USING DISCLAIMERS IN AN UNCERTAIN

ESTATE PLANNING ENVIRONMENT

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I. Introduction

A. Introduction and Comments.

These materials are generally intended to address the use of disclaimers under §2518 of the Internal Revenue Code. The statute was created by the Tax Reform Act of 1976. References to statutes, cases and rulings before 1977 are for informational purposes only.

B. Disclaimers – A Historical Review.

1. The Concept of a Refusal -- Intestacy. The concept of refusing an inheritance is not as basic as one might assume. In *Hardenbergh v. Commissioner*, 198 Fed. 2d 63 (8th Cir. 1952), *cert. denied*, 344 U.S. 836 (1952), the Court noted that "the general rule as to intestate succession is that the title to the property of an intestate passes by force of the rule of law . . . and that those so entitled by law have no power to prevent the vesting of title in themselves." The Court found that absent a statute to the contrary, an heir entitled to inherit by intestacy cannot renounce property. Thus, a renunciation of property passing by intestacy results in a gift from the renouncing party to the takers in default.

2. Beneficiaries Under a Will. The general rule as to devisees or legacees under a will has generally been that the recipient can refuse the inheritance. *See*, *Brown v. Routzahn*, 63 F.2d 914 (6th Cir. 1933), *cert. denied*, 290 U.S. 641 (1933).

3. Gifts. In the case of a disclaimer of a gift, the concept is simple. The basic elements of a gift are (1) intent, (2) delivery, and (3) acceptance. Without acceptance, there can be no completed gift. But without acceptance why does the gift not fail with the property returned to the donor? The disclaimer of a gift assumes the fact that the donor has relinquished dominion and control of the gifted property and the gifted property must therefore pass as contemplated by the donor or as by law.

4. <u>State Statutes</u>. By statute most states have replaced the common law specifically authorizing disclaimers. Unfortunately, consistency in state statutes is lacking.

5. <u>Current Law</u>. The disclaimer world changed in 1976 with the enactment of Internal Revenue Code §2518. This outline addresses issues relating to post-1976 disclaimers. The reader is warned that cases and rulings prior to the passage of §2518 may produce wrong conclusions regarding the law.

C. <u>Purposes of Disclaimers</u>. These materials will review many purposes of disclaimers. However, as a general rule, all disclaimers have one or perhaps two specific purposes.

1. <u>Tax Purposes</u>. Tax purposes to be achieved through a disclaimer include, but are not limited to: correcting provisions in a will or estate plan resulting from a failure of the testator to contemplate changes in the tax law, correcting mistakes of the drafting attorney, increasing or decreasing a marital deduction, qualifying an estate for special tax elections, planning to fit state inheritance tax needs and generation skipping planning.

2. <u>Non-Tax Purposes</u>. Non-tax purposes include, but are not limited to: rewriting a will, avoiding creditors, terminating a trust, and avoiding environmental problems. Thus, even if the estate tax should be repealed, disclaimers will remain a valuable estate planning tool.

3. <u>Repeal of Estate Tax</u>. Repeal of the estate tax, should it come to be, will alter the use of disclaimers but they will continue to be used for state inheritance tax and non-tax purposes. Planning for disclaimers may become more common because of the uncertainty of the estate tax law.

D. <u>The Disclaimer – Definitions</u>.

1. <u>Definition</u>. A disclaimer is a refusal or renunciation by an estate beneficiary or a donee of a gift of a transfer to the beneficiary during life or at death, by will, trust or otherwise.

2. The Missing Transfer.

   a. What makes a disclaimer possible is that a disclaimer, if properly accomplished, is not a "transfer." Without a "transfer" there can be no gift. §25.2518-1(b).

   b. Gift taxes are imposed on "the transfer of property by gift." §2501(a)(1). It is the word "transfer" that distinguishes disclaimers and allows these "non-transfers" to escape gift taxation even though the transaction otherwise fits within the general scheme which the gift tax law is designed to tax.

   c. Long before the current disclaimer statute existed, the Sixth Circuit in *Brown v. Routzahn*, 63 F.2d 714, 917 (6^{th} Cir.), *cert. denied*, 290 U.S. 641 (1933), held that a disclaimer was not subject to gift tax and recognized the distinction between a "transfer" and an "exercise of a right to refuse a gift." The regulations confirm this philosophy. §25.2511-1(c).

   d. The non-transfer concept was incorporated into §2518 which was enacted in 1976 by providing "the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer." §2518-1(b).

   e. The result of §2518 is that in the case of a qualified disclaimer, no transfer is deemed to be made from the person making the disclaimer. §2518(a); 25.2518-1(b).

3. Relation Back Theory. Not only does a qualified disclaimer not result in a transfer, it operates retroactively from the date of the disclaimer to cause the disclaimed property to be transferred to the secondary beneficiary as of the date of the original transfer – the date of death or date of gift. *See, e.g.*, Rev. Rul. 83-27. *Note, Estate of Leona Engelman*, 121 T.C. No. 4, (7/24/03). Husband and wife established a joint living trust. At the death of the first spouse to die, the trust was to be divided into two trusts, Trust A and Trust B. Trust A was designed to qualify for the marital deduction. The surviving spouse was given a general power of appointment. Trust B was designed to receive an amount equal to the unified credit equivalent. The trust provided that all assets would pass into Trust A upon the death of the first spouse except for any amounts disclaimed by the surviving spouse. Disclaimed assets would pass into Trust B. Husband died. A month later wife exercised her

power of appointment by executing a document that directed the disposition of the corpus of Trust A. Wife died a month thereafter. Two months later wife's Executor disclaimed $600,000.00 worth of wife's interest in Trust A. The government held that wife's exercise of her power of appointment was an acceptance of the property and the disclaimer was not qualified. The estate argued that the effect of the disclaimer and the Relation-Back Doctrine caused the assets to be disclaimed as of the death of the first spouse, thereby negating the exercise of the power of appointment, citing §25.2518-(2)(b)(4), ex. 7. The Court held that the Relation-Back Doctrine does not negate the exercise of the power of appointment and that the exercise of the power of appointment constituted acceptance which negates the ability to make a qualified disclaimer.

4. <u>Qualified Disclaimers</u>. In order for a disclaimer to avoid gift taxation it must be a "qualified disclaimer." §2518(b). A disclaimer is "qualified" only if it meets all requirements of §2518(b). The result of a qualified disclaimer is that no transfer is deemed to be made as a result of the disclaimer for gift or estate tax purposes.

