust established by her husband, who died in 1931, failed to meet the timeliness and non-acceptance requirements of the Regulation. "The gift tax attaches here regardless of the validity of any renunciation under Pennsylvania law because whatever renunciation there may have been did not, within the provisions of the statute and regulations, take place under such circumstances
In *Jewett v. Commissioner*, the Supreme Court focused on the meaning of "transfer" in the Regulation as applied to a contingent remainder following several life income interests under a testamentary trust. The Court concluded that the transfer triggering the disclaimer period for gift tax purposes occurred at the creation of the trust in 1939. Accordingly, the attempted disclaimer of the remainder in 1972, though concededly valid under state law, failed to meet the timeliness requirement of the Regulation and thus constituted a taxable transfer. In *Jewett*, the Court squarely rejected the position, successfully asserted by taxpayers in two previous Eighth Circuit cases, that the Regulation merely tracked state property law and permitted tax-free disclaimers to be made within a reasonable time after the time for indefeasible vesting of the disclaimed interest.

The continuing impact of *Jewett* is evident from the persistent efforts of taxpayers to circumvent its holding in litigated cases and as to eliminate the applicability of gift tax to petitioner in having at least "indirectly" made a gift in 1956." Id. at 155. In one early case arising before the enactment of the federal gift tax, however, a court concluded that a disclaimer could be taxed as a transfer in contemplation of death only if state property law treated the disclaimant as having accepted the interest and then retransferred it to the ultimate takers. See *Brown v. Routzahn*, 63 F.2d 914 (6th Cir.), cert. denied, 290 U.S. 641 (1933).


29. *Jewett* involved a testamentary trust created in 1939 which was to pay income first to the settlor's husband and then to her son and his wife for their respective lives, and to distribute corpus to the son's children (or issue) living at the death of the last surviving income beneficiary. In 1972, while the last income beneficiary was still living, one of the son's adult children disclaimed his contingent remainder interest in half the corpus (while retaining his interest in any income that might subsequently be accumulated). *Id.* at 306-07. The Court framed the issue as "whether the 'transfer' referred to in the Regulation occurs when the interest is created, as the Government contends, or at a later time when the interest either vests or becomes possessory, as argued by petitioner." *Id.* at 306.

30. *Id.* at 318-19.

31. See *Cottrell v. Commissioner*, 628 F.2d 1127 (8th Cir. 1980); *Keinath v. Commissioner*, 480 F.2d 57 (8th Cir. 1973); cf. *Jewett*, 455 U.S. at 308-09 (noting conflict with *Jewett v. Commissioner*, 638 F.2d 93 (9th Cir. 1980)).

32. For example, in *Griswold v. Commissioner*, 81 T.C. 141 (1983), the Tax Court rejected the taxpayers' attempt to recast *Jewett* as holding that the Regulation treats a disclaimer as a gift if it is not made "'within a reasonable time after the taxpayer has actual knowledge of the specific terms of . . . [his] interest and of the nature and value of the trust property.' " *Id.* at 152 n.12 (quoting taxpayers' supplemental brief). The court described the taxpayers' position as "an attempt to make an end run on the rationale of [Jewett]." *Id.* at 155 n.18. See also *Hallenbeck v. Commissioner*, 46 T.C.M. (CCH) 1204 (1983) (same trust, different disclaimant). Similarly, in *Poinier v. Commissioner*, 86 T.C. 478 (1986), aff'd in part, 858 F.2d 917 (3d Cir. 1988) (affirming this issue), cert. denied, 490 U.S. 1019 (1989), the Tax Court and the Third Circuit rejected the taxpayer's argument that the Supreme Court might have decided *Jewett* differently had it been aware of the government's allegedly inconsistent private ruling position. See *Poinier*, 86 T.C. at 485 ("Petitioners are grasping at straws."); *Poinier*, 858 F.2d at 919 ("Whatever merit [the argument that *Jewett* was wrongly decided] might have if addressed to the Supreme Court, it is not one that this intermediate appellate
in proposed legislation.\textsuperscript{33} A taxpayer who has a contingent or defeasible future interest created by a pre-1977 transfer has much to gain and little to lose (other than lobbying and litigation costs) by disclaiming the interest promptly after it becomes indefeasibly vested. If the disclaimer constitutes a taxable transfer, the taxpayer may avoid a tax-inclusive estate tax at the cost of a tax-exclusive gift tax.\textsuperscript{34} If the taxpayer successfully distinguishes \textit{Jewett}, the underlying property may pass to the ultimate takers with no additional transfer tax. The Ordway Trust disclaimers represent calculated gambles testing the limits of \textit{Jewett}.

