Agricultural Law Digest

An Agricultural Law Press Publication | Volume 9, No. 3 | February 13, 1998
Editor: Robert P. Achenbach, Jr. | Contributing Editor Dr. Neil E. Harl, Esq. | ISSN 1051-2780

DEVELOPMENTS IN DISCLAIMERS

— by Neil E. Harl*

The long battle over disclaiming interests in jointly-owned property moved a notch closer to conclusion with the publication of new regulations in late December, 1997.[1] The new regulations are effective for disclaimers on or after December 31, 1997.[2]

Disclaiming jointly-held property

Initially, IRS resisted all disclaimers of jointly-owned property interests, maintaining that such interests could be disclaimed only within nine months after creation of the interest. After losing in litigation, IRS came to accept the position that disclaimers of so-called "revocable" joint interests (such as joint bank or brokerage accounts) could be filed within nine months after death, not merely within nine months after creation of the joint interest.[3] Later, after losing two Court of Appeals cases,[4] IRS came to accept joint tenancy disclaimers in land within nine months after death and issued an Action on Decision to that effect. IRS continued, however, to resist disclaimers of interests held in tenancy by the entirety[5]

However, in regulations issued in late December, 1997[6] effective for disclaimers on or after December 31, 1997, the Department of the Treasury made several changes in its position on disclaimers:

• Under the new regulations, Treasury accepts disclaimers of interests in tenancy by the entirety property within nine months after death in the same manner as disclaimers of interests in joint tenancy property.[7] The regulations specifically note that disclaimers can be made regardless of whether the interest can be unilaterally severed under local law (which is a feature of joint tenancy ownership but not of tenancy by the entirety).[8]

• For disclaimers on or after December 31, 1997, a surviving joint tenant or tenant by the entirety cannot disclaim any portion of a joint bank, brokerage or other investment account attributable to consideration furnished by the surviving joint tenant or tenant by the entirety.[9] This means that 100 percent of a joint account funded by the first joint owner to die can be disclaimed by the survivor.[10] At the same time, no part of a joint account can be disclaimed if the survivor funded the account.[11] A disclaimed interest in a joint bank, brokerage or investment account (the creation of which is an incomplete gift for federal gift tax purposes)[12] loses its character as joint property and passes through the decedent's gross estate with the interest disclaimed subject to inclusion under I.R.C. § 2033 rather than I.R.C. § 2040.[13] The balance of the account not subject to disclaimer retains its character as joint property, and is includable in the gross estate under I.R.C. § 2040.[14]

For joint interests in real property (and presumably for personal property other than bank accounts, brokerage accounts and investment accounts), a gift is deemed to have occurred on creation of the interest where contributions were unequal and only half can be disclaimed.[15]

• The nine month period for disclaiming the interest is based upon the "transfer creating the interest," rather than upon a "taxable transfer."[16] This change clarifies that the beginning point for the nine month disclaimer period is not dependent upon the actual imposition of federal estate or gift tax at the time the interest to be disclaimed is created.

Inducements to disclaim

A troublesome area in the past has been the effect of cash gifts received by disclaimants at approximately the time disclaimers were executed and whether such gifts would disqualify the disclaimers.[17] A Tax Court case, *Estate of Monroe*,[18] held that cash gifts would disqualify the disclaimers. However, that case was reversed and remanded in 1997 to allow disclaimers where the payments were not consideration for the disclaimers and, therefore, those disclaimers were qualified.[19] The Court of Appeals remanded the case to determine whether some of the disclaimers were mutually bargained for which would disqualify the disclaimers.[20]

Quite clearly, any cash gift to a disclaimant raises a red flag; linking the cash gift to the disclaimer such that the disclaimer was considered to be mutually bargained for goes over the line.

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FOOTNOTES

[1] See T.D. 8744, amending Treas. Reg. §§ 25.2518-1, 25.2518-2. See generally 6 Harl, *Agricultural Law* §§ 44.09, 46.08 (1997); Harl, *Agricultural Law Manual* § 5.02[6] (1997).

[2] Treas. Reg. §§ 25.2518-2(c)(4)(iv), 25.2518-1(c)(3).

[3] Dancy v. Comm'r, 872 F.2d 84 (4th Cir. 1989), *rev'g*, 89 T.C. 550 (1987) (disclaimers of "revocable" interests were qualified; disclaimer of interest in tenancy by entirety in real property not permitted).

[4] Kennedy v. Comm'r, 804 F.2d 1332 (7th Cir. 1986), *rev'g*, T.C. Memo. 1986-3 (period for reasonable time to disclaim surviving spouse's interest in joint tenancy interest held by decedent runs from date of death and not creation of joint tenancy); McDonald v. Comm'r, T.C. Memo. 1989-140, *on rem. from*, 853 F.2d 1494 (8th Cir. 1988), *rev'g*, 89 T.C. 293 (1987) (disclaimer timely where surviving joint tenant made disclaimer within nine months of joint tenant's death but more than nine months after creation of joint tenancy).