5. <u>Non-Qualified Disclaimers</u>. The only definition of a non-qualified disclaimer is a disclaimer of property that does not meet the requirements of §2518. Accordingly, such a disclaimer will be treated as a taxable gift by the disclaiming party for federal gift tax purposes. The failure to qualify a disclaimer does not result in no disclaimer or transfer being accomplished. Rather, it simply taxes the transfer under the gift tax rules. The transfer is thus taxed twice, once when the first transfer is made (gift or inheritance) and again at the time of the disclaimer. The rules are unforgiving. Can you say "malpractice" if you do it wrong?

E. <u>Qualified Disclaimers</u>.

1. <u>The Code</u>. The entire disclaimer law is outlined in a single Code section, §2518, which is reprinted below. The section is deceptively simple in appearance.

§2518. Disclaimers

(a) General rule. -- For purposes of this subtitle, if a person makes a qualified disclaimer with respect to any interest in property, this subtitle shall apply with respect to such interest as if the interest had never been transferred to such person.

(b) Qualified disclaimer defined. – For purposes of subsection (a), the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if –

(1) such refusal is in writing,

(2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of –

(A) the day on which the transfer creating the interest in such person is made, or

(B) the day on which such person attains age 21,

(3) such person has not accepted the interest or any of its benefits, and

(4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either –

(A) to the spouse of the decedent, or

(B) to a person other than the person making the disclaimer.

(c) Other rules. -- For purposes of subsection (a)

(1) Disclaimer of undivided portion of interest. – A disclaimer with respect to an undivided portion of an interest which meets the requirements of the preceding sentence shall be treated as a qualified disclaimer of such portion of the interest.

(2) Powers. – A power with respect to property shall be treated as an interest in such property.

(3) Certain transfers treated as disclaimers. – A written transfer of the transferor's entire interest in the property –

(A) which meets requirements similar to the requirements of paragraphs (2) and (3) of subsection (b), and

(B) which is to a person or persons who would have received the property had the transferor made a qualified disclaimer (within the meaning of subsection (b)),

shall be treated as a qualified disclaimer.

2. The Regulations. Like the single Code section, the Regulations are very simple on their face, containing only three major sections. The

most interesting aspect of the Regulations is the large number of examples. There are 62 examples to assist in understanding the requirements of a qualified disclaimer, the uses of same and the pitfalls to be avoided.

3. State Laws.

a. Section 2518(c)(3) indicates that a written transfer of the transferor's entire interest in property which has the same legal effect as a qualified disclaimer under §2518(b) is treated as a qualified disclaimer. The purpose of this section, which was added in 1981, was to eliminate problems where a disclaimer is not permitted by state law or because of inconsistent state laws. This is clearly indicated in §25.2518-1(c). This section states that a transfer will be treated as "qualified" if under local law the property interest passes to someone other than the disclaimant without any direction from the disclaimant.

b. State law is still extremely important, if not for the purpose of outlining specific requirements that may be needed under the state law and to meet state disclaimer rules, if any, but more importantly in determining who will receive the disclaimed property. State law is especially important in a state which has its own gift tax. In those states, failure to follow both the federal and the state law in accomplishing a disclaimer can result in state gift tax even if no gift is made for federal gift tax purposes.

4. Florida Law. The Florida Uniform Disclaimer of Property Interests Act, 2005 Florida statutes, §739.101, *et. seq.* generally mirrors the federal law, but like most states, imposes its own rules which must be considered and followed.

a. Section 739.104 provides that a fiduciary may disclaim any interest in or power over property, including a power of appointment, but same requires court approval. A fiduciary may disclaim such powers without court approval if the instrument creating the trust explicitly grants the fiduciary the right to disclaim.

b. Section 739.104(2) provides that in the absence of a court appointed guardian, a natural guardian may disclaim on behalf of a minor child any interest that the minor child is to receive solely as the result of another disclaimer but only if the disclaimed interest or power does not pass to or for the benefit of the natural guardian as the result of the disclaimer.

c. Sections 739.202 and 739.203 provide specific guidelines for disclaiming joint tenancy with right of survivorship and tenancy by the entirety property.

d. Section 739.601 provides that a disclaimer of an interest in real property does not provide constructive notice to all persons unless the disclaimer contains a legal description of the real property to which the disclaimer relates and unless the disclaimer is filed in the office of the Clerk of the Court in the county where the real property is located.

II. The Qualified Disclaimer – The Basics

A. Irrevocable and Unqualified.

1. It Is What It Is. The first requirement for a disclaimer to be "qualified" is that it be "irrevocable and unqualified." It must constitute a refusal by a person to accept an interest in property distributable to a person by gift or by reason of the death, termination of trust or otherwise. §2518(b), 25.218-2(a)(1), -3(a)(1)(i). There are no special rules regarding the structure of the disclaimer other than perhaps the need to declare it to be "irrevocable and unqualified."

2. Continuing Gifts. An interesting question is presented in the case where an irrevocable trust is established and additional gifts are made over a period of time (*e.g.*, an irrevocable life insurance trust with Crummey provisions and continuing premium obligations). One would assume that the right to disclaim begins again with respect to each and every gift. *See*, PLR 9210014 where the beneficiary of an irrevocable trust disclaimed an "interest" in the trust attributable to the subsequent gifts.

3. Irrevocable. Making a disclaimer irrevocable is easily accomplished by a declaration in the document evidencing that the disclaimer is irrevocable. No definition of "irrevocable" is given. One could logically assume that the guidelines and rules associated with §2038 "Revocable Transfers" in the estate tax law would be applicable.

Thus, where the disclaimer is subject to any exercise of a power to alter, amend, revoke or terminate the disclaimer one could logically assume that the disclaimer would not be irrevocable.

4. Unqualified. No definition of "unqualified" is given. It is logical to assume that any disclaimer that is contingent upon another event, such as a disclaimer by yet another party, would not be an unqualified disclaimer.

B. In Writing. The second requirement for a disclaimer to be "qualified" is that it must be in writing. §2518 (b)(1), §25.2518-2(b)(1). No specific form is required. However, reference should be made to any specific state law requirements.

1. The Internal Revenue Code. The Code provides that the written disclaimer must be "received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates." §2518(b)(1). Note the word "or" as opposed to the word "and."