\section*{IV. THE ORDWAY TRUST DISCLAIMERS IN PERSPECTIVE}

The solution to the Ordway Trust cases should be quite straightforward. Since the facts of both cases are essentially identical and uncontested, the federal gift tax treatment of the grandchildren’s disclaimers presents a technical problem of determining the applicable legal standard under the relevant statutes, regulations, and case law. At the same time, the solution to the cases depends on how the issues are framed. To dispel the confusion evident in the several appellate opinions, it is important to order the issues in a manner that is both accurate from a technical standpoint and sound as a matter of tax policy.

\subsection*{A. \textit{Does the Regulation Apply?}}

The threshold issue is whether the Regulation, which by its own terms applies to disclaimers of interests created by “taxable transfers” occurring before 1977, governs the gift tax treatment of the Ordway Trust disclaimers. In reaching its conclusion that the Regulation did not apply to Sally’s disclaimer, the Eighth Circuit noted that the dis-
claimed interest was created in 1917—15 years before the enactment of the federal gift tax—by a transfer that could not have constituted a taxable gift.\textsuperscript{35} Accordingly, the Eighth Circuit saw "no occasion to consider the issues concerning the impact of [the Regulation] on [Sally's] disclaimer."\textsuperscript{36} By contrast, the Eleventh Circuit interpreted the term "taxable transfer" in the Regulation to mean "any transaction in which an interest in property is gratuitously passed or conferred upon another," even if that transaction was not subject to the gift tax."\textsuperscript{37} Under this definition, the Eleventh Circuit had no difficulty in applying the Regulation to John's disclaimer.

In interpreting "taxable transfer," the Eleventh Circuit referred to a regulation which provides that the 9-month period for making a qualified disclaimer under section 2518 generally runs from the time of "the taxable transfer creating the interest."\textsuperscript{38} Although the section 2518 regulations do not apply directly to the Ordway Trust disclaimers,\textsuperscript{39} they provide a key to the proper interpretation of the Regulation.

The reference to taxable transfers was inserted into the Regulation in 1986, in connection with the promulgation of the final section 2518 regulations.\textsuperscript{40} Aside from limiting the scope of the Regulation, the 1986 amendments made no change in the substance of the Regulation as originally promulgated in 1958. Indeed, the reference in the Regulation to taxable transfers, like the parallel reference in the section 2518 regulations,\textsuperscript{41} serves merely to demarcate disclaimers which are governed by section 2518 (i.e., disclaimers of interests created by taxable transfers made after 1976) from those which remain subject to the Regulation (i.e., disclaimers of interests created by taxable transfers made before 1977). The most sensible conclusion is that the 1986

\begin{itemize}
\item[36.] Irvine, 981 F.2d at 996.
\item[37.] Ordway v. United States, 908 F.2d 890, 895 (11th Cir. 1990) (citation omitted).
\item[38.] Treas. Reg. § 25.2518-2(c)(3).
\item[39.] The section 2518 regulations apply to a disclaimer of an interest created by a "taxable transfer" made after 1976. \textit{Id.} § 25.2518-1(a). The 9-month period for making a qualified disclaimer generally runs from the time of the post-1976 "taxable transfer" creating the interest. \textit{Id.} § 25.2518-2(c)(3). By contrast, the reasonable time for making a disclaimer runs from the time the disclaimant learns of the existence of the pre-1977 "transfer" creating the interest. \textit{Id.} § 25.2511-1(c)(2).
\item[40.] See T.D. 8095, 1986-2 C.B. 160 (promulgating final regulations under section 2518 and revising miscellaneous estate and gift tax regulations concerning disclaimers).
\item[41.] Treas. Reg. § 25.2518-1(a).
\end{itemize}
amendments to the Regulation merely implement the superseding provisions of section 2518, leaving the Regulation unchanged in its application to the Ordway Trust disclaimers. This conclusion is fully consistent with the effective-date provision of the statute that the 1986 amendments purport to implement.\footnote{42}

