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EFFECT OF DISCLAIMERS ON ALLOWANCE OF MARITAL DEDUCTION

SEPTEMBER 13 (legislative day, SEPTEMBER 7), 1966.—Ordered to be printed

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 483]

The Committee on Finance, to which was referred the bill (H.R. 483) to amend section 2056 of the Internal Revenue Code of 1954 relating to the effect of disclaimers on the allowance of the marital deduction for estate tax purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

This bill, as passed by the House, amends present law to allow an interest in property which a surviving spouse receives as a result of a disclaimer by a beneficiary under a will to qualify for the estate tax marital deduction where certain conditions are met. Under present law the marital deduction, in general, permits the deduction of up to one-half of the adjusted gross estate for property passing to a surviving spouse. For an interest in property which has been disclaimed to be eligible for the marital deduction under the House bill (1) the beneficiary must disclaim all bequests and devises to him; (2) the disclaimer must be made within 6 months after the decedent's will is admitted to probate; and (3) the disclaimer must be made before the beneficiary accepts any bequest or devise under the will. Under the House bill, where these conditions are met, the amount which may qualify as a marital deduction as the result of a disclaimer (when added to other amounts received by the surviving spouse) is limited to the greater of (1) the marital deductions which would be allowable without regard to the disclaimer if the spouse elected to take against the will under State law, or (2) one-third of the decedent's adjusted gross estate.

Your committee's bill retains the provisions of the House bill with respect to estates of decedents dying before the date of enactment of the bill and for which the date prescribed for the filing of the estate tax return occurs on or after January 1, 1965 (i.e., decedents dying on or after October 1, 1963), with the exception that your committee's bill extends the time within which a disclaimer must be made to the time for filing the estate tax return of the decedent, generally 15 months after the decedent's death.

As to disclaimers made with respect to estates of decedents dying on or after the date of enactment of this bill, however, your committee's bill provides that disclaimers by persons other than surviving spouses are to be fully effective for purposes of computing the estate tax marital deductions. Thus, for the future, under your committee's bill, interests passing as the result of partial (as well as of complete) disclaimers may qualify for the marital deduction, and the maximum amount of these interests which may qualify for the marital deduction is the same as in the case of interests passing to the surviving spouse directly; i.e., one-half of the adjusted gross estate. In addition, for the future, under your committee's bill, disclaimers with respect to property passing by the laws of intestacy or otherwise (e.g., insurance or by trust) are to be fully effective for purposes of computing the marital deduction (as well as disclaimers of bequests and devises under the will of a decedent).

Your committee has also added to the House bill a provision which, in the case of a trust or any other person, provides that items incurred in the administration of the property of a deceased person may be deducted either by the other person for income tax purposes or by the estate of the deceased for estate tax purposes, but not for both. This provision applies to taxable years ending after the date of enactment of this bill but only to amounts paid or incurred (or losses sustained) after that date.

The Treasury Department has indicated that it does not object to the passage of this bill as amended.

II. REASONS FOR THE BILL

(1) *Effect of disclaimer on allowance of marital deduction.*—Under present law (sec. 2056(d)), disclaimers (that is, where a beneficiary gives up all rights to property he otherwise would receive) in effect are recognized where they are made by a surviving spouse. The effect of this is to provide that in these cases no marital deduction is to be available. This result is accomplished, where a disclaimer is made by a surviving spouse, by providing that the property is considered as passing from the decedent to the person entitled to receive the property as a result of the disclaimer, rather than passing to the surviving spouse. On the other hand, disclaimers are not recognized under present law where they are made by someone other than the surviving spouse and, as a result of the disclaimer, the surviving spouse receives property. Thus, present law provides that property received by a surviving spouse as the result of a disclaimer is to be considered to pass from the decedent to the person making the disclaimer (and not to the surviving spouse).

