The Disposition of Trust, Probate and Related Property Interests

John H. Butala Jr.

Recommended Citation
Available at: http://scholarlycommons.law.case.edu/caselrev/vol17/iss3/4
The family relationship is often the source of numerous tax problems. Two of the more frequently occurring questions involve the disposition of beneficiary interests and the termination of an undesirable joint ownership. The first of these problems is analyzed in detail by Mr. John H. Butala. Focusing his discussion on interests in trusts and estates, the author provides insight into the methods of disposing of these interests by renunciation, assignment, or sale. Of primary importance to the tax attorney are Mr. Butala's observations on the tax consequences of each of these methods of disposition. Mr. W. Dean Hopkins summarizes tax effects of a termination of an unwanted joint ownership. Effectively utilizing a husband and wife example as the basis for his discussion, the author concentrates his efforts upon the termination of joint ownership in bank accounts, treasury bonds, real estate, and securities. He also gives special consideration to the gift, estate, and inheritance tax consequences involved in the termination of joint ownership of these types of property.

The Disposition of Trust, Probate and Related Property Interests

John H. Butala, Jr.

TAX LITERATURE abounds with advice to the property owner who is contemplating an original disposition of his property. However, considerably less advice is available to the beneficiary of property who wishes to dispose of his acquired interest. Therefore, this article will be concerned with the legal and tax consequences involved in the disposition of beneficiary interests, as contrasted with original owner interests. The original owner, however, will be considered in the situation in which he has previously made an irrevocable transfer of property but has retained an interest of which he now wishes to dispose. The property interests considered will be limited to interests in trusts and estates and to such other interests as are most frequently encountered by persons dealing in trust and probate matters.

There are three basic methods by which a donee or a prospective donee of property may dispose of his interest: (1) He may re-
nounce or disclaim the gift; (2) He may accept the gift and subsequently assign or release it to another person; or (3) He may accept the gift and subsequently sell it to another person.

I. RENUNCIATION OR DISCLAIMER

A. General Definitions

A renunciation or disclaimer is the refusal by a person to accept ownership of property which another attempts to confer upon him. The same concept may also be expressed by other terms, such as waiver. It should be distinguished from an assignment or release, both of which refer to the transfer of property to another after one has already accepted ownership of the property. The term relinquishment is also used to denote an assignment or release, although on occasion relinquishment is erroneously equated with disclaimer or renunciation. One can relinquish property only after he has acquired ownership.

B. Types of Property Which May Be Renounced

A beneficiary of an interest in property may renounce his interest only in certain circumstances. The decisive factor in determining whether renunciation is permissible is often the type of property conveyed.

(1) Bequest or Devise.—The rule is well established that one may disclaim or renounce a bequest or devise under a will. A bequest or devise constitutes an offer of a testamentary gift which one is free to accept or reject. A person cannot be compelled to accept a gift against his wishes.

(2) Gift in Trust.—The authorities are in agreement that a gift in trust may be renounced for the same reasons applicable to the renunciation of a bequest or devise, at least where the trust instrument does not contain a spendthrift clause. If the instrument does contain such a provision, there are indications in a number of cases that the beneficiary cannot renounce. This view appears to be erroneous. A spendthrift clause is designed to prohibit an as-

2 Id. at 718; See Brown v. Routzahn, 63 F.2d 914 (6th Cir.), cert. denied, 290 U.S. 641 (1933) (applying Ohio law); United States v. McCrackin, 189 F. Supp. 632 (S.D. Ohio 1960) (applying Ohio law).
3 1 SCOTT, TRUSTS § 36.1 (2d ed. 1956); Central Nat'l Bank v. Eells, 5 Ohio Misc. 187 (P. Ct. 1965).
4 See cases cited in 3 SCOTT, op. cit. supra note 2, § 337.7.
beneficiary interests

Assignment or a transfer of an interest which previously has been accepted. As noted above, a renunciation does not involve an assignment or release, but rather a refusal to accept. Clearly, if one is free to reject an absolute gift, he should be permitted to reject one which has conditions attached to it. This view has been adopted by the Tax Court in a federal estate tax charitable deduction case. 5

(3) Intestate Succession.—The prevailing view at common law was that one could not renounce property which was vested in him by the Statute of Descent and Distribution. 6 This view was based on the theory that although one may refuse to accept property which another attempts to confer upon him, intestate property vests in a person absolutely as a matter of law. There is no offer of a gift which the transferee may accept or reject. The soundness of this reasoning is open to question, and the common law rule has been changed by statute in some states including Ohio. 7

(4) Joint and Survivorship Property.—Three cases in Ohio have considered renunciations of joint and survivorship property. In In re Estate of Krakoff, 8 a decedent's widow renounced her interest in certain savings accounts, a commercial account, and corporate securities, all of which previously had been held in joint and survivorship form with the decedent. The Probate Court of Franklin County held that her renunciation was effective, and that these assets consequently became property of the probate estate. The validity of the renunciation was upheld on the ground that the joint and survivorship ownership arose under a contract which purported to confer a gift upon a third party beneficiary who was free to accept or reject the gift, much the same as a legatee or devisee. In Hershey

5 Estate of James M. Schoonmaker, Jr., 6 T.C. 404 (1946). Renunciation of trust income under a spendthrift trust is sanctioned by statute in Pennsylvania if the renounced income passes to one or more of the beneficiary's descendants. PA. STAT. ANN. tit. 20, § 301.3 (1955). See Rev. Rul. 62, 1964-1 CUM. BULL. 221, which recognizes a renunciation under this statute for income tax purposes.