Why then does the Regulation refer to “taxable transfers”? The most plausible answer lies in the problems that would arise if the Regulation defined its scope simply by referring to the time of the “transfer” creating the disclaimed interest.\footnote{43} For example, the creation of a revocable trust constitutes a “transfer” for estate tax purposes but does not constitute a completed transfer for gift tax purposes.\footnote{44} A gift of property subject to a retained life estate constitutes a completed gift of the remainder and may also trigger estate tax inclusion.\footnote{45} By referring to disclaimers of interests created by “taxable transfers” before 1977, the Regulation avoids these problems but also creates some new ones. The section 2518 regulations provide an extensive gloss which makes clear that a “taxable transfer” may include various transfers on which no immediate gift or estate tax is actually imposed.\footnote{46} Identifying when a taxable transfer occurs may still raise technical problems in determining whether to test the timeliness of a disclaimer under section 2518 or the Regulation.\footnote{47} Nevertheless, lingering ambiguities


43. As originally proposed in 1980, the amended Regulation would have applied to disclaimers of interests created by “transfers” made before 1977, Prop. Treas. Reg. § 25.2511-1(c)(2), 45 Fed. Reg. 48922, 48924-25 (1980), and the section 2518 regulations would have applied to disclaimers of interests created by “transfers” made after 1976, \textit{id.} § 25.2518-1(a), 45 Fed. Reg. at 48925.

44. See I.R.C. § 2038(a) (estate tax); Treas. Reg. § 25.2511-2(c) (gift tax) (as amended in 1983).

45. See I.R.C. § 2036(a)(1) (estate tax); Treas. Reg. § 25.2511-1(e) (gift tax). If the remainder beneficiary is a member of the settlor’s family, the entire value of the underlying property may be subject to gift tax. See I.R.C. § 2702.

46. See Treas. Reg. § 25.2518-2(c)(3) (“taxable transfer” triggering 9-month disclaimer period includes transfer qualifying for section 2503(b) exclusion or 2056(b)(7) marital deduction). Although not specifically enumerated, transfers qualifying for a section 2503(e) exclusion, a section 2522 or 2055 charitable deduction, or a section 2523 or 2056 marital deduction presumably represent additional examples of “taxable transfers” that do not trigger immediate gift or estate tax.

47. See Kennedy v. Commissioner, 804 F.2d 1332 (7th Cir. 1986) (disclaimer period began to run at deceased joint tenant’s death with respect to survivor’s accretive share); see also
in the application of section 2518 should not cloud the issue of whether the Regulation applies to the Ordway Trust disclaimers.

The Regulation applies to "the transfer of property by gift" in calendar periods after 1954. The question therefore becomes whether the Ordway Trust disclaimers are to be viewed as "transfers" for federal gift tax purposes and, if so, whether they occurred after 1954. A disclaimer inherently involves both an original transfer in which a transferor creates an interest in the disclaimant and a potential second transfer in which the disclaimant shifts that interest to the ultimate takers by refusing ownership.

The Regulation treats a disclaimer of an interest created by a pre-1977 transfer as a gift unless the disclaimer meets the requirements of state property law and also meets independent federal requirements of timeliness and non-acceptance. If the disclaimer meets those requirements, the disclaimant's "refusal to accept ownership does not constitute the making of a gift" by the disclaimant; instead, both transfers are collapsed and treated as a single transfer made by the original transferor to the ultimate takers. Thus, if the Ordway Trust disclaimers are respected for gift tax purposes, the Regulation views the remainder interests as being transferred only once, when Lucius created the trust in 1917. On the other hand, if the disclaimers constitute gifts, the Regulation views the remainder interests as being transferred a second time, when the grandchildren finally decided not to accept possession in 1979. Lucius made a gift in 1917, before the enactment of the federal gift tax; the grandchildren made gifts, if at all, in 1979, after the effective date of the Regulation. Accordingly, the Regulation (as amended in 1986) governs the gift tax treatment of the Ordway Trust disclaimers.