2. Legal Representative. The term "legal representative" is not defined. *See*, Reg. §25.2518-2(b)(1). One can assume that the legal representative would be any executor or personal representative for the estate of decedent, any court appointed fiduciary, including a conservator or guardian, an attorney in fact under a power of attorney, and a trustee under any trust which has or may have a relationship with the disclaimed interest or property.

3. Delivery to Holder of Legal Title. The disclaimer may also be delivered to "the holder of the legal title to the property." In PLR 9012026, the IRS approved a disclaimer of an annuity under a pension plan where the notice was delivered to the corporate employer and to the plan trustee.

C. Timing Rules. The third requirement for a disclaimer to be "qualified" is that the disclaimer must be received by the transferor or his legal representative no later than nine months of the date on which the transfer creating the interest in such person is made. §2518(b)(2)(A). The first problem with this requirement is determining the date of the transfer.

1. The Transfer. Section 25.2518-2(c)(3) defines a "transfer" as an otherwise taxable transfer that creates the disclaimant's interest. For gifts, the date on which the transfer creating the interest in the

disclaimant is generally the day the gift is deemed to be complete. *See, e.g.*, PLR 9001062. In this ruling, the Grantor retained the right to revoke a trust in conjunction with others. The IRS ruled that there was no completed gift and the disclaimer time period had not started upon the establishment of the irrevocable trust because no completed gift had occurred.

2. Regulation Examples. In §25.2518-2(c)(5), exs. 1-4, the IRS points out situations whereby a transfer made at death or which becomes irrevocable at death is a transfer which is effective as of the date of the decedent's death which triggers the qualified disclaimer time limitations.

   a. On May 13 in a transfer which constitutes a completed gift, A creates a trust providing income to B for life. B has a limited testamentary power of appointment over the corpus of the trust. The power may be exercised in favor of the issue of A or B. If no issue survive at B's death or if the power is not exercised, the corpus passes to E at B's death. On May 13 A and B have two surviving children, C and D. If A, B, C or D wishes to make a qualified disclaimer, the disclaimer must be made no later than nine months after May 13. §25.2518-2(c)(5), ex. 1.

   b. Assume the same facts in the preceding example except that B is given a general power of appointment over the corpus of the trust. B exercises the general power after B's death on June 17 in favor of C upon B's death. C may make a qualified disclaimer no later than nine months after June 17. If B had died without exercising the general power of appointment, E would have nine months after B's death on June 17 to make the disclaimer. §25.2518-2(c)(5), ex. 2.

   c. F creates a trust on April 1. F's child, G, is to receive the income from the trust for life. Upon G's death, the corpus of the trust is to pass to G's child, H. If either G or H wish to make a qualified disclaimer, it must be made no later than nine months after April 1. §25.2518-2(c)(5), ex. 3.

   d. A creates a trust on February 15 in which B is named the income beneficiary for life. The trust provides that upon B's death the assets pass to C if then living. If C predeceases D, the proceeds pass to D or D's estate. If either B, C, or D wishes to make a qualified disclaimer, it must be made no later than nine months after February 15. §25.2518-2(c)(5), ex. 4.

3. Transfer Creating the Interest. Section 25.2518-1(a) utilizes the term "transfer creating the interest" as the event which establishes a date for determining the nine month time limitations of the disclaimer. Note that the term "taxable transfer" is not used. See, for example, references to QTIP Trusts and "String Transfers" below.

4. Knowledge of Interest. No reference is found in the law which provides for a beginning point with knowledge of the existence of a transfer. Lack of knowledge does not suspend the nine month statute. §25.2518-2(c)(1). Any such references apply to pre-1976 law. But how can you make a disclaimer if you do not know of the transfer? And how can a gift be complete without delivery of the gift to the donee?

5. Power of Appointment – Holder of Power. The date a power of appointment is created is the disclaimer starting date for the holder of the power to disclaim the power. §25.2518-2(c)(3).

6. Powers of Appointment – Beneficiary of Power. The distinction between the starting date for a beneficiary to disclaim an interest in the trust where a third party holds a power of appointment is important. Where the holder of the power of appointment has a general power of appointment, the starting date for the beneficiary (recipient of the property under the power) is the date of death (or exercise or termination of the general power of appointment) of the holder of the power. On the other hand, in the case of a limited power of appointment (even one with an extremely broad definition for potential donees), the starting date is the date of the creation of the power. Contingent remainder beneficiaries are treated the same as vested remainder beneficiaries. *See*, §25.2518-2(c)(3) and (5), ex. (1) and (2).

7. QTIP Disclaimer. Section 25.2518-2(c)(3) addresses the time period for a remainder beneficiary to disclaim an interest in a QTIP trust properly qualified under §2056(b)(7). One might wrongly assume that since the QTIP trust is included in the estate of the deceased spouse, that the nine month period for the remainder beneficiary to disclaim would begin running at the date of the surviving spouse's death when the assets are properly includable in the estate of the

deceased spouse. The IRS holds otherwise stating that the remainder beneficiaries must disclaim within nine months after the death which creates the QTIP trust and therefore creates the interest in the beneficiary.

8. Revocable Trusts. The date a revocable trust becomes effective (usually the date of death of Grantor) is the disclaimer starting date. PLR 8008078, 8003020. We find no authority to support an argument that the starting date could be the date the Grantor is incapacitated or declared to be incompetent.

9. Irrevocable Trusts. In the case of an irrevocable trust, the starting date is the date the trust is created even if the interests of the beneficiaries are uncertain and not vested. PLR 9027026.

10. Retirement Plans. The date of death of the owner of a retirement plan is the disclaimer starting date. PLR 8012129. WARNING: Be sure to remember that if the disclaimer causes the plan assets to pass to the estate of the plan participant, an extended payout of the planned assets will not be available. *See*, PLR 200327059.

11. Contingent Remainder Interests. Transfers such as the one that creates a life estate for a beneficiary with a remainder interest, even a contingent remainder interest, must be disclaimed within nine months of the date of the original transfer rather than the date of the termination of the life interest. §25.2518(c)(3).

12. Inclusion in Estate – String Sections. An interesting question is raised regarding the starting date for a disclaimer where the asset, although transferred during life, returns to the estate at death by reason of §§2035-2038. The Regulations hold the starting date to be the date of the gift or the first transfer. The fact that the assets are included in the estate is of no consequence. §25.2518-2(c)(3).