6 lanthe B. Hardenbergh, 17 T.C. 166 (1951), aff'd, 198 F.2d 63 (8th Cir.), cert. denied, 344 U.S. 836 (1952).

7 OHIO REV. CODE § 2105.061. The section provides as follows:

Any competent adult entitled to receive any right, title, or interest in any property through intestate succession as provided by Section 2105.06 of the Revised Code, may renounce such interest by filing a written statement of renunciation with the probate court within sixty days after notice of the hearing on inventory of the intestate's property has been given. . .

See also ILL. ANN. STAT. ch. 3, §§ 15b-1 (Smith-Hurd Supp. 1965); IND. ANN. STAT. § 6-604 (1953); N.Y. DECED. EST. LAW § 87-a; R.I. GEN. LAWS ANN. §§ 34-5-1 to -12 (1956); W. VA. CODE ANN. § 4095a (Supp. 1960); WIS. STAT. ANN. § 237.01 (8) (Supp. 1960).

8 179 N.E.2d 566 (Ohio P. Ct. 1961).
an Ohio court of appeals decision, the majority opinion also recognized the effectiveness of a renunciation of joint and survivorship certificates of deposit for Ohio inheritance tax purposes. The Ohio Department of Taxation had argued that the right to the property interest accrued upon death, that the tax was levied upon interests existing as of the moment of death, and that the subsequent action of the survivor therefore could not affect the taxable successions already determined. These contentions were rejected by the court on the ground that mere establishment of a joint and survivorship account does not create a new ownership interest unless there is an assent or acceptance by the third party beneficiary. Although this assent is normally presumed, the presumption may be rebutted by evidence of a disclaimer. The value of the decision as precedent is limited, however, since the issue presented to the court involved a technical tax question rather than the validity of the disclaimer. In fact, the disclaimer had been found to be effective for property law purposes in a declaratory judgment action filed in the Probate Court, and the appellate court assumed its validity in the tax case. The decision in the Hershey case is contrary to that reached earlier by the Probate Court of Fulton County in In re Bauer. The latter case may therefore be regarded as having been superseded by a later, higher court decision. The Bauer case, however, involved an unusual factual situation which possibly may distinguish it from Hershey v. Bowers. In Bauer the residue of the probate estate passed to decedent's three sisters. His niece filed a disclaimer of certain joint and survivorship bank accounts with the executor. The accounts were thereupon treated as probate assets, and the three sisters and niece filed claims against the estate for services rendered in amounts sufficient to consume the estate and to eliminate any inheritance tax. Although the holding in the case was formally based upon the principle that subsequent action by a beneficiary cannot affect successions which accrue at the moment of death, the court obviously doubted the bona fides of the transactions. Thus,

---

9 1 Ohio App. 2d 511, 205 N.E.2d 590 (1965).
10 Id. at 513, 515.
11 Id. at 512.
12 191 N.E.2d 859 (Ohio 1962).
the real basis for the holding is probably that the renunciation was not genuine, but rather was used simply as a tax avoidance device.

Theoretically, there is no reason why a joint and survivorship interest may not be renounced. If one may reject a proffered gift under a will or trust agreement, he should similarly be permitted to reject a gift created by a third party beneficiary contract. Indeed, virtually no distinction, either in form or in substance, can be made in this respect between a gift of a trust interest and a gift of a joint and survivorship interest. As a practical matter, however, only in rare cases will the survivor-donee not be regarded as having accepted the gift, and thus being precluded from renouncing it. As to bank accounts, it is common practice to have the third party beneficiary sign the bank signature card. This act probably constitutes an acceptance of the gift. As to other types of joint property, long-standing knowledge of the joint ownership will create a presumption of acceptance which may be difficult to overcome.14

(5) Power of Appointment.—A power of appointment created by will or trust agreement is essentially a limited and specialized form of gift; as such, it should be subject to renunciation in the same manner as any other bequest, devise, or gift in trust. In Ohio, a renunciation of a power of appointment is specifically authorized by the Revised Code15 which provides that a donee of a power of appointment may disclaim the power in the same manner in which he may release it. The disclaimer may be made at any time and may be in whole or in part. The same statutory section provides for the release of a power of appointment by an instrument in writing, signed and acknowledged in the same manner prescribed for the execution of deeds; however, the statute also makes it clear that this method of release is not exclusive.