B. Does Jewett Control?

The timeliness of the Ordway Trust disclaimers under the Regu-
 TIMELY DISCLAIMERS

lation depends on whether Sally and John disclaimed "within a reasonable time after knowledge of the existence of the transfer." The taxpayer in Jewett attempted to make a tax-free disclaimer in 1972 of a contingent remainder interest in a testamentary trust created in 1939. The Supreme Court, however, held that the "transfer" occurred when the interest was originally created rather than when it vested in interest or possession, and concluded that the disclaimer constituted a taxable transfer.

Because the Ordway Trust disclaimers occurred in 1979, three years before the Supreme Court announced its decision in Jewett, the taxpayers in Irvine argue that Sally's disclaimer should be governed by the interpretation of the Regulation prevailing in 1979. Generally, however, when the Supreme Court applies a holding to the parties before it in a civil case, the holding has full precedential effect in pending and future cases from the time it is announced, regardless of when the underlying transactions occurred. By applying its holding in Jewett to the parties before it, the Supreme Court impliedly held that its interpretation of the Regulation would be given full retroactive effect.

Moreover, as a matter of common sense, Jewett should control the Regulation as applied to the Ordway Trust disclaimers. Under the Regulation, failure to disclaim an interest within a reasonable time after knowledge of the transfer constitutes an acceptance, which precludes a subsequent disclaimer. A contingent future interest repre-

52. Treas. Reg. § 25.2511-1(c)(2).
54. Both the Eleventh Circuit and the Eighth Circuit panel refused to consider arguments for nonretroactive application of Jewett. See Ordway v. United States, 908 F.2d 890, 896 (11th Cir. 1990) (taxpayer failed to raise issue); Irvine v. United States, 936 F.2d 343, 348-49 (8th Cir. 1991) (same). On rehearing, the Eighth Circuit found that the Regulation did not apply at all, and therefore did not address the issue. See Irvine v. United States, 981 F.2d 591, 596 (8th Cir. 1992). Even under the balancing test of Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), invoked by the taxpayers in Irvine, it seems likely that Sally took a calculated risk in view of the unsettled state of the law in 1979. See Cottrell v. Commissioner, 72 T.C. 489 (1979), rev'd, 628 F.2d 1127 (8th Cir. 1980); Estate of Halbach v. Commissioner, 71 T.C. 141 (1978); Jewett v. Commissioner, 70 T.C. 430 (1978), aff'd, 638 F.2d 93 (9th Cir. 1980); aff'd, 455 U.S. 305 (1982); Keinath v. Commissioner, 58 T.C. 352 (1972), rev'd, 480 F.2d 57 (8th Cir. 1973).
55. For example, the holding in Dickman v. Commissioner, 465 U.S. 330 (1984), that interest-free loans to family members may constitute gifts has been given full retroactive effect. See, e.g., Cohen v. Commissioner, 910 F.2d 422 (7th Cir. 1990); Estate of Arbury v. Commissioner, 99 T.C. 136 (1989). Courts have consistently rejected attempts to distinguish or reconsider the Jewett holding. See supra note 32.
sents a presently existing, transferable interest in property, even if its value must be discounted to reflect the uncertainty of future possession. The Regulation draws no distinction between present and future interests, or between vested and contingent future interests, in determining whether a disclaimer is timely. Under a uniform interpretation of the Regulation, the time of creation rather than the time of vesting in interest or possession makes sense as a means of requiring that a beneficiary decide promptly whether to disclaim or accept a future interest.\(^5\)

In effect, the Eighth Circuit in *Irvine* resurrected the discredited approach of *Keinath v. Commissioner*,\(^5\) which apparently would treat the term "transfer" as referring in some cases (viz., present interests and indefeasibly vested remainders) to the time of creation but in others (viz., contingent future interests and vested remainders subject to divestment) to the time of vesting in interest or possession.\(^6\) The Eighth Circuit's interpretation creates an unwarranted disparity between indefeasibly vested remainders and other future interests, by requiring prompt disclaimers of the former but not the latter. Moreover, the Eighth Circuit's interpretation overlooks the substantial benefit, in terms of estate planning, enjoyed by a beneficiary who can wait for an extended period to decide whether or not to accept a future interest.\(^6\)