13. Mailing/Delivery Rules. The Code establishes the standard IRS mailing/delivery rule by stating that timely mailing is timely delivery if the mailing rules of §301.7502-1 are met. The first day following a Saturday, Sunday or legal holiday is technically the due date. §301.7502-1; §2518(b)(2).

14. State Law. If state law requirements designate who should receive the disclaimer, the disclaiming party should comply with both federal and state rules. A number of states require the disclaimer to

be filed in the court where the probate of the estate is conducted or would have been conducted if a probate estate had been opened.

15. Special Rules for Minors. Section 2518(b)(2)(B) provides an exception to the nine month rule with respect to a beneficiary who has not attained the age of 21. This exception is applicable even though the state law may declare the disclaiming party to be an adult at age 18.

16. Extensions of the Federal Estate Tax Return. One might incorrectly assume that where the estate tax return is extended, the period for filing a disclaimer should likewise be extended. There is no such provision in the law which allows for same.

17. Extensions of Time to File Disclaimer. THERE ARE NO EXTENSIONS AVAILABLE FOR MAKING DISCLAIMERS. NO COURT CAN GRANT AN EXTENSION.

D. Non-Acceptance of Interest or Benefits.

1. No Acceptance. The fourth requirement for a disclaimer to be "qualified" is that the person making the disclaimer must not have accepted the interest of the disclaimed property or any of its benefits. §2518(b)(3).

2. Consideration Given for Disclaimer. Consideration given by a third party for making the disclaimer disqualifies the disclaimer. §25.2518-2(d)(4).

a. It is tempting, in the case where Party A gives a disclaimer with the expectation that Party B will take a desired action to place such language in the disclaimer or to assure the required actions through another agreement. Any such planning will result in the disclaimer being "unqualified" under §2518(b)(3).

b. In *Monroe Estate v. Commissioner*, 104 T.C. 352 (1995), the tax court ruled that disclaimers were not qualified because the decedent's husband indicated that he would "take care of" the disclaiming parties. He thereafter made a cash gift to the disclaiming parties approximating their disclaimed interest. The appellate court reversed the trial court stating that actual consideration rather than an expectation or implication seemed to be the test and that a disclaimer would stand or fall on the factual issues. 124 F.3d 699 (5th Cir. 1997).

c. If the disclaimer is part of a "plan" and if following the disclaimer the party who benefits from the transaction makes a gift back to the disclaiming party or others, the IRS can easily apply the substance vs. form argument or the step-transaction arguments in asserting that there was an actual agreement and thus consideration given for the disclaimer.

d. It is suggested that if there is an informal plan, as much time as possible should pass between the date of the disclaimer and the date of any subsequent gift or other transaction that might be construed to be consideration given for the disclaimer.

3. Accepting Benefits. A qualified disclaimer cannot be made with respect to an interest in property if the disclaimant has accepted the interest or any of its benefits, expressly or impliedly, prior to the making of the disclaimer. §25.2518-2(d)(1). The regulations require that acceptance be manifested by an affirmative act which is consistent with ownership of the interest of the property. This includes using the property or the interest in property, accepting dividends, interest or rents, or directing others to act with respect to the property. It does not include "merely taking delivery of an instrument of title." The fact that real property vests immediately in the disclaimant upon the death of the decedent does not constitute acceptance. §25.2518-2(d)(1).

a. Accepting benefits can be difficult to define. In the case of residential property held in joint tenancy, a joint tenant is not considered to have accepted the joint interest merely by residing in the property before disclaiming his interest. §25.2518-2(c)(5), ex. (10).

b. Acting as a fiduciary, unless the fiduciary has the power to direct payment of the disclaimed interest, is not an acceptance of benefits. §25.2518-2(d)(2).

c. Paying real estate taxes on real property is not an acceptance of benefits. §25.2518-2(d)(4), ex. (3).

d. Especially troubling are examples (4) and (5) of §2518-2(d)(4) which provide that exercising control over property, even where the disclaimant does not have the legal power to exercise that control, may be deemed an acceptance of benefits.

(1) Pursuant to A's will, B inherited a farm. B requested the Executor to sell the farm and give the proceeds to B. The Executor followed the request. B then disclaimed $50,000 of the proceeds from the sale of the farm. The disclaimer is not qualified. Requesting that the Executor sell the farm, even though the Executor may not have been obligated to comply, constituted acceptance by B. §25.2518-2(d)(4), ex. 4.

(2) Assume the facts in the immediate preceding example except that B pledged the farm as security for a loan which was paid off by B prior to receiving the distribution from the estate. B disclaimed his interest in the farm. By pledging the farm as security, B accepted the farm. §25.2518-2(d)(4), ex. 5.

e. Withdrawing funds from a joint brokerage account prohibits a later disclaimer. Returning the funds does not help. PLR 9012053. However, see PLR 199932042 where the spouse deposited an income check from the brokerage account into her joint bank account and then transferred it to the estate account. Such an action did not constitute acceptance.

f. Exercising powers to control and manage a business entity may be deemed an acceptance of benefits. TAM 9123003.

g. Withdrawing a portion, but not all, of property in a brokerage account may not constitute a disclaimer if the remaining property and the post death income generated from the remaining property are all properly segregated. *See*, §25.2518-3(d), ex. 17. *See also*, PLR 9036028.

h. Payment of a spouse's personal bills from the estate account precluded the spouse's disclaimer of estate assets. TAM 8405003.

i. In the case of a minor, accepting benefits prior to age 21 does not preclude a disclaimer made within nine months following the beneficiary attaining the age of 21 so long as the beneficiary does not accept any benefits after attaining the age of 21. *See*, §25.2518-2(d)(4), exs. 9, 10 and 11 and PLR 200333023, 200348011.

j. *See*, *Estate of Engelman* (¶ I.D.3. above) where the Court ruled that the exercise of a power of appointment constituted acceptance of benefits and precluded a subsequent qualified disclaimer.

k. PLR 200503024 is an excellent example of a disclaimer that works even though the spouse accepted benefits from the disclaimed property and took control of some of the assets. Husband died owning a brokerage account. Wife, upon advice of stock broker, directed the broker to transfer title into her name. Wife directed the sale of securities. Wife withdrew cash from the account. Six months later, on advice of counsel, Wife directed that the brokerage account be divided into separate accounts. Assets over which Wife had exercised control were placed in her account. Other assets were placed in the estate account. Wife then disclaimed the estate account assets. The IRS ruled favorably on the disclaimer based on the fact that the assets in the account were severable. Read the PLR carefully before relying upon it.