(6) Insurance.—No cases have been found in which the renunciation of insurance proceeds was considered.16 However, since insurance represents a contract arrangement providing for a gift to a third party beneficiary, there appears to be no reason why such a renunciation cannot be made. If the insurance contract itself provides for the possibility of a renunciation, it seems clear that a re-

---

14 On the ground that a failure to renounce within a reasonable time creates a conclusive presumption of acceptance. See Annot., 93 A.L.R.2d 8, 29 (1964).

15 Ohio Rev. Code § 1339.16. The section states “A donee or holder of a power of appointment may disclaim the same at any time, wholly or in part, in the same manner and to the same extent as he might release it.”

16 But see Treas. Reg. § 20.2056d-1(b) (1958) [hereinafter cited as Reg. §] which, in an example given, assumes that such a renunciation can be made.
nunciation could be made, since in such cases the gift itself may be considered to be conditioned upon its acceptance by the donee. The renunciation of insurance also involves fewer practical obstacles than the renunciation of other forms of gifts. The beneficiary usually is not required to sign any documents which might indicate acceptance. Further, a beneficiary's interest is commonly regarded as little more than an expectancy, and knowledge of the designation therefore is not likely to be equated to acceptance of the gift.

(7) Compensation for Acting as a Fiduciary.—One may gratuitously render services to another. For this reason, it is clear that a fiduciary may, by timely action, renounce or waive a statutory right to executor's or trustee's fees. In two rulings, the Internal Revenue Service (Service) has recognized that a timely waiver will protect the fiduciary from being subjected to income tax and gift tax upon the amount of the waived fee. If the waiver is not timely, however, the adverse tax consequences ensue, presumably upon the ground that the fiduciary has accepted the fee and, in fact, is in constructive receipt of it. He thus can no longer renounce or waive the fee. Unfortunately, in the later of the two rulings, the Service has obscured the theory by apparently proceeding upon the doctrine of anticipatory assignment of income. If the application of this doctrine is correct, even a timely tax-free waiver of fees is impossible, since the anticipatory assignment doctrine is not predicated upon the timing of the action, but rather upon the nature of the interest assigned. The Service's error arises from its failure to correctly recognize the renunciation of a benefit in which timing is significant in determining whether there has been an acceptance which precludes later rejection.

(8) Statutory Tax Benefits.—The Internal Revenue Service has ruled, in a somewhat unusual case, that the benefits of the federal estate tax marital deduction cannot be waived if qualified property passes to the surviving spouse. The ruling was based upon the wording of section 2056(a) of the Internal Revenue Code, which is phrased in the following mandatory terms: "[T]he value of the taxable estate shall ... be determined by deducting ..." The same

18 See Rev. Rul. 472, 1956-2 CUM. BULL. 21, which adopts this theory.
20 The ruling cites Helvering v. Horst, 311 U.S. 112 (1940), a case involving an anticipatory assignment of income, in support of its conclusion.
reasoning will likely be applied to most other statutory tax deductions, particularly if the failure to claim the deduction will result in some other tax advantage.22

C. Form and Legal Effect of Renunciation

(1) Form of Disclaimer.—The majority of courts hold that a renunciation need not be in writing.23 It may be made by clear and unequivocal words or conduct. Although there is no direct holding in Ohio on this point, dicta in one case indicates that Ohio will probably follow the majority rule.24 If intestate property of an Ohio decedent is involved, however, section 2105.061 of the Revised Code specifically requires that the renunciation be in writing.25 A written renunciation must also be unequivocal. If it is couched in uncertain terms or is conditioned against the loss of other benefits provided by the instrument, the renunciation may not be recognized.26

Several courts have upheld the validity of a renunciation made by the fiduciary of a deceased donee’s estate.27 The question presented in such cases is whether the fiduciary has the right to reject the beneficial ownership of property where this action is in the immediate interest of the estate, but, for tax or other reasons, may not be in the best interest of the beneficiaries of the estate. The courts have tended to adopt a more permissive approach and have permitted renunciation, although a difficult policy question may arise when creditors of the donee’s estate are deprived of property which passes to the same beneficiaries through an alternative route of inheritance.28

22 In Rev. Rul. 123, 1959-1 CUM. BULL. 248, the fiduciary seeking the ruling desired to obtain an advantage by reducing the taxable estate of the surviving spouse, who had died shortly after the decedent, and by obtaining a credit for tax on prior transfers.


25 In addition, OHIO REV. CODE § 1339.16 provides for written renunciations of powers of appointment but states that releases or renunciations of powers of appointment effected in any other form or manner shall not be affected.


27 Perkins v. Phinney, 61-1 U.S. Tax Cas. 80496 (W.D. Tex. 1961) (deaths in common accident); Sick v. Rock, 240 Iowa 584, 37 N.W.2d 305 (1949) (acceptance of gift with conditions on it); In re Howe, 112 N.J. Eq. 17, 163 Atl. 234 (Prerogative Ct. 1932) (deaths in common accident; renunciation four months later not timely).