The regulations under present law do recognize disclaimers under certain conditions for gift tax purposes. The regulations (sec. 25.2511-1(c)) provide that where a beneficiary unqualifiedly refuses

to accept ownership of property transferred from a decedent (whether the transfer is by will or by law of descent), a refusal to accept ownership of the property does not constitute the making of a gift "if the refusal is made within a reasonable time after the knowledge of the existence of the transfer." The refusal must be effective under local law, and no refusal is acknowledged after the property has been accepted. The practical effect of the regulations thus is to recognize for gift tax purposes that property passing as the result of a disclaimer does not pass from the person who disclaims, but from the deceased.

Cases in the estate tax area have arisen where the nonrecognition of a disclaimer, which resulted in property passing to surviving spouses, has given rise to inequities and discrimination. Where the beneficiary disclaims his right to receive property and, as a result, the property is received by a surviving spouse, it is difficult to see why a larger tax should be recovered from the estate than would be true where the property goes directly to the surviving spouse (rather than indirectly as a result of a disclaimer). In both cases the economic effect of the transaction is the same. Moreover, frequently the failure to make provision for the marital deduction in the first instance stems from an absence of knowledge concerning estate tax law by the decedent. This is an area of the law which, of necessity, contains complexities and frequently is not fully understood by an individual preparing his own will. A special problem is created by the fact that it is possible to obtain a lesser marital deduction than intended solely because of a failure to determine the exact interrelationship of the different estate tax provisions of present law.

For the reasons indicated above, your committee has reached a conclusion similar to that reached by the House; namely, that disclaimers should be recognized for purposes of determining a marital deduction. For the future, however, your committee believes property passing to a surviving spouse by way of a disclaimer should be treated no differently than where the property passes directly to the surviving spouse. For that reason, it does not apply the limitations contained in the House bill to disclaimers made in the future (these limited the application of the House bill to disclaimers of interests bequeathed or devised to a person, required the disclaimer by a person of all bequests and devises in his favor, and limited the maximum marital deduction available by reason of disclaimers).

As to pending cases, where failure to grant relief would produce an inequity, your committee agrees that the effect of recognition of disclaimers should be limited to the alternative available under the then existing law. This alternative was for the widow to elect under State law to take a statutory share in lieu of the provision made for her in her husband's will. Since in most States the widow could take an amount equal to a third or more of her husband's estate, as to pending cases, your committee has retained the limitation in the House bill, which generally limits the marital deduction to one-third of the adjusted gross estate in the case of disclaimers. As indicated above, in the case of disclaimers made in the future, however, your committee has concluded that property passing to a surviving spouse in this manner should be given the same treatment for purposes of the estate tax marital deduction as in the case of property passing to her in any other manner.

(2) *Disallowance of certain double deductions.*—Under present law (secs. 2053 and 2054) an estate may deduct certain items—funeral

and administration expenses, claims, and losses—in computing its estate tax liability or, alternatively, may deduct these items in computing its income tax liability. An estate may not deduct these items for both estate tax purposes and income tax purposes, however (sec. 642(g)). Nevertheless, some courts have held that even though an estate is prohibited from enjoying this double deduction for one expenditure, where both an estate and a trust are involved the prohibition does not apply. Thus, where a trust paid certain expenses of administering property in the estate, courts have held that the estate could deduct the items as administration expenses in determining its estate tax liability and at the same time the trust could deduct the items as expenses necessary to manage income-producing property in determining its income tax liability.[1]

Your committee believes that where only one amount is spent, there should be only one deduction. This explains why an estate is not allowed to deduct the same item twice in determining both its estate tax liability and its income tax liability, and your committee believes the same reason applies where a trust is involved. The number of taxable entities does not change the effect of the transaction, and it should not change its tax consequences.

