OFFICIAL TRANSCRIPT

PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: UNITED STATES, Petitioners v. JOHN O. IRVINE AND FIRST TRUST NATIONAL ASSOCIATION

CASE NO: 92-1546

PLACE: Washington, D.C.

DATE: Monday, December 6, 1993

PAGES: 1-41

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IN THE SUPREME COURT OF THE UNITED STATES

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UNITED STATES, :

Petitioners :

v. : No. 92-1546

JOHN O. IRVINE AND FIRST :

TRUST NATIONAL ASSOCIATION :

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Washington, D.C.

Monday, December 6, 1993

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:02 a.m.

APPEARANCES:

KENT L. JONES, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of the Plaintiff.

PHILLIP H. MARTIN, Minneapolis, Minnesota; on behalf of the Respondents.

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C O N T E N T S

	PAGE
ORAL ARGUMENT OF	
KENT L. JONES, ESQ.	
On behalf of the Petitioner	3
ORAL ARGUMENT OF	
PHILLIP H. MARTIN, ESQ.	
On behalf of the Respondents	22
REBUTTAL ARGUMENT OF	
KENT L. JONES, ESQ.	
On behalf of the Petitioner	37

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PROCEEDINGS

(10:02 a.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument first this morning in Number 92-1546, United States v. John Irvine and First Trust National Association.

Mr. Jones.

ORAL ARGUMENT OF KENT L. JONES

ON BEHALF OF THE PETITIONER

MR. JONES: Mr. Chief Justice and may it please the Court:

In 1917, Lucius Ordway formed a trust with substantial assets. Each of his grandchildren, including Sally Ordway Irvine, was given a remainder interest in the trust. By 1931, when Mrs. Irvine was 21 years old, she was aware of her remainder interest. In 1966, when her father died, she became entitled to receive and did receive each year a portion of the income from the trust.

In 1979, when the trust terminated, Mrs. Irvine was entitled to receive one-thirteenth of the corpus of the trust, which then exceeded $1/2 billion in value. Mrs. Irvine at that time was 68 years old and had five adult children.

She determined that she did not need her entire share of this enormous fortune, and filed a written disclaimer of a portion of her interest in the trust.

Under the disclaimer, each of her children received one-sixteenth of her interest in the trust. Mrs. Irvine retained the remaining eleven sixteenths of her interest for herself.

The Federal gift tax supplements the estate tax by imposing a tax on any direct and indirect transfer of property by gift. The question presented in this case is whether Mrs. Irvine's 1979 disclaimer of five-sixteenths of her interest in the trust represents a gratuitous transfer of property to which the gift tax applies.

Many of the issues presented in this case have already been resolved by the Court. Since 1943, in Smith v. Shaughnessy, it has been established that a remainder interest in a trust is a form of property, to which the gift tax applies, and the fact that the remainder interest is subject to defeasance goes only to the value of that interest and not to its character as property.

The only other question posed by the statute is whether the disclaimer of such an interest in property represents a transfer of that property for purposes of the gift tax, and in 1982, in Jewett v. Commissioner, this Court held that it does. The Court accepted the interpretation of the Commissioner that a disclaimer that is not made within a reasonable time after the taxpayer learns of his interest in the property is an indirect

transfer of property to which the gift tax applies.

The Court explained that the passage of time is crucial to the gift tax scheme. With the passage of time, the taxpayer can decide whether to retain the property for himself or allow it to pass to the next generation. The analysis of the Court in Jewett obviously applies to Mrs. Irvine's long-delayed disclaimer in this case.

The court of appeals concluded, however, that the gift tax does not apply to this 1979 disclaimer solely because the interest that was disclaimed was created in 1917, before the gift tax was enacted.

The Court's analysis ultimately rests upon its acceptance of a legal fiction.

QUESTION: What section are we talking about here, Mr. Jones?

MR. JONES: What section of the Internal Revenue Code?

QUESTION: Yes, where -- that the court of appeals relied on, the fact that it was not created by that particular date.

MR. JONES: The section of the code that is relevant would be section 2511, but I think that the answer to your question is that in the enactment of the Federal gift tax there was a provision that says that this statute will not apply to any transfer prior to the date

of enactment, and so it was that retroactive -- it was that feature of the statute that the court had in mind.

QUESTION: Well, the Eighth Circuit also relied on one section or subsection that talked about something being a taxable transfer, didn't it?

MR. JONES: Well, that was a different portion of the court's rationale that I haven't yet discussed.

QUESTION: Okay. You're going to get to that?

MR. JONES: Yes, sir.

QUESTION: Okay.