Finally, the approach of *Jewett*, requiring that a disclaimer generally be made promptly after the creation of an interest rather than after vesting in interest or possession, facilitates orderly administration of federal transfer taxes. In the case of a taxable transfer of a future interest, the transferee's identity may have important tax consequences. For example, the transfer may qualify for a marital deduc-

---

58. "The Regulation also requires 'knowledge of the existence of the transfer'; since a person to whom assets have actually been distributed would seldom, if ever, lack knowledge of the existence of such a transfer, it seems more likely that this provision was drafted to protect persons who had no knowledge of the creation of the interest." *Jewett*, 455 U.S. at 312.

59. 480 F.2d 57 (8th Cir. 1973).

60. The Eighth Circuit apparently took the position that the term "transfer" in the Regulation referred to the time of creation in the case of an indefeasibly vested remainder but to the time of vesting in interest or possession—the court did not specify which—in the case of a contingent remainder (or a remainder vested subject to divestment). *See id.* at 63. By contrast, the Supreme Court in *Jewett* attached no importance for transfer tax purposes to the technical distinction between a contingent remainder and a vested remainder subject to divestment. *See Jewett*, 455 U.S. at 308-09 n.5.

tion if the interest passes to the transferor's spouse, or it may be subject to special gift tax valuation rules if the transferee is a "member of the transferor's family," or it may avoid triggering a generation-skipping transfer tax if the transferee is a "non-skip person." In each case, however, a disclaimer by the original transferee might shift the interest to another person and produce dramatically different tax results. Permitting a transferee to make a tax-free disclaimer after the expiration of the limitation period for assessing tax on the original transfer would create uncertainty and severely disrupt transfer tax administration.

C. "Retroactivity" and Fairness

The Eighth Circuit in Irvine was apparently concerned that treating Sally's disclaimer as a taxable transfer would constitute an impermissible "retroactive" application of the gift tax. Although the gift tax does not apply to completed transfers made before June 7, 1932, the Eighth Circuit made a leap of logic in assuming that Sally's disclaimer related back to the creation of the Ordway Trust in 1917. This assumption makes it impossible to determine the gift tax consequences of Sally's disclaimer under the Regulation or any other federal gift tax standard applicable to transfers made in 1979.

62. See I.R.C. §§ 2056, 2523. A future interest may qualify for a marital deduction (notwithstanding the "terminable interest" rule), although the amount of the deduction may be reduced to reflect postponed possession. On the other hand, no marital deduction is available for an interest that passes to another person as a result of a disclaimer by the spouse.

63. See I.R.C. § 2702. For example, the special valuation rules apply when a settlor creates an irrevocable inter vivos trust, retaining an income interest and transferring the remainder to the settlor's sibling. The rules do not apply, however, if the remainder passes to the sibling's child as a result of a disclaimer by the sibling. See I.R.C. §§ 2702(e), 2704(c)(2) (defining "member of the transferor's family").

64. See I.R.C. § 2613. For example, there is ordinarily no generation-skipping transfer when a settlor creates a trust to accumulate income for 10 years and then distribute corpus to the transferor's children. If a living child's share passes to the child's issue as a result of a disclaimer by the child, a generation-skipping transfer will occur no later than the time for distribution of corpus. See I.R.C. §§ 2611, 2612 (defining "generation-skipping transfer").


66. The gift tax applies to gifts made after June 6, 1932, the date of enactment. See supra note 35.


68. Even under the state property law standard proposed by the taxpayers in Irvine, the Eighth Circuit's premise is flawed. Under applicable state law, Sally's disclaimer related back to the time her remainder interest became "indefeasibly vested in quality and quantity," (i.e. Katharine's death in 1979). MINN. STAT. § 501.211, subd. 5 (1978). Apparently, therefore, even assuming that the disclaimer had the same effect for federal gift tax purposes as for state
effect, the Eighth Circuit assumed its conclusion that Sally's disclaimer did not constitute a transfer subject to gift tax. The Eighth Circuit might have avoided this circularity by paying closer attention to the distinction between Lucius's 1917 non-taxable "transfer" that created the Ordway Trust and the disputed 1979 taxable "transfer" that resulted from Sally's disclaimer.