E. <u>Distribution of Disclaimed Property</u>.

1. <u>No Direction or Control</u>. The fifth requirement for a disclaimer to be "qualified" is that the interest which is disclaimed must pass to another without any direction or control by the disclaimant. §2518(b)(4); §25.2518-2(e)(1).

2. <u>Precatory Language</u>.

a. Precatory language is tempting to use in a disclaimer. It is especially valuable where there is concern that the persons reviewing the disclaimer (e.g., the insurance company) will misconstrue the effect of the disclaimer and incorrectly distribute the property. It helps a bank, insurance company, or brokerage company know who to pay. The Regulations specifically allow precatory language in a disclaimer. §25.2518-2(e)(4).

b. Example (8) in §2518-2(e)(5) addresses a situation where language contained in the disclaimer expressed the intention of the disclaiming party that assets disclaimed would be shared equally by children as the result of the disclaimer. The Regulations allow for precatory language which has no legal effect. *See*, TAM 9509003. Be very careful with such language. Be careful to specifically refer to it as "precatory" language.

3. Five and Five Powers. The no direction rule is not violated by reason of a five and five power held by a spouse who is the beneficiary of a trust estate funded for the spouse by reason of a disclaimer by the spouse. For example, B's will creates a marital trust and a non-marital trust. Spouse C is income beneficiary of both trusts. Spouse C has a $5,000 or 5% limited withdrawal power over principal. C disclaims a portion of the marital trust. The disclaimed assets pass into the non-marital trust. The retention of the five and five power over the non-marital trust does not defeat the disclaimer. §25.2518-2(e)(5), ex. 7.

4. Multiple Interests. Perhaps the most common example of failure to comply with the no direction requirement is the situation where A creates a trust naming B and C as income beneficiaries with D as a remainderman. D is the Trustee and as the Trustee has a discretionary power to invade principal for the benefit of B and C. If D disclaims his remainder interest but retains the discretionary power of invasion, even for B and C, D has not made a qualified disclaimer. On the other hand, if the distributions to B and C are based on ascertainable standards under §2041, the disclaimer can be qualified. §25.2518-2(e)(5), ex. (11) and (12).

5. Agreement by Parties. Any expressed or implied agreement that the disclaimed interest in property is to thereafter be distributed or transferred by the recipient in some specified way is a retention of control and will cause the disclaimer to be disqualified and can create secondary gift tax issues to the recipient. §25.2518-2(e)(1).

6. The Circular Disclaimer. The disclaimed property must pass to someone other than the disclaiming party. §2518(b)(4)(B). Beware of the boomerang disclaimer. Section 2518(b)(4) requires that as a result of the disclaimer, the property must pass, without any direction on the part of the person making the disclaimer, to a person

other than the person making the disclaimer. Consider the following examples:

a. A makes a specific bequest to B of $200,000 and leaves the balance of the estate into a trust for B for life and then to B's children, C and D. B disclaims the $200,000 thereby causing the property to be distributed under the residuary paragraph into the trust for B for life and then his children, C and D at B's death. In this case, the effect of the disclaimer is to cause the assets to pass into a trust in which B has an interest as a beneficiary. Such a disclaimer is not qualified. But what is the value of the gift? The remainder interest?

b. A dies leaving a will directing all assets to daughter B. A also names B as the beneficiary of A's life insurance policy. B desires for the life insurance proceeds to pass to B's children. B disclaims the proceeds of the insurance. The proceeds pass not to B's children but to A's estate because the life insurance policy did not have a contingent beneficiary designation. B must also disclaim B's interest in A's estate to accomplish a qualified disclaimer.

c. *The Estate of David Katz*, T.C. Memo 2004-166 (71404), is a classic circular disclaimer case where things went wrong. Husband's will established a pecuniary credit shelter trust to be funded with the federal estate tax exemption equivalent that provided that the amount of the credit shelter trust could not be reduced by reason of any disclaimer by the wife. That language proved to be fatal. The residue was distributed to the wife. In the residuary distribution portion of the will, it stated that if the wife disclaimed any assets distributable outright to her, they would pass into the credit shelter trust. Wife disclaimed specific assets and further disclaimed all interest in the credit shelter trust. Because of the language in the will, the assets in the disclaimed part of the credit shelter trust passed to the wife and thus were returned to the credit shelter trust. The specific assets in the residue disclaimed by the wife were paid to the credit shelter trust. The result was disastrous. The disclaimers accomplished nothing except to increase the credit shelter trust to an amount in excess of the unified credit (by reason of the specific assets disclaimed). The result was to produce tax when no tax otherwise could have resulted. This is a classic case where the draftsman failed to appreciate how disclaimers worked and the attorney who structured the disclaimers failed as well.

7. Spousal Exception. An important exception to the no benefit rule is made for the spouse of a decedent. Section 2518(b)(4)(A) provides that property may, as the result of a disclaimer by a spouse, pass to or for the benefit of the spouse. Thus, a disclaimer by a spouse into a trust in which the spouse is a beneficiary is not only authorized, it is a specific estate planning tool which should be utilized in the drafting of estate planning documents in an uncertain period of estate tax exemptions. However, the surviving spouse may not retain the right to direct the beneficial enjoyment of the disclaimed property in a transfer that is not subject to federal estate or gift tax (as Trustee or otherwise) unless the power is limited by an ascertainable standard. §25.2518-2(c)(2).

III. The Qualified Disclaimer Special Rules

A. What Can Be Disclaimed? Section 2518(b) specifically requires that the disclaimer be irrevocable and unqualified. The term "unqualified" does not mean that all property must be disclaimed. A partial disclaimer is possible if the property or the interests are severable.

B. Separate Parts. The disclaimer regulations §25.2518-3(a)(1)(i) address the disclaimer of "property which can be divided into separate parts each of which, after severance, maintains a complete and independent existence."

C. Fraction or Percentage. Section 25.2518-3(b) defines an undivided interest as a fraction or percentage of each and every interest owned. Any disclaimer must extend over the entire interest of the disclaimant's property where a partial disclaimer is desired.