MR. JONES: At this point, what I'm pointing out is that the court's analysis ultimately rests upon its acceptance of a legal fiction about disclaimers. Under State law, a valid disclaimer is treated as if it were made ab initio, at the same time that the initial transfer was made, and that State legal fiction is designed to protect the property from the intervening claims of creditors and other third parties, but in Jewett the court explained that those State law concerns do not control application of the Federal gift tax, and that's because the State legal fiction is counterfactual. It is only a fiction and not a fact that a long-delayed disclaimer is made ab initio. In this case, for example, Mrs. Irvine's disclaimer was made 62 years after the trust was formed and a full half-century after she reached her age of

majority.

QUESTION: But under State law principles, it would be treated as having occurred back in 1917?

MR. JONES: That is correct. Under State law principles, the State deems the disclaimer to have been made ab initio.

QUESTION: And in Jewett, did this Court indicate, the majority, that State law supplies the answer in cases before the promulgation of the 1958 regulation?

MR. JONES: No, to the contrary, the Court held in Jewett that a disclaimer represents an indirect transfer and then looked to the regulation to determine the limitations on that analysis that the Secretary had reached in issuing the interpretive regulation that was in effect at that time.

QUESTION: Do you take the position that in light of Jewett there is no way that the court of appeals judgment here can be affirmed?

MR. JONES: I think Jewett and Jacobs, read together, answer all the questions in this case.

Jewett answers the question of whether this is an indirect transfer of property by gift. Jacobs and Estate of Sanford answer the question of whether this gift tax is applied retroactively when it's applied to a transfer that occurs after the date of enactment but with

respect to an interest that was created before the date of enactment, and what the Court squarely held in Jacobs and Estate of Sanford is that the gift tax retroactivity -- nonretroactivity requirement has nothing to do with a tax that's imposed on a transfer that occurs after enactment.

QUESTION: In your view, when did the taxable transfer take place?

MR. JONES: Well, the transfer that is subject to tax in this case occurred in 1979, when Mrs. Irvine made a disclaimer.

QUESTION: When did the taxable transfer within the meaning of the regulation take place?

MR. JONES: Within the specific words of the regulation, the taxable transfer referred to in the regulation is the initial, completed gift.

QUESTION: So that's 1917?

MR. JONES: That would have been in 1917, with the gift in trust.

QUESTION: So is it necessary for your case to say that the 1917 creation of the trust was a taxable transfer?

MR. JONES: It is not necessary for our case.

QUESTION: Is that your number 1 line of defense?

MR. JONES: No, not really. I guess to answer

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that question you really have to start from the beginning of describing what the '86 regulation does and what it says.

The '86 regulation was made necessary by the enactment of 2518 of the code, which established a fixed 9-month period for tax free disclaimers of interest created after 1976. In adopting the regulations in 1986, under -- to implement the old and the new statutory provisions, the '86 Treasury gift tax regulations used the term, taxable transfer, to describe the initial completed gift.

Now, we know that because the regs specifically cross-reference to the contemporaneous regulations adopted under 2518. Those regulations contain a definition of the term taxable transfer for the purpose of the regulations, and that definition is a completed gift regardless of whether a tax was imposed. Now, this --

QUESTION: May I just ask you a question there? You said, regardless of whether a tax was imposed, but that isn't the verb tense used in the reg, is it? The verb tense used -- the reg uses the present tense.

MR. JONES: I thought I -- well, I thought I said regardless of whether a tax is imposed, but --

QUESTION: I thought you said was. In any case, your brief on page 26, second line from the bottom of the

text, quotes the phrase, "was not subject to the gift tax," and you then cite the reg 2511, and I don't think that's what the reg says. It makes it -- I understand it makes it easy for your case if you use the past tense, but that's not what the reg uses.

MR. JONES: We -- respondents properly took us to task for having a citation mistake at that page of our brief, and we discussed that citation mistake in our reply brief.

QUESTION: The language came out of Ordway, is that correct?

MR. JONES: Yes. The ibid -- what should have been on page 26 was an ibid, and the simple explanation is that the cite checkers in our office don't accept an ibid at the beginning of a paragraph, and so when they struck out the ibid, they looked to the last thing in the prior quote. The last thing in the prior quote was the reg that was cited in Ordway. The proper citation is simply to the Ordway opinion again.

QUESTION: I'm still not sure when, in your view, the taxable transfer within the meaning of the regulation took place.

MR. JONES: Within the meaning of the regulation there are two relevant transfers. The initial transfer is described as the taxable transfer in the regulation. It

is defined in the regulation to simply mean, a completed gift without regard to whether a tax is imposed. It is simply a clock-starting mechanism.

The phrase is awkward, and but for the definition in the cross-section it would be confusing, but with the cross-reference it's not confusing. It simply says you start the clock running from the date of the initial completed gift.

QUESTION: And in your view that is 1917?