(2) Irrevocability of Renunciation.—The Internal Revenue Service has indicated that it will recognize a renunciation for tax purposes only if the renunciation is irrevocable.\(^{29}\) The Service has also indicated, however, that it ordinarily will consider a renunciation to be irrevocable if it is filed with the probate court.\(^{30}\) This well-defined stand is fortunate, since state law on the necessary elements of an irrevocable renunciation is far from settled. It has been held in a number of cases that a renunciation may be revoked at any time if there has been no change of position by others in reliance upon the renunciation.\(^{31}\) Several cases in Ohio have also considered the problem. In \textit{Erman v. Erman},\(^{32}\) an Ohio court of appeals specifically held that a renunciation may be revoked. In \textit{United States v. McCrackin},\(^{33}\) the \textit{Erman} decision was cited by a federal district court as indicative of Ohio law on the revocability of renunciations. However, in \textit{In re Estate of Wolfrum},\(^{34}\) it was indicated that a written renunciation filed with a court may be revoked only by a showing of fraud or a mistake of fact. The case was decided upon a jurisdictional point, however, and therefore the court's discussion of renunciation is of limited precedential value. The authorities may be reconciled by considering a renunciation by word or conduct to be revocable and a written renunciation filed with a court to be irrevocable. However, the cases have not expressly adopted this distinction.

(3) Partial Renunciations.—If a person is given two separate gifts under the same instrument, he may accept one gift and renounce the other.\(^{35}\) If there is a single gift, he cannot renounce a burdensome part and, at the same time, accept a beneficial part.\(^{36}\) However, there is very little authority as to whether a person may make a partial renunciation of a single, uniform gift, such as cash. Those cases which have considered the problem have permitted a


\(^{35}\) Brown v. Routzahn, 63 F.2d 914 (6th Cir.), \textit{cert. denied}, 290 U.S. 641 (1933) (applying Ohio law); Colett v. Cook & Mills, 3 Ohio C.C.R. 119 (Cir. Ct. 1888).

\(^{36}\) Colett v. Cook & Mills, \textit{supra} note 35, at 125.
partial renunciation. The treasury regulations state that the question is dependent upon state law. These regulations represent a considerable relaxation of the position originally advocated in the proposed regulations. Nevertheless, in actual practice the Service has exhibited a strong reluctance to recognize a partial renunciation of a single gift. This position appears to be unfounded since the existing case law supports a partial renunciation and it is difficult to conceive of any theoretical objections to such action.

D. What Constitutes an Acceptance of a Gift

(1) Timeliness.—A renunciation is a refusal to accept a gift; therefore, it must be made within a reasonable time after the donee has learned of the existence of the gift. If the donee fails to make a timely renunciation, he is presumed to have accepted the property.

What constitutes a reasonable time depends upon all the facts and circumstances. Some of these circumstances include: (a) the donee's age; (b) his physical and mental condition; (c) his business experience; (d) the complexity of the problem; (e) the presence or lack of advisors; and (f) any change of circumstances during the time intervening between the offer of the gift and the ultimate renunciation. The last factor is particularly significant. Obviously, if the donee does nothing until some event occurs which makes it undesirable for him to accept the property, the court will assume that the donee decided to reject the gift only after that event occurred.

(2) Ohio Law Regarding Timeliness.—The leading tax case on the question of renunciation is Brown v. Routzahn, which was


38 Reg. § 25.2511-1(c) (1958).

39 Proposed Reg. § 25.2511-1(c), 22 Fed. Reg. 58 (1957) which contained this subsequently deleted statement: "A renunciation of a portion of the property is not a complete and unqualified refusal to accept the property to which one is entitled." Ibid.

40 Reg. § 25.2511-1(c) (1958).

41 See Seifner v. Weller, 171 S.W.2d 617 (Mo. 1943), in which a renunciation by a remainderman made fourteen years after the testator's death and sixteen months after the life tenant's death was held to be timely, largely because of the complexity of the problem facing the remainderman.


43 63 F.2d 914 (6th Cir.), cert. denied, 290 U.S. 641 (1933) (applying Ohio law).
decided in 1933. In that case, the beneficiary of an estate waited until the administration was completed before he renounced the gift. The administration of the estate was not completed until seven years after the decedent's death. Nevertheless, the court held that the beneficiary's renunciation was timely and that under Ohio law a renunciation may be made at any time prior to the acceptance of the gift. The import of the decision is that an acceptance occurs only if dominion or control over the property is exercised, or some other deliberate and unequivocal act indicating an intention to do so is performed; acceptance never arises from mere lapse of time. The Brown case has been cited repeatedly by the courts. Nevertheless, it is doubtful whether it constitutes reliable law today, since the holding is contrary to the weight of authority that an undue delay, in itself, will constitute an acceptance of the gift.