III. GENERAL EXPLANATION

(1) *Effect of disclaimer on allowance of marital deduction for the future.*—For the reasons given above, this bill, as amended by your committee, in the case of decedents dying on or after the date of enactment of the bill reverses the provision in present law which, for purposes of computing the marital deduction, ignores disclaimers of interests in property which thereby are received by a surviving spouse. The bill provides instead that for the future, any interest, or portion of an interest (including a contingent interest), in property received by a surviving spouse as the result of a timely disclaimer is to be treated as passing to the spouse. Where this occurs, the interest is to qualify for the marital deduction for estate tax purposes. In the case of decedents who die on or after the date of enactment of the bill, interests passing as the result of a disclaimer may qualify for the marital deduction to the same extent as interests passing directly from the decedent (i.e., taking into account any other qualifying property passing to the spouse, to the extent of 50 percent of the adjusted gross estate).

Under the bill as amended by your committee, for an interest to be considered as passing to a surviving spouse where there has been a disclaimer, two conditions must be met. First, the person who disclaims must do so before he accepts any property under the disclaimed interest. This means, for example, that a person who has been receiving benefits under a trust during a decedent's lifetime may not disclaim the interest he has been enjoying during that time upon the decedent's death within the meaning of the bill. However, a person disclaiming with respect to the estate of a decedent dying after date of enactment may accept an undivided interest in a property and still disclaim the remainder within the meaning of the bill. What constitutes an acceptance is, of course, in any event a question of fact. Second, for a disclaimed interest to be considered as passing to a surviving spouse, the disclaimer must be made within the time prescribed

[1] See, *Comm'r* v. *Burrow Trust* (333 F. 2d 66 (10th Cir. 1964)), affirming 36 T.C. 1080.

for filing the estate tax return, generally 15 months after the decedent's death. Present law is to continue to apply to an interest disclaimed after this period—that is, an interest in property which is disclaimed after this period is to continue to be considered as passing to the person who disclaims, and not to the surviving spouse.

A disclaimer, for the purposes of this bill, is a complete and unqualified refusal to accept some or all of the rights to which one is entitled. It must be a valid refusal under State law and be made without consideration.[2] Thus, it cannot be made for the purpose of serving the interests of a person who disclaims. For example, a disclaimer for the benefit of a surviving spouse who promises to give or bequeath property to a child of the person who disclaims is not a disclaimer within the meaning of the bill.

(2) *Effect of disclaimer on allowance of marital deductions for certain past periods.*—The bill also changes present law with respect to timely disclaimers of bequests and devises passing under the will of a decedent dying on or after October 1, 1963, and before the date of enactment of the bill. In these limited cases, unlike disclaimers of interests passing from a decedent dying on or after the date of enactment of the bill, the amendment applies only where the person who disclaims does so with respect to all bequests or devises in his favor (including those resulting from disclaimers by other named beneficiaries).[3]

The interests passing by disclaimer to surviving spouses in the case of decedents who died before the date of enactment of the bill also are to qualify for the marital deduction only to the extent that, when added to any other allowable marital deductions, they do not exceed the greater of (1) the deductions which would be allowable without regard to the disclaimer if the surviving spouse exercised her election under State law to take against the will, or (2) one-third of the decedent's adjusted gross estate (i.e., generally, all property passing from the decedent at the time of his death less expenses, indebtedness, property taxes, and losses).

The limitation with respect to one-third of the adjusted gross estate is measured with respect to the entire adjusted gross estate of the decedent and, in applying the one-third limit to any one disclaimer, all such disclaimers are to be taken into account. This limitation also takes into account all other property interests passing to a surviving spouse in determining the additional amount which may qualify for the marital deduction as a result of the disclaimer. The property passing by way of a disclaimer for this purpose, as well as in the case of estates of decedents dying on or after the date of enactment of the bill, includes life estates or terms of years which qualify for the marital deduction only as a result of the disclaimer. For example, a life estate devised to a surviving spouse would be taken into account in computing the marital deduction if, as a result of a disclaimer, the surviving spouse also receives the remainder interest, thereby making the combination of the two interests eligible for the marital deduction.