MR. JONES: That was in 1917, and we know -- the phrase, completed gift, comes out of this Court's decisions in Burnet v. Guggenheim and cases of that type, and what it -- the completed gift is a gift made when the donor has parted with all control and dominion over the property, which Mr. Ordway did in 1917.

QUESTION: Do you still -- do you take the position here that the disclaimer had to be made prior to the enactment of the gift tax?

MR. JONES: To be subject to tax, the disclaimer would have to be made after the date of the gift tax.

QUESTION: No, but for the disclaimer to be effective to avoid the tax on this transfer, Mrs. -- whatever her name was's transfer, do you take the position that she was required to make that disclaimer prior to 1932?

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MR. JONES: In all likelihood, we would take that position if the issue had arisen, but I want to amplify that in two ways.

QUESTION: That was the position that the IRS took below, wasn't it?

MR. JONES: It was an answer to a hypothetical question.

QUESTION: Is it an academic question, because in fact she did not disclaim after the gift tax came into effect?

MR. JONES: Yes. It really has no relevance to this case.

QUESTION: So you don't have to answer the question whether, and suppose she had done it in 1933 or 1934, because she didn't do it till '79.

MR. JONES: No, we don't have to answer that question here, because here we have a full half century that passed between the time she reached her age of majority and the time that she disclaimed.

QUESTION: Would you agree that if she had done it within a reasonable time of reaching her majority --

MR. JONES: Oh, yes.

QUESTION: -- that that would have sufficed?

MR. JONES: Yes. She reached her majority -- actually, the record's a little bit mixed on this.

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Apparently, in Minnesota the age of majority was 18, so she actually reached her age of majority in 1928, but it really doesn't make any difference, and with respect to your point --

QUESTION: But possibly it was unconstitutional not to give her the extra 3 years.

(Laughter.)

MR. JONES: I don't have any views on that.

QUESTION: You can concede that.

MR. JONES: But I just want to point out that there isn't anything odd --

QUESTION: Well, there's a decision of this Court -- Stanton, I think v. Utah -- that suggests that the differential in age of majority might be unconstitutional.

MR. JONES: I accept that fully.

QUESTION: Alternatively, it might be unconstitutional to give the men 3 more years. I mean, one or the other is bad.

MR. JONES: I would leave that to you.

QUESTION: We'll argue --

MR. JONES: I really don't have an opinion on that at this time, but I wanted to point out in response to Justice Souter that there's nothing odd about saying that for her to make a tax-free disclaimer it might have

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been necessary to do it before the gift tax was enacted. For anyone to make a tax-free gift, it would have been necessary to do it before the gift tax was enacted.

That's equally true whether the gift was made by disclaimer or by outright grant, so there's nothing odd or unfair about suggesting that if she wanted to make a tax-free disclaimer, it should have been done before the gift tax --

QUESTION: But the argument that's being made is that the disclaimer in effect precludes her acceptance of the gift in the first place, and if the reason she wants to preclude the acceptance is to avoid the gift tax, then it would be sort of unreasonable to say that she was required to make that act of refusal prior to the enactment of the tax which she's trying to avoid.

MR. JONES: There have been no cases that have really been at the border that test the -- how you decide what a reasonable time is.

QUESTION: But you could concede that if she did it a reasonable time from the effective date of the gift tax, that would be a different case.

MR. JONES: It might be a different case, but I doubt that we would take that position. We think that the reasonable time describes one of two things, and you can look at it either the way the dissent or the majority did

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in Jewett. The reasonable time either reflects a passage of time that allows the disclaimer to work in an estate planning function, which is clearly what we have in this case.

Another way to look at the passage of time is the way the 1986 regulations describe their interpretive rationale, and that is that property cannot be disclaimed free of tax after it is accepted, and that property is deemed to be accepted when it has been retained without disclaimer for more than a reasonable time.

Either of those rationales is really satis -- is sufficient under the Jewett decision and under the interpretive regulations.

QUESTION: So your position is it shouldn't be a decision driven by tax consequences, that what you're looking to see is if this person was -- exercised control, or --

MR. JONES: That is absolutely correct, because there's no -- the gift tax doesn't apply only when it's a substitute for estate planning.

QUESTION: Well, it can be driven by tax purposes. I can decide not to accept the gift simply because it will cost more in taxes if I accept it and then give it to my children than if I let it go to my children directly, and so long as I don't accept it, it can be

driven as much as I like by tax consequences, can't it?

MR. JONES: As long as --

QUESTION: You're just saying --

MR. JONES: As long --

QUESTION: -- you shouldn't accept it first, and you accept it automatically if too much time passes.

MR. JONES: That is the analysis of the regulations which seems appropriate.

QUESTION: Now, leaving aside the question of when the reasonable time would come, your position would be the same whether the reg -- what is it, 2511? -- applies or not.