(3) Remainder Interests.—A difficult problem as to timeliness is presented when a remainderman wishes to renounce his remainder interest. The remainder interest frequently is contingent on the happening of some event, and the remainderman does not know whether he will ever succeed to the property. Under such circumstances, may he wait until the life tenant dies before renouncing, or must he renounce within a reasonable time after he learns of the existence of the possible gift? Several state court decisions indicate that he may validly renounce after the life tenant's death, but no federal tax cases have been decided on the point. One writer has stated that the Internal Revenue Service will not consider as timely a renunciation made after the death of the life tenant.

---


45 Annot., 93 A.L.R.2d 8, 29 (1964).

46 Seifner v. Weller, 171 S.W.2d 617 (Mo. 1943); Coleman v. Burns, 103 N.H. 313, 171 A.2d 33 (1961); Dare v. New Brunswick Trust Co., 122 N.J. Eq. 349, 194 Atl. 61 (Ch. 1937) (dictum).

47 See Lentz, Income and Gift Tax Effects of Renunciation of a Bequest or Inheritance, N.Y.U. 21ST INST. ON FED. TAX 313, 324 (1965). Although all the facts and circumstances must be considered, the following have been held not to preclude the possibility of a renunciation: (1) acting as a co-executor, Brown v. Routzahn, 63 F.2d 914 (6th Cir.), cert. denied, 290 U.S. 641 (1933) (applying Ohio law); (2) acting as trustee, Estate of Ida F. Doane, 10 T.C. 1258 (1948); cf. Cerf v. Commissioner, 141 F.2d 564 (3d Cir. 1944); (3) electing to take under will, Brown v. Routzahn, supra; In re Hartman's Estate, 29 Ohio Op. 256 (P. Ct. 1944).
E. Tax Consequences of Renunciation.

(1) Gift Tax.—A critical consideration in all renunciation situations is the potential gift tax liability of the donor. If the renunciation is timely, there is simply a refusal to accept property by the donee and no gift tax liability is imposed. However, if the renunciation is not timely, the action will be considered to be an assignment rather than a renunciation, and a taxable gift will have been effected. It is therefore imperative that one carefully examine his position before proceeding with a renunciation or, at least, consider the consequences of an unfavorable attitude on the part of the Internal Revenue Service.

(2) Estate Tax Charitable Deduction.—If property passes to a qualified charity as the result of a renunciation, a federal estate tax charitable deduction will be allowed for the amount of the property so passing. Section 2055(a) of the Internal Revenue Code imposes two conditions upon the allowance of the deduction: (1) the renunciation must be made before the date prescribed for filing the federal estate tax return; and (2) the renunciation must be irrevocable. If a power to consume, invade, or appropriate property for the benefit of an individual, terminates as a result of such individual’s death prior to the due date for filing the return and prior to any exercise of the appropriation power, a charitable deduction will be allowed for any property which passes to a qualified charity upon such individual’s death. This result apparently obtains only when there is a power in the fiduciary or beneficiary to divert property from the charity to the individual. If a charity receives property as an alternative taker, because of the death of a beneficiary prior to a distribution date, no charitable deduction is allowed even though the property passes before the due date for filing the return. In the latter case, death is not the equivalent of a disclaimer.

A renunciation can be used effectively as a postmortem estate planning device in certain cases in which remainder interests are vested in qualified charitable organizations. If the trustee is authorized by the terms of the instrument to invade the principal for the life tenant’s benefit, and the standard for invading the principal has

---

48 Reg. § 25.2511-1(c) (1958).
49 INT. REV. CODE OF 1954, § 2055(a) [hereinafter cited as CODE §].
50 Ibid.
been too broadly stated to permit a charitable deduction, the charitable deduction may nevertheless be saved by a timely renunciation of all interest in the principal by the life tenant.\footnote{See Estate of James M. Schoonmaker, Jr., 6 T.C. 404 (1946). See also Camp v. United States, 65-2 U.S. Tax Cas. 97167 (D. Ga. 1965), for use of such renunciation for other tax purposes.}

(3) **Marital Deduction.**—If property passes to a surviving spouse as the result of a renunciation, no marital deduction is allowable.\footnote{Code § 2056(d)(2).} The congressional policy in this area of the law is not to permit postmortem estate planning, since the possibilities of abuse are much greater in transactions among family members than in cases in which a charity is the beneficiary of the disclaimed property.\footnote{However, H.R. 483, 89th Cong., 1st Sess. (1965) which was reported out by the House Committee on Ways and Means on October 14, 1965, would permit a marital deduction for property passing to a surviving spouse as the result of a disclaimer. 2 Fed. Est. & Gift Tax Rep. ¶ 8404 (Sept. 25, 1965).}

(4) **Powers of Appointment.**—If a power of appointment created after October 21, 1942 is released by the donee of the power, this release constitutes a transfer which is subject to gift tax.\footnote{Code § 2514(b).} However, a renunciation is not considered to be a taxable release for this purpose.\footnote{Ibid.} Inasmuch as a release and a renunciation both involve an extinguishment of the power by the donee’s action, the distinguishing factor between a release and a renunciation is again the timing of the action. A timely refusal to accept the power is a renunciation; the same action taken after a reasonable period of time has elapsed will probably constitute an acceptance of the power and a taxable release.