A separate but related argument raised by the taxpayers in Irvine concerns the perceived unfairness of applying the Regulation (as interpreted in Jewett) to interests created before the effective date of the Regulation.69 The Supreme Court rejected a similar argument in Jewett, finding that the Regulation did not unfairly deprive the taxpayer of any preexisting right to make a tax-free disclaimer because the taxpayer "never had such a right."70 In rejecting the retroactivity argument, however, the Court noted that the federal gift tax was already in effect "long before" the creation of the disclaimed interest in 1939.71

The taxpayers in Irvine purport to distinguish Jewett on the ground that the federal gift tax had not yet been enacted when the Ordway Trust was created in 1917.72 This argument leads back to the Eighth Circuit's flawed conclusion that the gift tax cannot apply to a disclaimer of an interest created before June 7, 1932.73 To illustrate the pernicious implications of that conclusion, imagine a testamentary trust created in 1917 with dispositive provisions identical to those of the Ordway Trust.74 Would the Eighth Circuit distinguish its Irvine property law purposes, Sally owned the remainder interest from 1917 until 1979, and the same interest shifted to Sally's children as a result of her disclaimer. The transaction functioned as a gift made by Sally in 1979, within the meaning of the Regulation. Cf. Estate of Lang v. Commissioner, 613 F.2d 770 (9th Cir. 1980) (running of statute of limitations on parent's outstanding loan to child treated as transfer for gift tax purposes).

69. The Irvine taxpayers argue that under the government's view "Mrs. Irvine's time for making an effective disclaimer under the 1986 Regulation expired before enactment of the federal gift tax, before she ever could have known that a disclaimer not yet required under state law nevertheless would be untimely, and thus taxable, under a federal tax statute not yet enacted." Brief of Respondents at 14, Irvine (No. 92-1546).

70. Jewett v. Commissioner, 455 U.S. 305, 317 (1982). The Court observed that the taxpayer's argument "would have more appeal had he attempted to renounce the interest immediately after the adoption of the 1958 Regulation, rather than some 14 years later." Id. at 317, n.20.

71. "Indeed petitioner does not argue that taxation of the disclaimers is inconsistent with the statutory provisions imposing a gift tax, which were enacted long before the petitioner's interest in the trust was created. The 1958 Regulation was adopted well in advance of the disclaimers in this case; we see no 'retroactivity' problem." Id. at 317.

72. Brief of Respondents at 12-13, Irvine (No. 92-1546).

73. For an example of a taxable disclaimer made in 1956 of a present income interest created before the enactment of the gift tax, see Fuller v. Commissioner, 37 T.C. 147 (1961).

74. The creation of the testamentary trust would have been subject to estate tax. See Revenue Act of 1916, ch. 463, §§ 201-203, 39 Stat. 756, 777-78.
holding and apply the Regulation (as interpreted in Jewett) to a 1979 disclaimer of an interest in the hypothetical trust? If so, the result would be to acknowledge an independent federal timeliness requirement for disclaimers of interests created by "taxable" transfers but not for disclaimers of interests created by "non-taxable" transfers. Moreover, the Eighth Circuit's facile distinction between taxable and non-taxable transfers would compound the confusion engendered by its interpretation of the Regulation.

V. REAPPRAISAL AND CONCLUSION

Many of the difficulties surrounding the transfer tax treatment of disclaimers, both under the Regulation and under section 2518, stem from the distinction between disclaimers and transfers. More precisely, the concept of a tax-free disclaimer requires that two related transfers be recast as a single transfer. The disclaimed property is treated as passing not from the original transferor to the disclaimant and then from the disclaimant to the ultimate taker, but instead directly from the original transferor to the ultimate taker. As long as the formal requirements for a disclaimer are met, the disclaimant's participation is disregarded and the transaction attracts only a single gift or estate tax.