MR. JONES: Absolutely, and I do want to emphasize that point. This is simply an interpretive regulation. If -- it does not purport to be a complete codification of every conceivable application of the statute. It sets forth an interpretive rationale that guides application of the statute, and whether or not one were to think that this specific transaction fell squarely within the language of the regulation, the rationale of the regulation is still a suitable guide for this Court.

Because, ultimately, whether the tax is imposed or not is a matter of statutory construction, and the interpretive guide that this regulation contains for any situation involving disclaimers is the one that we've

discussed, which is that a disclaimer not made within a reasonable time represents an indirect transfer of property.

The other way to reach -- to make somewhat the same point is that the interpretive regulation describes an exception from the gift tax, that the gift tax applies unless a disclaimer is made within a reasonable time, and that if a tax exception does not apply, then the tax does.

QUESTION: What precise regulation are we talking about here?

MR. JONES: The 1986 Treasury gift tax regulations in 26 C.F.R. 2511-1(c).

QUESTION: And where do we find that in the brief?

MR. JONES: Those are quoted in full, both the '58 and '86 versions are quoted in the appendix to the petition in full.

QUESTION: At page 62-A in the petition?

QUESTION: 62-A?

MR. JONES: That's one of the pages. I think they might begin on 59.

QUESTION: So you're just talking about interpretive regulations en bloc, kind of, here, if you're talking about two or three pages. You're not talking about any particular sentence or sentences?

MR. JONES: No, sir. I have referred to some of the specific sentences, but the -- under the '86 regulation at page 62-A, down towards the middle of the page, the interpretive regulation states, "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."

QUESTION: And the term, transfer, refers to taxable transfers, which is the beginning phrase of that sentence?

MR. JONES: That is absolutely correct, and the definition of the phrase, taxable transfer, is contained in the cross-reference provisions of section 2518 of the regulations, and those, Chief Justice Rehnquist, are quoted at the beginning of our merits brief on page 2, where it says, "With respect to inter vivos transfers a taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift," and again, a completed gift for Federal gift tax purposes is the one described by this Court in Burnet v. Guggenheim, where the transferor has parted with complete dominion over the property. That was Mr. Ordway's gift in trust in 1917.

I want to emphasize simply, we are not --

QUESTION: It seems to me a little odd to say a

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gift tax imposed or not imposed can be meaningfully applied in 1917, when there was no gift tax at all.

MR. JONES: It isn't the most felicitous phrasing -- I'm not suggesting that it is -- but it is phrasing that has been clearly articulated in the regulation to have this specific meaning, and I think there's a historical explanation for why they used this perhaps awkward term.

It relates to the fact that the 1976 -- post 1976 transfers under section 2518, the initial starting date was referred to in some of the legislative materials as the original taxable transfer, and when they coordinated these regulations in '86, they picked up that same terminology, but it has no -- notwithstanding the fact that the court of appeals seemed to give it great weight, you cannot read the contemporaneous cross-references in the regulations and be confused.

QUESTION: Well, what would happen if we decided that this regulation was not applicable to her because it was not a taxable transfer? Would she then be outside the safe harbor provision and in even worse condition, or --

MR. JONES: For two reasons, she would still -- the transfer would be subject to tax. If she doesn't come within the exception for disclaimers made within a reasonable time, then she has no exception to rely on, and

she's taxable under the general rule set forth in the statute and the regulation, but more importantly, this is an interpretive regulation, it is not a substantive one. It doesn't necessarily try to cover every conceivable situation.

Justice Stevens' opinion for the Court in Jewett goes through the history of this regulation, and points out that in its original 1958 form, it was written in a broader manner that by its terms would have covered inter vivos, testamentary, and every type of transfer.

QUESTION: Mr. Jones, you're relying on the definition of taxable transfer contained in 2518-2(c)(3).

MR. JONES: I think that's the right number, yes, sir.

QUESTION: But the problem with that definition is that it's -- it really only applies to transfers or disclaimers that are made after 1976, transfers creating an interest in the person disclaiming that are made after 1976, so technically that -- I mean, you may argue that it applies by analogy, but it seems to me you can't argue that it applies strictly speaking.

MR. JONES: I think what I mean to say in connection with that is that the history of the regulations as adopted leaves it clear that the terms were used in the same manner in both --

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QUESTION: All right --

MR. JONES: -- sets of regulations.

QUESTION: -- but you don't -- you do not assert that 2518-2(c)(3) defines the meaning of taxable transfer in 2511?

MR. JONES: In 2518 it defines it for purposes of 2518.

QUESTION: Right, and you're saying --

MR. JONES: And the same --

QUESTION: -- we can assume that it has the same meaning, although that definition doesn't technically cover 2511?

MR. JONES: Most of it does.

QUESTION: Most of it does.

MR. JONES: All of it except the date.

QUESTION: It does not cover it to the extent that this case here is involved.