(5) **Trust Income Tax.**—A number of cases have recognized, for income tax purposes, renunciations of the right to receive trust income.\footnote{See, e.g., Frances Marcus, 22 T.C. 824 (1954); First Nat'l Bank, 39 B.T.A. 828 (1939). See also Rev. Rul. 62, 1964-1 Cum. Bull. 221.} Several of these cases, however, have not permitted the renunciation to operate retroactively. Instead, they have treated the renunciation as though it were an assignment which was effective in relieving the beneficiary from tax liability upon future income, but not upon income earned or accrued prior to the time of the renunciation.\footnote{Grant v. Smith, 174 F.2d 891 (5th Cir. 1949); Kathryn S. Fuller, 37 T.C. 147 (1961); Robert E. Cleary, 54 T.C. 728 (1960); Frances Marcus, supra note 57; First Nat'l Bank, supra note 57, at 833 (dissenting opinion); Rev. Rul. 62, 1964-1 Cum. Bull. 221.} This treatment is apparently based upon two theories.
The first is the constructive receipt doctrine under which a person is charged with all income which he may appropriate at will for his own use. The second arises from the fact that income tax is determined upon a periodic basis; the courts apparently have assumed that the tax must be measured by considering only those events which occur during the taxable period. Neither of these approaches appears to be valid. While constructive receipt requires the acceptance of a benefit and a temporary deferral of its enjoyment, the essence of a renunciation is the absence of an acceptance. A renunciation also relates back to the date of the gift and the fact that the renunciation actually occurs after the end of a taxable period should be irrelevant.

Finally, it should be noted that if a beneficiary possesses a power over the corpus or the income of a trust which causes the income to be taxable to him, the Code expressly permits a disclaimer of the power if the disclaimer is made within a reasonable time after the beneficiary first becomes aware of its existence.\(^5\)

\(^5\) CODE § 678(d).


\(^7\) Hershey v. Bowers, 1 Ohio App. 2d 511, 205 N.E.2d 580 (1965); In re Bauer, 191 N.E.2d 859 (Ohio P. Ct. 1962); In re Bute's Estate, supra note 60, at 340.

\(^8\) 6 AM. JUR. 2d Assignments § 24 (1963).

\(^9\) 54 AM. JUR. Trusts § 10 (1945).
against public policy. Ohio, by statute, permits the assignment of contingent remainders, executory interests, and other expectant estates, no requirement of consideration is imposed. Contractual interests involving personal service or a confidential relationship cannot be assigned; however, these interests usually are not involved in probate and trust estates and hence are beyond the scope of this discussion.

B. Restrictions on Assignment

A party creating an interest may also prohibit its transfer. A common example is a trust spendthrift clause which prohibits a voluntary or involuntary alienation of a beneficiary's interest in the trust. In Sherrow v. Brookover, the Ohio Supreme Court refused to recognize the validity of a spendthrift clause as against the interest of a creditor of the trust beneficiary. However, the spendthrift clause in issue merely prohibited the alienation of the beneficiary's interest, without any threatened termination, and the court expressly confined its decision to clauses of that nature. The validity of the more common type of clause, in which an attempted alienation by the beneficiary will result in a termination of his interest, has not been litigated in Ohio and remains an open question, although the validity of such clauses is commonly assumed.

United States Savings Bonds are an example of property interests, the transfer of which is restricted by the issuing organization. Such savings bonds may not be transferred except in limited circumstances, such as death, disability, or situations involving a transfer from one co-owner to another.

---

64 6 AM. JUR. 2d Assignments § 8 at 192.3 (1963).

65 OHIO REV. CODE § 2131.04. The section states: "Remainders, whether vested or contingent, executory interests, and other expectant estates are descendible, devisable, and alienable in the same manner as estates in possession."


67 There is a split of authority as to whether such bonds nevertheless may be the subject of a gift by delivery and evidence of an intention to make a gift. Cases holding that a gift may be made take the position that the restrictions against transfer are for the benefit of the federal government only and do not control property rights between individuals. Cases holding to the contrary find a governmental policy to spread ownership of the public debt. See Annot., 40 A.L.R.2d 788 (1955). In Ohio, a lower court decision has held that such bonds cannot be transferred. Collins v. Jordan, 110 N.E.2d 825 (Ohio C.P. 1950), appeal dismissed, 113 N.E.2d 911 (Ohio Ct. App. 1950).
C. Tax Consequences of Assignments

In some cases the assignment of certain property interests will immediately accelerate the taxation of income, and the tax practitioner should be aware of this possibility.