In functional terms, a taxpayer's ability to disclaim closely resembles a general power of appointment: both arrangements offer the taxpayer an opportunity to accept or reject ownership of the underlying property. The main difference (aside from transfer tax consequences) is purely formal: a disclaimant must act affirmatively to avoid ownership while the holder of a general power of appointment must act affirmatively to obtain ownership. Nevertheless, for

75. For example, the creation of a testamentary trust in 1915 would not have been subject to estate tax. See id. Similarly, the creation of a trust by exercise of a general testamentary power of appointment in 1917 would not have been taxable. See United States v. Field, 255 U.S. 257 (1921). Would the Eighth Circuit refuse to apply the Regulation (as interpreted in Jewett) to a 1979 disclaimer of a remainder interest in either trust?

76. For example, it is far from clear how the Eighth Circuit would treat gifts qualifying for the annual exclusion or the marital or charitable deductions. Although the Eighth Circuit perceived a "definitive difference" between annual exclusion gifts and completed transfers occurring before the enactment of the gift tax, it failed to explain why the former were any more "taxable" than the latter. See Irvine v. United States, 981 F.2d 991, 995 (8th Cir. 1992).


78. For transfer tax purposes, a power of appointment is disregarded to the extent that the holder owns an independent beneficial interest in the underlying property. Assume, for example, that a settlor creates a trust to pay income to the settlor's child for life, remainder as the child appoints by will or in default of appointment to the child's estate. The child should be treated as owning the trust property regardless of whether the power of appointment is
federal transfer tax purposes a disclaimer enjoys tax-free treatment while a release of a general power of appointment normally constitutes a taxable transfer.\textsuperscript{79}

Not surprisingly, taxpayers and the government have frequently disagreed over the proper application of the timeliness and non-acceptance requirements of the Regulation. In reality, those requirements are interrelated. The longer a taxpayer may wait before deciding to disclaim, the more likely it becomes that some benefit will have been accepted.\textsuperscript{80} Indeed, it could be argued that by deciding whether or not to disclaim, the taxpayer unavoidably participates in designating the ultimate taker of the property, and that disclaimers should generally be treated as taxable transfers.\textsuperscript{81}

Tax-free disclaimers, however, have become firmly entrenched in the federal transfer tax system. Congress has decided to define and regulate them by imposing formal restrictions and limiting the disclai-


tant’s control over the disposition of the underlying property rather than by treating all disclaimers as taxable transfers. As a policy matter, this decision can be defended on the ground that post-transfer flexibility is desirable as long as it does not undermine the integrity of the transfer tax system. The real problem arises from a tension between the goal of implementing a uniform federal standard and the need to rely on non-uniform state property laws in determining the transfer tax treatment of disclaimers.\textsuperscript{82} By imposing independent federal requirements, the Regulation prevents taxpayers from exploiting state property law doctrine as a short-cut to wholesale tax avoidance.

The Regulation applies to the Ordway Trust disclaimers, and will continue to apply to disclaimers of other interests created before 1977. Under the Regulation as interpreted in Jewett, the Ordway Trust disclaimers constituted taxable transfers because they were untimely for federal tax purposes. The Eighth Circuit’s decision

\textsuperscript{79.} A general power of appointment created after October 21, 1942, is generally treated as equivalent to ownership of the underlying property for federal estate and gift tax purposes. See I.R.C. §§2041(a)(2), 2514(b). By contrast, a general power of appointment created on or before October 21, 1942, is taxable only if exercised; a complete release is not taxable. See I.R.C. §§2041(a)(1), 2514(a). In a curious reversal of the usual roles, the taxpayers in Irvine analogize Sally’s disclaimer to a release of a pre-1942 general power of appointment. Brief of Respondents at 28 n.22, Irvine (No. 92-1546).

\textsuperscript{80.} Under a broad reading of the Regulation, a court might find that a taxpayer had accepted benefits simply by waiting too long to see whether a disclaimer would be advantageous from an estate-planning perspective. See supra note 61.

\textsuperscript{81.} See Martin, supra note 22.

\textsuperscript{82.} The same tension arises in other contexts as well. See, e.g., I.R.C. §2053(a) (claims and administration expenses deductible only if allowable under state law).
offers the Supreme Court a timely opportunity to reaffirm the proper scope of the Regulation, and in doing so to prevent further unnecessary and wasteful litigation.