D. Examples of Disclaimers of Less than Entire Interest. Some examples of severable property and non-severable property which can or cannot be disclaimed are as follows:

1. An income interest and a remainder interest in the same trust are separate interests and either can be disclaimed. For example, E died September 13. E's will leaves E's stock into trust with income currently payable to F and G until F attains the age of 45 at which time the trust terminates with the trust assets being divided equally between F and G. F disclaims the income interest retaining the remainder interest in the corpus. G disclaimed the remainder interest

in the corpus retaining the income interest. Both disclaimers are qualified. §25.2518-3(d), ex. (8).

2. Contrast the above with a non-trust bequest of a fee simple interest in real property to B. B disclaims the remainder interest but retains the life estate. This bequest is not qualified. A disclaimer of some specific rights (the remainder interest) while retaining the other rights (the life interest) is not a qualified disclaimer of an "undivided portion" of the disclaimant's interest in property. §25.2518-3(b).

3. A power of appointment is treated as a separate interest in property and may be disclaimed. §25.2518-3(a)(1)(iii). *See also*, PLR 20003023. For instance, a disclaiming party may disclaim a power of appointment retaining an income interest. §25.2518-3(d), ex. (21).

4. The disclaimer of a portion (percentage) of a general power of appointment over a trust leaving a right to appoint the remaining portion is specifically allowed. §25.2518-3(d), ex. (21).

5. A fractional interest in death benefits under a pension plan can be disclaimed. PLR 9016026.

6. The right to amend or revoke a trust can be disclaimed. PLR 9818008.

7. Fractional interests may be disclaimed. PLR 8326033 and 9016026. Fractional interests, including a fractional share formula similar to a marital deduction formula, may be disclaimed. PLR 8502084. §25-2518-3(b).

8. Pecuniary disclaimers are specifically allowed. §25.2518-3(c).

9. A trust beneficiary may <u>not</u> disclaim income from specific assets that remain in a trust. In order for such a disclaimer to be effective, it would require that the asset itself be removed from the trust and distributed to other beneficiaries. §25.2518-3(a)(2).

10. A portion of funds in a bank account can be disclaimed. PLR 8015014.

11. Fifty of 100 shares of stock, even though represented by a single stock certificate, can be disclaimed. §25.2518-3(a)(1)(ii).

12. A fractional interest in employee pension plan benefits can be disclaimed. PLR 9016026.

E. Disclaimers of Joint Property.

1. Joint Property. Disclaimers of jointly held property changed substantially after AOD 1990-06 and final regulations which were issued in 1997. The disclaimer of jointly held property can best be summarized and understood by looking at joint tenancies that can be unilaterally severed and those that cannot and by dividing the property into types: (1) Bank, investment and brokerage accounts and (2) other assets.

2. Bank, Brokerage and Investment Accounts.

a. The case of a transfer of a joint bank, brokerage or investment accounts (e.g., an account held at a mutual fund or brokerage company) if the transferor may unilaterally regain the transferor's own contributions to the account without the consent of the other co-tenant, such that the transfer is not a completed gift, the transfer creating the survivor's interest in the decedent's share of the account occurs on the death of the deceased co-tenant. Accordingly, the surviving joint tenant in order to make a qualified disclaimer with respect to the funds contributed by the deceased co-tenant, must complete the disclaimer within nine months of the co-tenant's death. §25.2518-2(c)(4)(iii).

b. The surviving joint tenant may not disclaim any portion of the joint account attributable to consideration furnished by the surviving joint tenant. §25.2518-2(c)(4)(iii). This is the case even if only half of the funds in the account are included in the estate by reason of Section 2040(b).

3. Other Property.

a. With the exception of joint bank, brokerage and investment accounts referenced above which can be unilaterally regained, the surviving joint tenant may disclaim the one- half survivorship interest in all other property held in joint tenancy with right of survivorship within nine months of the date of the death of the first joint tenant to die. This is the rule regardless of whether the property can be unilaterally severed. The disclaimed interest is the one-half interest in the property, regardless of the property attributable to the consideration furnished by the disclaimant and the percentage of the property included in the gross estate under Section 2040. §25.2518-2(c)(4)(i).

b. With respect to the interest which the disclaimant receives upon the creation of the tenancy, the disclaimer must be made within nine months after the creation of the tenancy. §25.2518-2(c)(4)(i).

c. On February 1, 2000, A purchased real property with A's funds. Title to the property was conveyed to A and B as joint tenants with right of survivorship. Under applicable state law, the joint interest is unilaterally severable by either tenant. B dies on May 1, 2004, and is survived by A. A disclaims (within nine months) the one-half survivorship interest in the property to which A succeeds as a result of B's death. A has made a qualified disclaimer of the one-half survivorship interest but not the interest retained by A upon the creation of the tenancy. The result is the same whether or not A and B are married and regardless of the proportion of the consideration furnished by A and B in purchasing the property. §25.2518-2(c)(5), ex. (7). The result is the same even if the state law does not allow unilateral severance. §25.2518-2(c)(5), ex. (8).

F. <u>IRA Rules.</u>

1. <u>Safe Harbor Rules</u>.

a. A common problem in estates occurs where a decedent was required to take a minimum required distribution (MRD) from his IRA in the year of death but has not made the MRD withdrawal prior to death. To avoid penalty, the named beneficiary of the account must withdraw the MRD (or any remaining balance where the decedent made a partial withdrawal) before the end of the year. For instance, X dies October 1. X historically withdraws from his IRA the required MRD in December. The IRA is payable to spouse. Spouse only has three months to make the MRD withdrawal or face a penalty.

b. In the example above, by making the required MRD the spouse has "accepted" the MRD amount. One would assume that such acceptance of benefits prohibits a later disclaimer within the nine month period allowed by the statute.

c. In Rev. Rul. 2005-36, the IRS provides a safe harbor for disclaiming an IRA by stating that accepting the MRD in the year of death does not constitute acceptance of the entire account.

d. It should be noted that Rev. Rul. 2005-36 requires the IRA beneficiary who makes an MRD distribution to also take the income earned post-death on that portion of the IRA which makes up the MRD. This portion cannot be disclaimed.

2. Disclaiming an IRA. Disclaiming an IRA payable to a primary beneficiary (spouse) in order to cause benefits to be distributable to the Trustee of a trust and allow the required minimum distributions to be paid over the lifetime of the trust beneficiary is addressed in P.L.R. 200522012.

G. Community Property Rules.

In the case of a community property state where husband and wife take title to real property as community property and not as joint tenants with right of survivorship, upon the death of the husband, wife can disclaim that portion of the property which is husband's share of the community property but she cannot disclaim her share originally acquired years earlier. §25.2518-2(c)(5), ex. 11; PLR 9507017.