MR. JONES: Well, it covers it to the extent of this case here. It's just that the definition in 2518 relates to the context of 2518, which is post-'76 transfers.

QUESTION: Okay.

QUESTION: But even if it doesn't cover -- even if we don't look to the reg for analogy, we're still dealing with a gift, a gift implies an acceptance, and if

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there's no renunciation within some reasonable period of time of an intent to transfer, there's still a completed gift, and if she later renounces, she's still giving something away. That would be your argument.

MR. JONES: That is our argument, and the facts of this case are really, I mean, perhaps one of the strongest settings in which this issue could arise.

We have a transfer of a contingent interest in an enormously valuable property that was made after the transferor had held the interest for more than 50 years. She did it when she was 68. The property passed to the natural objects of her bounty. All of the economic realities of this case indicate that this was an indirect transfer of property by gift, to which the statute applies.

I would like to save my remaining time for rebuttal.

QUESTION: Very well, Mr. Jones. Mr. Martin, we'll hear from you.

ORAL ARGUMENT OF PHILLIP H. MARTIN

ON BEHALF OF THE RESPONDENTS

MR. MARTIN: Mr. Chief Justice, and may it please the Court:

The Government's position in this case is that Mrs. Irvine should have had the foresight to disclaim her

interest, her remainder interest in the Ordway Trust in 1928 when she turned age 18, which was then the age of majority in Minnesota for her disclaimer to be free of gift tax.

Now, at that time, her interest was contingent, it was subject to her surviving the six living life income beneficiaries, and it was dependent upon the number of grandchildren who would be living at the time of the death of the last --

QUESTION: You're not contending --

MR. MARTIN: -- of those beneficiaries.

QUESTION: -- that it didn't have value because it was continent -- could have been valued?

MR. MARTIN: We're not contending that it didn't have value, no. That is not the issue as far as we're concerned. We're not contending that it isn't property, either. I think Smith v. Shaughnessy is a red herring. We agree that a contingent remainder interest is property.

QUESTION: So she had something that she was capable of conveying or relinquishing.

MR. MARTIN: She had something. What she had under the leading authority of Brown v. Routzahn was a right to accept or a right to reject, and she exercised, eventually, her right to reject.

QUESTION: If you don't exercise that right

until decades later, then aren't you holding the control rein in the interim, as you would not if you relinquished control within -- if you said, no I don't want it, within a reasonable time.

MR. MARTIN: Well, I think the passage of time is also misleading. You know, the Government has a regulation -- in fact, it comes out of the 1932 act legislative history -- that says that the creation of a joint bank account where a transferor transfers property to an account and allows a transferee the right to withdraw, that that's not a gift until the transferee exercises that right to withdraw, and the transferee can wait as long as he wants, and in fact the regulations under section 2518 contain an example authorizing and permitting that transferee to disclaim within 9 months after the death of the transferor, so I think that the issue of passage of time is not an end-all. The Service has indicated that that's not necessarily the case here.

QUESTION: When did she first become entitled to receive the income, at what age?

MR. MARTIN: 1966. She was born in 1910 -- 56.

QUESTION: 1966.

MR. MARTIN: 1966, yes, on the death of her father.

QUESTION: Mr. Martin, on the timing, can I ask

you one question? Assume that her rights had vested in 1957. Say the death had come a little earlier -- in other words, before the regulation was adopted. Would you prevail, if, say, she had immediately renounced at that time?

MR. MARTIN: I think under the rule of Brown v. Routzahn, she definitely -- we definitely would have prevailed. That would have been a disclaimer that was valid under Minnesota law. Under Brown v. Routzahn, Minnesota law was controlling.

QUESTION: Assume also Jewett had been decided at that time.

MR. MARTIN: The --

QUESTION: Assume it's correct. I know you disagree with it --

(Laughter.)

QUESTION: But if Jewett was on the books then, would she have any basis for --

MR. MARTIN: Well, yes, Justice Stevens --

QUESTION: -- avoiding the tax?

MR. MARTIN: -- she would. I mean, the issue -- really, the bottom line issue here is what rule of disclaimer do we apply? Do we apply the rule that was in existence at the time the trust was created, or do we apply the rule that was interpreted by this Court in

Jewett?

QUESTION: In other words, you really -- this is a question of whether Jewett is retroactive or not, I guess.

MR. MARTIN: It's a question of whether --

QUESTION: The basic position --

MR. MARTIN: -- it's a question of whether the gift tax was --

QUESTION: The basic position is inconsistent with Jewett, and maybe Jewett's wrong. I have to acknowledge that there's good arguments on both sides, but don't you really have to say that Jewett should not apply to preregulation transfers?

MR. MARTIN: That's exactly what we do say.

QUESTION: Yes.