[5] Ltr. Rul. 9208003, Oct. 28, 1991, *rev'g* Ltr. Rul. 9106016, Nov. 8, 1990 (disclaimer of tenancy by entirety interest by husband); Ltr. Rul. 9427003, March 30, 1994 (joint interest in tenancy by entirety real property could not be disclaimed within nine months after death). See also Hennessy v. U.S., 98-1 U.S. Tax Cas (CCH) ¶ 60,298 (S.D. Ind. 1997) summarized in this issue**.**

[6] T.D. 8744, amending Treas. Reg. §§ 25.2518-1, 25.2518-2, and conforming Treas. Reg. §§ 20.2041-3, 20.2046-1, 20.2056(d)-2, 25.2511-1, 25.2514-3.

[7] Treas. Reg. § 25.2518-2(c)(4)(i).

[8] *Id*.

[9] Treas. Reg. §§ 25.2518-2(c)(4)(iii); 25.2518-2(c)(5), Ex. 13.

[10] Treas. Reg. § 25.2518-2(c)(5), Ex. 12.

[11] *Id*.

[12] Treas. Reg. § 25.2511-1(h)(4).

[13] Treas. Reg. § 25.2518-2(c)(5), Ex. 12.

[14] *Id*.

[15] Treas. Reg. § 25.2518-2(c)(5), Ex. 7, 8.

[16] Treas. Reg. §§ 20.2041-3(d)(6); 20.2056(d)-2(a),(b); 25.2511-1(c); 25.2514-3(c); 25.2518-1; 25.2518-2(c)(3).

[17] See Estate of Monroe v. Comm'r, 104 T.C. 352 (1995), *rev'd and remanded*, 124 F.3d 699 (5th Cir. 1997).

[18] 104 T.C. 352 (1995).

[19] Monroe v. Comm'r, 124 F.3d 699 (5th Cir. 1997).

[20] *Id*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

FEDERAL TAXATION-*ALM* § 13.03[7].*

ADEQUATE PROTECTION. Prior to the filing of the bankruptcy petition, the IRS filed a Notice of Levy against the debtor's funds in a bank account. After the filing of the bankruptcy petition, the debtor sought recovery of the bank account funds from the bank and the IRS also sought to execute the levy. The debtor argued that the Notice of Levy did not extinguish all of the debtor's rights to the funds and, upon the filing of the petition, the funds became bankruptcy estate property subject to bankruptcy administration. The court agreed, holding that the Notice of Levy made the IRS only a secured party as to the funds. However, the IRS also sought recovery of the funds as adequate protection for a $84,000 secured tax claim. The debtor argued that the IRS had to have first filed a motion for adequate protection. The court disagreed, holding that the funds could be used for adequate protection at any time that adequate protection was shown to be needed. The IRS argued that the debtor had been making payments to other secured creditors but had not made any payments to the IRS. The court granted the funds to the IRS as an adequate protection payment. **Matter of Creel, 214 B.R. 838 (Bankr. E.D. La. 1997)**.

AUTOMATIC STAY. The IRS filed a claim for unpaid income taxes, penalties and interest and unpaid employment taxes, penalties and interest. Prior to the filing for bankruptcy, the IRS had filed a notice of levy against the debtors' real property which was subject to an Illinois land trust. The notice was not filed with the trustee. After the bankruptcy filing, the IRS erroneously filed a duplicate notice of levy and sent the debtors a notice of audit of employment taxes for pre-bankruptcy tax years. The IRS later rescinded the duplicate notice of levy. The debtors first argued that the duplicate levy notice and audit notice violated the automatic stay, but the court held that the rescission of the duplicate notice removed any violation and that an audit notice was not a violation of the automatic stay. The debtors also argued that the rescission of the duplicate notice caused the initial levy to be rescinded because the second notice merged with the first. The court held that this argument failed because the debtors failed to provide any support for the merger theory in statute or case law. The debtors also argued that the assessed penalties and interest should have been abated because the debtors' failure to pay the taxes resulted from the high medical bills for their disabled child. The court held that the debtors had sufficient means to either pay the taxes from income or by borrowing the money against their substantial equity in the debtors' home. **Carlson v. U.S., 126 F.3d 915 (7th Cir. 1997),** ***aff'g*****, 198 B.R. 949 (N.D. Ill. 1996),** ***aff'g*****, 189 B.R. 454 (Bankr. N.D. Ill. 1996)**.