(1) Income in Respect of a Decedent.—The Internal Revenue Code specifically provides for the taxation of income in respect of a decedent to the decedent’s estate or to his beneficiary when such income is received. However, an assignment of the right to the income, other than one effecting a normal distribution to or from an estate, will cause the income to be taxed at the time of the assignment and prior to its actual receipt.\(^68\)

(2) Installment Obligations.—In certain circumstances, income from the sale of real estate and personal property sold on an installment basis may, for tax purposes, be reported periodically as payments are made.\(^69\) However, if such obligations are assigned, other than by reason of death, taxation of the income is accelerated to the year of assignment.\(^70\)

(3) Increment of United States Savings Bonds.—The Internal Revenue Service has ruled that the unreported increment on United States Savings Bonds becomes taxable upon the voluntary assignment of the bonds by the purchasing owner to another.\(^71\) The basis for taxability is the realization of income doctrine under which one may realize income from a transaction other than a sale such as by gift.

(4) Accrued Income on Debt Obligations.—Accrued interest on indebtedness will become taxable immediately upon assignment under the same reasoning applicable in the taxation of increment on government savings bonds.\(^72\)

In all of the cases, the gratuitous assignment constitutes a taxable gift even though the interest assigned may be highly contingent in nature.\(^73\) The contingency is relevant in determining the value of the gift, but does not negate the fact of the gift.

---

\(^68\) CODE § 691(a)(2).

\(^69\) CODE § 453(b).

\(^70\) CODE § 453(d).


\(^72\) Income Tax Unit Ruling 3011, XV-2 CUM. BULL. 132 (1936).

D. Trust Interests

The assignment of interests in trust income has given rise to much tax litigation on the question of whether the assignment is effective to shift the tax burden on future trust income to the assignee. The leading case in this area is *Blair v. Commissioner*, in which the United States Supreme Court held that the assignment of a life estate effectively shifted the tax burden on future income to the donee on the ground that the life estate constituted a substantial property interest and the transaction was not merely an anticipatory assignment of future income. The case is also authority for a shift of the tax burden to the donee of a fractional portion of a life estate. However, if the interest transferred is less than a life estate in duration, difficult problems of interpretation may be encountered. In *Blair*, the Court indicated that the transfer must be of a substantial interest, but it declined to lay down any further guidelines. Later, in *Harrison v. Schaffner*, the Court held that the assignment of one year's income was not an assignment of a substantial interest, and that the assigned income therefore remained taxable to the assignor. However, the Internal Revenue Service has filled in the resulting void by ruling that a transfer of income for a period of ten years or more is substantial and operates to shift income tax liability. The Service was obviously influenced by the ten-year short-term trust statute; if an owner may shift income tax liability by transferring the income for a ten-year period, then clearly a beneficiary should be able to do the same. Thus, the cut-off period is ten years unless a charity is the assignee. In the latter case, a transfer of two year's income should be sufficient upon the analogy to the short-term trust statute which permits an owner to shift two year's income to a qualified charitable organization.

---

74 300 U.S. 5 (1937).
75 Id. at 13.
76 312 U.S. 579 (1941).
78 CODE § 673 (a).
79 CODE § 673 (b). For the sake of completeness, the statutory tax rules relating to the exercise or release of a power of appointment should be stated inasmuch as they in effect cause an assignment of property interests. As to general powers of appointment created prior to October 21, 1942, an exercise during lifetime constitutes a taxable gift, but a complete release is not deemed to be an exercise. CODE § 2514 (a). As to a general power of appointment created after that date, either an exercise or a release during lifetime constitutes a taxable gift. CODE § 2514 (b). A limited power of appointment may be exercised or released without gift tax consequences.
III. SALES

The subject of sales of probate and trust interests has been largely preempted by the sale of trust income interests. This latter area has given rise to much litigation, largely because of the very attractive tax advantages to be achieved. This portion of the discussion will therefore be confined to the sale interests in trust income.

A. Income Tax Effect Upon the Seller

It is now settled that the sale of a life estate interest in a trust is the sale of a capital asset which gives rise to a capital gain or loss. Thus, by selling his income interest, a trust income beneficiary not only receives his income in advance, but also converts it from ordinary income to capital gain, and perhaps even to a capital loss depending upon his cost basis for the income interest. The Internal Revenue Service argued strenuously in the courts that the consideration for a sale of a life interest is nothing more than an advance payment of future income. In addition, it has urged a distinction between an “assignment” of the income and a “surrender” of it to the remainderman. Both of these arguments have been repeatedly and consistently rejected by the courts and the Service is now resigned to attacking such sales only if they represent tax-motivated schemes. The extent of the Service’s capitulation was demonstrated in Gladys Cheesman Evans, in which the taxpayer sold her life interest in a trust containing closely held stock to her husband in return for a consideration payable over her lifetime. The closely held company thereafter paid dividends sufficient in amounts to cover the payments scheduled to be paid to her by her husband. The Tax Court concluded that the transaction represented the sale of a capital asset. Despite the fact that the source of the income remained the same, the time of its receipt was not substantially changed, and the only material change was the tax treatment of the income; the Service dispiritedly entered its acquiescence to this case.