MR. MARTIN: In Jewett -- in Jewett, they acknowledge that Brown v. Routzahn not only controlled that state law was controlling, but they also said that State law was controlling as to the timeliness. That was specifically acknowledged by the Court in Jewett.

QUESTION: Help me out on that, will you, and I should know this, but I'm not sure. Was the point being made when the effectiveness -- when the crucial role of State law was being discussed the point of effectiveness as between the donor and the donee of the disclaimer, or

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was the point being made the effectiveness for purposes of tax avoidance?

MR. MARTIN: The effectiveness -- as we use the term effectiveness in our brief, we're talking about an effective disclaimer for tax purposes, one that is recognized by the tax law as being a refusal to accept property.

QUESTION: But that is, of course, ultimately a Federal question.

MR. MARTIN: That is ultimately a Federal question, and the question is whether, when Congress enacted the Gift Tax Act in 1932, did they intend to disturb the preexisting rights under existing instruments such as Mrs. Irvine had under the Lucius Ordway Trust, or did they intend to apply a brand new rule which, as Justice Stevens pointed out, this Court interpreted in Jewett.

It implied it was a new Federal standard, it had a new requirement, it had a new timeliness requirement which did not exist under State law, under the law that was controlling at the time that the Gift Tax Act itself was enacted.

QUESTION: It's not at all unusual that you have one set of consequences for State law purposes, a transaction is regarded as one way, this is retroactive

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for State law purposes so creditors can't reach it, and a different result for Federal income tax purposes. That's

MR. MARTIN: That's --

QUESTION: -- quite common.

MR. MARTIN: That's right, it is not unusual, and we're not saying that that's the difference here. What we're saying here is that when Congress enacted the Gift Tax Act in 1932, it did not intend to apply that act retroactively. It did not intend --

QUESTION: But isn't it applied when --

MR. MARTIN: -- to disturb the existing rules.

QUESTION: -- there's no -- nothing retroactive to the original donor? There's an action taken long after the gift tax is in effect, and that's what we're talking about, a 1979 act.

MR. MARTIN: That's right, but the right that Mrs. Irvine took in 1979 was based on a right that was existent back in -- when the trust was created. As the Court in Brown v. Routzahn held, she had a right to accept and a right to reject, and that was governed by State law, and that was the status of things when Congress enacted the Gift Tax Act in 1932.

When Congress has enacted disclaimer rules, they have always looked prospectively. In 1976, when they enacted section 2518 here, they specifically provided that

that would not apply to preexisting interests. Similarly, in 1981 when they amended it, they did not retroactively apply that amendment.

It's interesting that counsel for the Government, when he argued this case in Jewett, specifically said with respect to why 2518 wasn't applied retroactively, he said that Congress normally legislates prospectively in the estate and gift tax area.

QUESTION: Well, it seems to me the question is not whether they intended to be retroactive in 1932, but rather whether they intended, in 1932, to have State law govern at all for the purposes of whether there is a subsequent transfer, a subsequent gift.

MR. MARTIN: I think the question --

QUESTION: If they did not intend State law to govern at all when they enacted it in 1932, then there's nothing retroactive, right?

MR. MARTIN: Well, that's right, Your Honor. The question, though, is what they intended, and at that time the rule in Brown v. Routzahn was already being established, was -- had been decided in the district court by the time the Gift Tax Act was enacted. It became the well established rule. The Service has implied it itself.

QUESTION: Jewett said it was wrong.

MR. MARTIN: Jewett said it was wrong -- Jewett

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was interpreting the 1958 regulation. The 1958 regulation dealt with the transfers after the act. The 1958 regulation was subsequently replaced by the 1986 regulation, which says that it does not apply to taxable transfers after the act.

Now, incidentally, there is a no cross-reference in section 111-1(c)(2), which is the section we're focusing on, to section 2518. There is a cross-reference in section 2511-1(c)(1) to section 2518, but that makes sense, because that's post '77, and they're talking about qualified disclaimers, but with respect to taxable transfers for pre-'77 transfers, there is no cross-reference, and so the definition that the court -- that the Government is relying on in 2518 simply doesn't apply. It doesn't apply for that reason, it also doesn't apply because it is really directed to the issue of when the 9-month period begins, and the 9-month period is only relevant with respect to post-'76 transfers. It is not --

QUESTION: Where does that leave us as to the governing principle in this case?

MR. MARTIN: Well, I think it leaves us back with where we were, where we started. The rule of Brown v. Routzahn, which the Government still applies -- they cited it in a 1991 GCM, described it, said that -- and interestingly called it the no-transfer rule, and that's

really what we're saying, is that a disclaimer is not a transfer, it's a refusal to accept property.

QUESTION: Is there any indication in this record why it was five-sixteenths?

MR. MARTIN: There is not -- none. There is nothing in the record on that.

