Cottrell v. Commissioner, 72 T. C. 489 (1979)

A disclaimer of an indefeasible remainder interest must be made within a reasonable time from the creation of the interest to avoid gift tax.

Summary

Lois Cottrell disclaimed her remainder interest in a testamentary trust established by her father's will in 1937, doing so in 1970 after the death of the life tenant. The Tax Court held that her disclaimer, executed 33 years after the trust's creation, was not timely under the gift tax regulations which require disclaimers to be made within a reasonable time of the interest's creation. Consequently, the disclaimer was considered a taxable gift. However, the court found no negligence in Cottrell's failure to report the disclaimer on her gift tax return, as she had relied on legal advice.

Facts

Parker Webster Page's will, executed in 1935 and probated in 1937, established a trust for his wife Nellie with the remainder to be divided equally between his daughters, Lois Cottrell and Helen Halbach, or their issue if either predeceased Nellie. In 1970, after Nellie's death, Lois executed a disclaimer of her remainder interest, which was upheld as valid under New Jersey law. The trust assets, valued at approximately $10,132,000, were distributed to Lois's children. Lois did not report the disclaimer on her 1970 gift tax return, following her attorney's advice that it was not necessary.

Procedural History

The Commissioner of Internal Revenue determined a gift tax deficiency and an addition to tax for Lois Cottrell's 1970 tax year, asserting that her disclaimer constituted a taxable gift and that her failure to report it was negligent. Lois petitioned the Tax Court for review. The court found that the disclaimer was not timely, thus constituting a taxable gift, but also found that Lois was not negligent in not reporting it on her return.

Issue(s)

1. Whether Lois Cottrell's disclaimer of her remainder interest in the trust, executed 33 years after the trust's creation, was made within a reasonable time to avoid gift tax.
2. Whether Lois Cottrell was liable for additions to tax under section 6653(a) for failing to disclose the disclaimer on her 1970 gift tax return.

Holding

1. No, because the disclaimer was not made within a reasonable time from the

creation of the interest, as required by the gift tax regulations. The court found that a reasonable time for disclaiming an indefeasible interest begins at the creation of the interest, not upon the death of the life tenant.
2. No, because Lois Cottrell relied on the advice of an experienced attorney who concluded that the disclaimer did not constitute a taxable gift and need not be disclosed on her return.

Court's Reasoning

The court applied the rule from section 25. 2511-1(c) of the Gift Tax Regulations, which requires a disclaimer to be made within a reasonable time after knowledge of the existence of the transfer. For an indefeasible remainder interest, the court determined that the reasonable time begins at the creation of the interest, not upon the death of the life tenant. The court distinguished the case from Keinath v. Commissioner, as Lois held an indefeasible interest, not one subject to divestiture. The court also considered the policy against allowing taxpayers to use hindsight for estate planning purposes. Regarding the second issue, the court found that Lois's reliance on her attorney's advice negated any negligence or intentional disregard of tax rules, citing precedent from Hill v. Commissioner and Brown v. Commissioner.

Practical Implications

This decision clarifies that for gift tax purposes, disclaimers of indefeasible interests must be made promptly after the creation of the interest, not upon the occurrence of a future event like the death of a life tenant. This impacts estate planning, requiring individuals to consider disclaiming interests soon after they are created rather than using disclaimers as a last-minute estate planning tool. The ruling also reinforces that reliance on professional tax advice can protect taxpayers from penalties for negligence, emphasizing the importance of seeking competent legal counsel in complex tax situations. Subsequent cases have applied this principle, and it continues to guide practitioners in advising clients on the timing of disclaimers.