IV. Planning for Disclaimers

A. The Disclaimer Trust. Section 2518(b)(4)(A) provides a unique opportunity when planning an estate to specifically plan for the utilization of a disclaimer during this period of uncertainty as to the amount that will pass tax free for federal estate tax purposes and amount that will or should pass into a credit shelter type trust. Remember that rules which limit a disclaimer which results in the property passing to or for the benefit of the disclaimed party do not apply to the spouse.

1. Example. Consider the husband and wife with a collective estate of $3 million. The value of the estate exceeds the current exemption

equivalent in 2006 ($2 million). The value is less than the exemption which will be in effect in the future. No tax planning is needed for federal estate tax purposes if the estate tax should be eliminated.

a. There are three uncertainties with respect to this estate.

i. The first uncertainty is when will death of each spouse occur.

ii. The second uncertainty is the value of the assets in the estate at death; either now or in the future.

iii. The third uncertainty is Congress and the law. What will they do?

b. This produces a unique problem for the estate planner. We must know when the clients will die, what their assets will be worth at that time, and what the law will be in that year. Only through large quantities of alcohol can we possibly know the answers to these questions.

2. <u>Funding of Disclaimer Credit Shelter Type Trust</u>. A disclaimer trust established under §2518(b)(4)(A) offers a unique opportunity to the surviving spouse to fund a credit shelter type trust at death or not fund it, depending on the law and other circumstances that exist at the first death. If the assets are valued at $3 million at the time of death and if the exemption is $2 million, the surviving spouse might disclaim $1 million or more into the disclaimer trust which operates much like a credit shelter trust. If the exemption is $3.5 million at the death of the spouse or if the estate tax has been repealed, such a disclaimer is unnecessary.

3. <u>Problems with the Spousal Disclaimer Trust</u>.

a. For this technique to work, the spouse must make the disclaimer. There is a hesitancy to disclaim assets that are payable outright to the spouse. The bird in the hand is much more attractive than the bird in the trust. For disclaimer planning to work, the spouse must make a timely and correct decision.

b. Unfortunately, family and friends all become tax experts at death. More than one needed disclaimer never materialized at death because family and friends warned the spouse not to give up control of the assets.

c. A disclaimer trust is not feasible where the spouse has no incentive to make the disclaimer. For instance, if the spouse is not the mother of the children who will inherit, the spouse will not likely disclaim and give up control of the assets and the right to redirect the assets as he/she might later desire. When given the choice between leaving assets to those we wish to receive them and pay taxes vs. leaving the assets to those who we do not wish to receive the assets tax free, tax considerations will no longer be a factor.

d. Flexibility can be built into a planned credit shelter type trust which cannot be put in the disclaimer trust. This includes giving the spouse a limited *inter vivos* or testamentary power of appointment to alter the ultimate distribution of the trust assets (e.g., shifting assets between children, delaying or accelerating distribution of the trust assets, or bypassing children in favor of grandchildren). In the case of the disclaimer trust, because the spouse cannot retain the right to control or modify the ultimate benefit and enjoyment of the disclaimed assets, care must be taken in structuring the disclaimer trust to take into account all potential changes in family circumstances. No limited power of appointment can be built into the disclaimer trust. The spouse may not have the right, as Trustee or otherwise, to direct the income or principal of the trust to family members unless the power is limited by an ascertainable standard. §25.2518-2(e)(2).

B. <u>Other Disclaimers</u>. There are a number of other reasons why we might plan or utilize disclaimers. They are as follows:

1. <u>Killing a Trust</u>. Disclaimers can be used to eliminate a trust. For instance, if the beneficiary entitled to receive all income for life disclaims the interest, the remainder interest in the trust is accelerated which will result in the trust being distributed to the remainder beneficiaries where the trust provisions called for termination following the death of a life tenant. *See*, PLR 8402121, TAM 8851002 and 8804004.

2. <u>Adjusting Shares</u>. An equal division of assets between children may be desirable, but in the case of one child who is extremely wealthy,

the normal disclaimer process which would result in the disclaiming child's share passing to his/her children might not be the desired result. Providing in the document that if Child A disclaims, the assets pass to Child A's siblings gives the parent the ability to defer in favor of the wealthy child a decision as to whether the parents' wills might properly not divide the estate equally but, rather, leave the estate to the children with fewer assets. *See*, Beans, "Connecticut Disclaimers," 2 Conn. Probate Law Journal 47 (1986).

3. Increasing the Marital Deduction. Perhaps the first place where disclaimers are found to be attractive is to preserve the marital deduction that would otherwise be lost.

   Where the decedent died without a will, leaving property by intestacy equally to a spouse and two children, a disclaimer by the children of all or a portion of their intestate share might cause the assets to be distributable to the spouse by intestacy. This will increase the marital deduction for larger estates and provide necessary assets for the spouse in smaller estates. Note grandchildren would be required to disclaim, too. A disclaimer by a minor might not be possible. Court approval might not be granted. *See*, PLR 8409089, 8514095, 8729008 and 9301005. *See also*, TAM 8701001 and 8926001.

4. Decreasing the Marital Deduction. In the case of a simple will which leaves all assets to the surviving spouse, a disclaimer by the spouse of an amount up to the exemption equivalent will operate to reduce second death tax.

5. Common Disasters. In the case of a common disaster or where there is a relative short period of time between the deaths, the proper utilization of disclaimers may minimize overall estate and inheritance taxes or maximize GST elections. *See*, PLR 8749041 and *Accord Estate v. Comm'r*, 93 T.C. 1 (1989).

6. Fixing Malpractice.

   a. In the case of a defective QTIP trust, such as a QTIP trust containing a limited *inter vivos* power of appointment, the effective use of a disclaimer of that power saves the marital deduction when it would otherwise be lost.

b. In the case of a defective credit shelter trust such as a trust that includes a general power of appointment, the disclaimer of the "power" protects the trust assets from taxation at the death of the surviving spouse. PLR 8603030.

c. In the case of a marital trust containing provisions for a beneficiary other than the spouse, proper use of disclaimers saved the marital deduction and the drafting attorney as well. PLR 8337069.