The -- this Court in Jewett did not decide that all disclaimers are transfers. The very premise of the decision in Jewett was that a disclaimer may be an indirect transfer. That's all that the Court said. When the Court said that a transfer may be unquestionably encompassed, that language was really referring to whether we have a property interest, whether a contingent remainder is a property interest, and that really is not the issue here.

I want to emphasize that this case is not simply a replay of Jewett, that in Jewett the Court found it very significant that the right, the Jewetts' right to disclaim did not come into existence until -- that his interest did not come into existence until after the Gift Tax Act had been enacted.

Mrs. Irvine's right, on the other hand, was in existence well before the enactment of the gift tax, and therefore she did have a right to disclaim. She had a right under local property law to --

QUESTION: You'd be on the same footing with Jewett, I suppose, if we took the position that her right to disclaim within a reasonable time was a right to do so within a reasonable time either of the enactment of the statute or of her attainment of majority. That would bring you within Jewett, wouldn't it?

MR. MARTIN: I'm sorry, Justice Souter, I did not follow that.

QUESTION: I say, if we took the position that she had a reasonable -- that she had a right to disclaim within a reasonable time, and that that time would be calculated either from the date of the enactment of the gift tax statute or from the date she attained her majority, that would put you in the same boat as the taxpayer in Jewett, wouldn't it?

MR. MARTIN: The -- well, I'm sorry, I must be missing something here.

QUESTION: Well, the -- if we take the position -- I guess you can have two arguments here, and I was assuming you were making one and maybe you're making the other one.

You could be making the argument that this entire scheme of disclaimer cannot apply to your trust because your trust was created prior the enactment of the gift tax and therefore nothing that relates to the gift

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tax applies to your trust because of the time it was created, or you could be arguing that the crucial point in Jewett was that there was an opportunity, after the enactment of the gift tax, to make the disclaimer, which precluded the property from vesting in the taxpayer and hence precluded the making of a gift at the time of the disclaimer.

I thought you were making the second argument. Maybe you're making the first one.

MR. MARTIN: Well, actually, Your Honor, we're making both arguments.

QUESTION: Okay. If you're making both arguments -- if you're making both arguments, then with respect to the second one, you would be in the same position as the Jewett taxpayer, would you not, if we held that the effective disclaimer by the taxpayer could have been made within a reasonable time of the enactment of the gift tax statute or within a reasonable time of her attainment of majority?

MR. MARTIN: Which really is saying that there was some kind of a hidden grace period in the enactment of the Gift Tax Act to permit disclaimers even though the reasonable time had already expired.

QUESTION: Well, it's saying that reasonable time is to be determined with respect to the point of the

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disclaimer, and if the point of the disclaimer is tax planning, then reasonable time certainly couldn't start running before there was any tax.

MR. MARTIN: But in this case, the Government has conceded, has acknowledged that under their position of the case her right to disclaim expired before the enactment of the gift tax.

QUESTION: I think Mr. Jones said it was an academic question. He acknowledged it would be a different case.

MR. MARTIN: I'm -- I'm relating what the Government conceded at oral argument in the Eighth Circuit, Justice Ginsburg, but that's right, he did -- he did say that it would be academic, but I don't know that it is academic, because it points out the problem with the statutory construction here, that we have a statute which would apply to --

QUESTION: Well, the Court could take the position, could it not, that even if there had to be -- if the reasonable time had to run from the date the gift tax took effect, even if that were so, it wouldn't make any difference because here the disclaimer came over 40 years later.

MR. MARTIN: Well, it -- but that's the point, that she would never have had any notification that she

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was expected to disclaim at the time the gift tax was enacted.

QUESTION: Isn't there an intermediate position, Mr. Martin, that -- she began to get income in 1966, as I remember the facts --

MR. MARTIN: That's right.

QUESTION: -- when her father died, and she -- and substantial income. Had she disclaimed immediately after becoming an income beneficiary, perhaps your case would be much -- much more attractive.

MR. MARTIN: Well, but, Justice Stevens, the Government acknowledges the fact --

QUESTION: And I know the Government doesn't take that position at all.

MR. MARTIN: Well, they not only don't take that -- they've acknowledged that there is no acceptance here.

In their regulations under section 2518, they treat income interest and principal interest as separate, and they make it clear that the acceptance of an income interest does not prohibit a person from accepting a principal interest, and so the fact that she received income under the Government's own regulations is really irrelevant.

The other -- another point that was brought up

is that the Court, when they decided Jewett, was not aware that the Commissioner had consistently taken the position that Brown v. Routzahn was the proper rule and that there was a -- even more materials than what was available to the Court at that time indicating that the regulation was intended to codify Brown v. Routzahn and that the Commissioner's position had not been entirely consistent in interpreting the disclaimer regulations, that the --

QUESTION: Mr. Martin, you're dead right that you've called our attention to things that were not before us at the time of Jewett.