[2] It is not material for this purpose whether a particular State law uses the term "disclaimer" or uses another term describing the same legal effect. All that is necessary to qualify under the bill is a refusal, made without consideration, which is valid under State law and by reason of which the interest "disclaimed" is received by the surviving spouse either by operation of law or other provision made by the decedent.

[3] In this case, the person does not have to disclaim interests passing other than by will (such as an interest passing under an insurance policy or by the laws of intestacy or by the exercise of a power of appointment), for the interest passing to the spouse to qualify for the marital deduction.

(3) *Disallowance of certain double deductions.*—For the reasons stated above, this bill as amended by your committee extends to trusts and other persons the prohibition in present law, applicable to estates, against claiming amounts deducted in computing the taxable estate of a decedent for estate tax purposes, again as deductions in computing the taxable income for income tax purposes. This means that if an estate deducts administration expenses in arriving at the estate tax base, a trust cannot also deduct these same expenses in determining its income tax liability. This prohibition is to have effect where a trust has paid certain expenses on behalf of the estate. This may occur, for example, where a decedent has placed the bulk of his property in a trust during his lifetime and empowered the trust to pay expenses which are incurred as the result of his death.

Under the bill, the estate retains the right to deduct the particular items covered—funeral and administration expenses, claims, and losses—in determining the estate tax base, or to waive the deduction of these expenses for estate tax purposes. In the case of such a waiver the estate may take these deductions into account in computing its income tax liability if it paid the expenses. Where the estate waives its right to these deductions for estate tax purposes, a trust may take the deductions into account in computing its income tax liability where it is otherwise entitled to them.

IV. CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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SUBTITLE A—INCOME TAXES

CHAPTER 1—NORMAL TAXES AND SURTAXES

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SUBCHAPTER J—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

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SEC. 642. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.

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(g) DISALLOWANCE OF DOUBLE DEDUCTIONS.—Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction in computing the taxable income of the estate *or of any other person*, unless there is filed, within the time and in the manner and form prescribed by the Secretary or his delegate, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the

right to have such amounts allowed at any time as deductions under section 2053 or 2054. This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of decedents).

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CHAPTER 11—ESTATE TAX

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SUBCHAPTER A—ESTATES OF CITIZENS OR RESIDENTS

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PART IV—TAXABLE ESTATE

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SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

[Sec. 2056(a)]

(a) ALLOWANCE OF MARITAL DEDUCTION.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

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(d) DISCLAIMERS.—

(1) BY SURVIVING SPOUSE.—If under this section an interest would, in the absence of a disclaimer by the surviving spouse, be considered as passing from the decedent to such spouse, and if a disclaimer of such interest is made by such spouse, then such interest shall, for the purposes of this section, be considered as passing to the person or persons entitled to receive such interest as a result of the disclaimer.

[(2) BY ANY OTHER PERSON.—If under this section an interest would, in the absence of a disclaimer by any person other than the surviving spouse, be considered as passing from the decedent to such person, and if a disclaimer of such interest is made by such person and as a result of such disclaimer the surviving spouse is entitled to receive such interest, then such interest shall, for purposes of this section, be considered as passing not to the surviving spouse, but to the person who made the disclaimer, in the same manner as if the disclaimer had not been made.]

(2) BY ANY OTHER PERSON.—If under this section an interest would, in the absence of a disclaimer by any person other than the surviving spouse, be considered as passing from the decedent to such person, and if a disclaimer of such interest is made by such person and as a result of such disclaimer the surviving spouse is entitled to receive such interest, then—

(A) if the disclaimer of such interest is made by such person before the date prescribed for the filing of the estate tax return and if such person does not accept such interest before making the disclaimer, such interest shall, for purposes of this section, be considered as passing from the decedent to the surviving spouse, and

(B) if subparagraph (A) does not apply, such interest shall, for the purposes of this section, be considered as passing, not to the surviving spouse, but to the person who made the disclaimer, in the same manner as if the disclaimer had not been made.

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