By analogy to the assignment of income cases, the sale of any substantial interest in a trust, although less than a life estate, will also give rise to a capital gain or loss. However, no cases have yet

---

80 Allen v. First Nat’l Bank & Trust Co., 157 F.2d 592 (5th Cir. 1946); McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946); Bell’s Estate v. Commissioner, 137 F.2d 454 (8th Cir. 1943); Sayers F. Harman, 4 T.C. 335 (1944), acq., 1945 CUM. BULL. 3.
81 Bell’s Estate v. Commissioner, supra note 80, at 455.
82 McCallister v. Commissioner, 157 F.2d 235 (2d Cir. 1946).
84 1958-2 CUM. BULL. 5.
been decided on the point. The application of the reasoning adopted in the assignment of income cases also permits the conclusion that a sale of ten year's income or more is a sale of a capital asset.

The income tax basis for computing gain or loss of a life estate interest (or other income interest) is determined by apportioning the basis of the underlying trust assets between the income beneficiary and the remainderman. The apportionment is made in accordance with each beneficiary's actuarial interest in the trust. These interests are calculated by using the appropriate tables set forth in the regulations for valuing income interests and remainders for estate and gift tax purposes. Thus, it may be observed that both the fair market value and the income tax basis of the life estate interest decrease as the life tenant becomes older.

B. Income Tax Effect Upon the Purchaser

The purchaser of a life estate interest in trust income is also favorably regarded by the courts. The courts have held, and the Service now agrees, that the purchaser is entitled to recover his cost by amortizing it over the life tenant's expectancy by ratable annual deductions. Thus, if the purchaser pays 10,000 dollars for a life estate and the life tenant's expectancy is ten years, the purchaser may deduct 1,000 dollars per year in his income tax return for a period of ten years. The deduction is permitted on the ground that the purchaser has acquired an exhaustible asset and by analogy to the law developed in regard to purchases of leasehold interests. Initially, the Service argued that if the sale is by a life tenant to the remainderman, there is a merger of interests and nothing remains to be amortized. It has now abandoned this argument, however, and is left only with the right to challenge the bona fides of a transaction if the transaction is a blatant tax avoidance scheme.

C. Estate Tax Consequences

The remaining point of controversy regarding the sale of trust

---

85 Income Tax Unit Ruling 3911, 1948-1 CUM. BULL. 66.
87 Commissioner v. Fry, 283 F.2d 869 (6th Cir. 1960), affirming 31 T.C. 522 (1958); Bell v. Harrison, 212 F.2d 253 (7th Cir. 1954); Rev. Rul. 132, 1962-2 CUM. BULL. 73. The Service argued that the purchaser should be permitted to recoup his cost only when he sold or otherwise disposed of the assets.
88 Bell v. Harrison, supra note 87 at 255.
89 Id. at 254.
income interests lies in the estate tax field. It arises when an original owner has previously created a trust while reserving a life estate which he later wishes to sell. In United States v. Allen,91 decided by the Tenth Circuit Court of Appeals in 1961, the settlor sold her life estate interest to her son in contemplation of death, thereby completely divesting herself of any interest in the trust. The court nevertheless included the trust in her taxable estate, relying upon congressional intent and general policy considerations, but without specifically indicating any statutory provision upon which it relied. It is possible to sustain the holding under section 2036 of the Code on the ground that the sale of the life estate merely accelerated the receipt of income. However, nothing in the opinion indicates that section 2036 was the basis for the decision, and this line of reasoning was previously rejected by the Tax Court in Estate of Robert J. Cuddihy.92 If the contemplation of death provisions of section 2035 were the basis of the holding, then the question of adequacy of consideration must be resolved. While the consideration was clearly equal to the value of the life estate, it was still inadequate if the value of the entire trust be considered. The case, therefore, is authority for the proposition that the consideration given must be equal to the amount removed from the taxable estate; however, this is objectionable from an economic viewpoint, since no purchaser would ever pay such an amount. Such reasoning also runs counter to the trend in other areas of the estate tax law.93 It also may be argued that since neither a transfer with a retained income nor a transfer in contemplation of death may escape tax, a transfer combining the elements of both, although not fitting either category precisely, should not escape taxation. The policy considerations to the contrary are highly persuasive, however, since an opposite holding would lead to the avoidance of tax by the simple expedient of a death-bed sale for a nominal amount. This is more than the already well-favored taxpayer has the right to expect in selling trust interests.


93 See Sullivan's Estate v. Commissioner, 175 F.2d 657 (9th Cir. 1949), in which a joint tenancy was converted into a tenancy in common in contemplation of death. Although the decedent had contributed all the funds toward acquisition of the joint asset, only one-half of the asset was included in his taxable estate on the ground that the interest transferred to the survivor in contemplation of death was in exchange for an adequate consideration i.e., the spouses sold their respective joint tenancy rights to each other in exchange for undivided interests in the asset. It should be noted that the consideration did not equal the amount removed from the taxable estate.