Their response, and I'd like you to directly respond to their -- their response, as I understand it, is that in each of the instances on which you place primary reliance, there was a prompt disclaimer right after the interest was disclaimed. Do you agree with that appraisal of the various cases that you've cited?

MR. MARTIN: Well, I don't think that was true at all in the 1966 private letter ruling, where we had an inter vivos trust that was created in 1933. The beneficiary started receiving income in 1936, and 30 years later, in 1966, her brothers died, and she became entitled to an increased income interest.

Now, she was aware of that interest from the time that she became a beneficiary of the trust. It was a

contingent interest. It was contingent upon whether her brothers had issue when they died, and it turned out that they -- both of them had adopted children, and the court ultimately held -- a State court -- that adopted children were not issue.

As a result of that holding, the Government takes the position that that's what gave rise to the increase in the income, but that really isn't -- that isn't any different than if one of those children had died ahead of time, that if it had been a natural child and had died ahead of the brother, we still would have had the situation where there was an increase in income.

And certainly she was aware of that trust from the time that she started receiving income, so she was aware of her interest for 30 years, which is -- which was the gist of Jewett's interpretation of the regulation, and that was a trust that was established after the act.

Unless there are any further questions, Your Honor --

QUESTION: Thank you, Mr. Martin. Mr. Jones, you have 5 minutes remaining.

REBUTTAL ARGUMENT OF KENT L. JONES

ON BEHALF OF THE PETITIONER

MR. JONES: With respect to the 1966 letter ruling that was just referred to, we've discussed this in

our brief.

I just want to emphasize again that it was the Commissioner's interpretation in that case that the taxpayer did not have knowledge, or should not be attributed to have knowledge of that interest until the supreme court of Pennsylvania, after somewhat lengthy litigation, determined that the adopted children could not succeed to the interests of the other affected interest.

What is absolutely clear about that ruling is that that was the Commissioner's interpretation, so in stating his interpretation he was plainly being consistent with the analysis of the regulation, which is that a taxpayer has a reasonable time to disclaim after the taxpayer becomes aware of the interest.

In brief, a person who transfers property by gift is subject to tax. In Estate of Sanford, in 1939, Chief Justice Stone held for the Court that the Federal gift tax looks to the economic realities of the transfer of control. Justice Cardozo said exactly the same thing for the Court in 1933 in Burnet v. Guggenheim.

This Court's decision in Jewett is an amplification of that simple principal, and as I've already described, it is not subject to argument here that the economic realities in this case reflect a lengthy control over the property by Mrs. Irvine and an enjoyment

of the income interest, and an ultimate transfer of that property to her children. Therefore, the gift tax applies.

QUESTION: I don't know why an effective disclaimer doesn't exercise effective control over the property anyway. Why don't you go whole hog and say, even a disclaimer amounts to a gift? That exercises control over the property, doesn't it? It says, it doesn't come to me, it goes to him, even if you exercise it promptly.

MR. JONES: You're saying a disclaimer made within a reasonable time. I believe that the Commissioner's view of a disclaimer made within a reasonable time is that if a tax is imposed on that transfer, then it requires the taxpayer to accept the gift, and the Commissioner doesn't want to impose that requirement.

The Commissioner allows the gift to be disclaimed within a reasonable time, but if it occur -- if more than a reasonable time passes --

QUESTION: I understand Justice Scalia to be suggesting the Commissioner's giving away the Government's money when he does that.

MR. JONES: I think that what the Commissioner is attempting to do is not to give away the Government's money but to come up with a sensible approach to this

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scheme.

Congress ultimately adopted a similar, even though more objective rationale. They give the taxpayer 9 months to disclaim.

I think that the legislation ultimately enacted under 2518 reflects that the Commissioner's interpretation of the proper application of this statute was sensible and correct, and certainly the Court upheld it in Jewett.

QUESTION: Why did Congress agree with it if it was wrong?

MR. JONES: Well, I believe it also reflects that it was sensible and correct.

QUESTION: And I suppose there's no largesse involved, unless we assume that the Commissioner could redefine the very concept of gift in a way which certainly is not suggested by any act of Congress.

MR. JONES: Well, what's really at issue here is, when was the property transferred? There's no question that it was a gratuitous transfer. The disclaimer is an indirect transfer, and that was really the event that the Commissioner's regulation focused on, and this Court's decision in Jewett did.

Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Jones. the case is submitted.

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(Whereupon, at 10:51 a.m., the case in the above-entitled matter was submitted.)

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USA V. JOHN O. IRVINE AND FIRST NATIONAL TRUST ASSOCIATION

CASE92-1546

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and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY Ann Marie Federico

(REPORTER)