7. Buying Peace in the Family.

a. In PLR 8908022, the decedent left the entire estate to one sibling to the exclusion of the other siblings. Through the proper use of disclaimers, the sibling caused the entire estate to be shared by all siblings without gift tax consequences.

b. In PLR 8702024, the decedent's sister was named the sole beneficiary of a life insurance policy. Proper use of disclaimers resulted in the insurance proceeds being distributed to the decedent's daughter.

8. Shifting Tax Burdens. A disclaimer of the benefits provided under a tax apportionment paragraph (§2207A) was declared to be a qualified disclaimer. PLR 200127007.

9. The Oops Child. In PLR 20028020, the decedent's spouse and two children and other family members gave disclaimers in order to protect the interest of a third (pretermitted) child not included as a remainder beneficiary of a marital and residuary trust.

10. If It Glows in the Dark. Consider a disclaimer by a beneficiary and/or fiduciaries where property may be environmentally hazardous. *See*, Vaughn, "Environmental Dangers to Fiduciaries," 16 ACTEC Notes 77 (1990).

11. Fixing Old Wills. Consider an old will with a 50% marital deduction clause and a residuary trust for the benefit of the spouse but with powers (limited *inter vivos* powers) or provisions (for children) which make a QTIP election of the residuary trust impossible. Disclaimers may allow you to fix the problem. *See*, PLR 8637044, 8704023, 0906036 and TAM 8546007, 9003007,

9247002. *See also*, *Lassiter Estate v. Comm'r*, T.C. Memo 2000-324.

12. Defective Charitable Trusts. A defective charitable trust (not a CRUT or CRAT) established for a beneficiary for life with a remainder to charity may be saved through disclaimers coupled with reformations of the trust. *See, e.g.*, , PLR 9004011, 9532026 and 200010019.

13. One to Think About. In the case of the death of husband and wife within a short period, a disclaimer may be used to not only decrease the taxable estate of the survivor but also to increase the credit for tax on prior transfers. This is an unexpected benefit because the value of the income rights to the nontaxed portion of the credit shelter trust in the estate of the second spouse to die is taken into account in the computation of the credit based on the actuarial value of the life estate. TAM 8512004. This will not work where the deaths are simultaneous. *See, Carter Estate v. U.S.*, 921 F.2d 63 (5th Cir. 1991).

14. Example. Consider a case of poor planning. Husband's estate was $3 million. Wife's estate was $10 million. Husband prepared a will which left all assets to the two daughters thinking that Wife's sizeable estate would be sufficient to provide for her. At his death in 2006, the daughters learned that the total federal estate tax on the $3 million bequest was $460,000, leaving $2,540,000 for the daughters. The daughters and their adult children (there were no minor descendents to complicate the disclaimer) disclaimed that pecuniary amount over the exemption equivalent. Thus, the daughters received $2 million free of federal estate tax. The mother took the $1 million balance of the estate by intestacy (the daughters and their issue disclaimed their intestate shares as well) thereby qualifying for the marital deduction and producing no first death tax liability. Sometime after the disclaimers were completed, the mother then made a gift (Surprise!) to the daughters of $1 million using her entire federal exemption equivalent. The daughters received the entire $3 million tax free. The mother's net worth was not affected. Everyone was happy. Taxes can be paid later.

15. Example. The preceding example operates equally as well in a situation where the estate is larger and the gift is larger. Consider the following:

Assume the same facts above except Husband dies leaving a $5 million estate to the daughters. The death tax would have been $1,138,000 leaving the daughters with $3,620,000. The daughters disclaim all over $2 million. Three million passes to the spouse and qualifies for the marital deduction. Sometime after the disclaimer is complete, the spouse gives $2,387,000 to the daughters using the $1 million gift exemption and leaving $1,387,000 subject to gift tax. The federal gift tax is $613,000. Thus, the total tax consequence has been reduced by $767,000 to the benefit of the daughters without any direct monetary detriment to the mother.

16. Example. One problem with a disclaimer is a failure to appreciate the full impact of the disclaimer. Consider the following:

    Dad dies leaving an estate of $4 million to wife. Wife has sufficient assets and desires to disclaim $2 million. It is counsel's belief that this will qualify for the exemption and there will be no taxes resulting from the transfer to the daughters.

    It is learned after death and after the disclaimer is made that Dad made a few taxable gifts in his lifetime, specifically, $200,000. The additional tax due as a result of the disclaimer is about $90,000. Wrong. The additional tax due is actually about $170,000. The tax provisions in the will provide for the payment of all taxes before the distribution of the residue to the spouse. Thus, the taxes come out of the share distributable to the spouse. This reduces the marital deduction and therefore further increases the taxes through an interrelated calculation.

C. Miscellaneous Disclaimer Issues.

1. Tax Liabilities. Avoiding the IRS through a disclaimer will not work. *See*, *Drye v. U.S.* 528 U.S. 49 (1999), *aff'g*, 152 Fed. 3rd 892 (8th Cir. 1998).

2. Creditors. There is a split of authority as to whether a disclaimer can be used to avoid creditors with many states holding that such is an act to defraud creditors. *See, e.g.*, *Stein v. Brown*, 480 N.E.2d 1121 (Ohio 1985) citing California decision, *In Re. Kalt's Estate* 16 Cal 2nd 807, 108 P.2d 401 (1940), which was subsequently overruled by statute (Cal. Prob. Code Sec. 283). *See also*, *Hoesley v. State*, 243 Neb. 304, 498 N.W.2d 571 (1993).

3. Medicaid Planning. Questions are continually raised as to the effect of the disclaimer with respect to Medicaid planning, specifically the five-year disqualification provisions under the law for transfers by an individual who seeks to qualify for Medicaid benefits. If a disclaimer is not a "transfer," then surely a disclaimer will protect disclaimed assets from being taken into consideration as though they were transferred by the Medicaid recipient. Wrong. 42 U.S.C. 1396p(e) provides that the term "assets" used to determine income and resources of an individual or the individual's spouse includes any income or resources which the individual "is entitled to but does not receive because of action by any person, including any court or administrative body, acting at the direction or upon the request of the individual or such individual's spouse." In administering the Medicaid statute, most state governments take the position that a disclaimer constitutes an "action" and that for Medicaid purposes, a disclaimer is a transfer. Note the distinction between a disclaimer which requires an action and a refusal to take an elective share which is a non-action. Using a disclaimer trust might be beneficial in an uncertain world with respect to Medicaid planning. Might a spouse disclaim into a trust which is specifically designed by the deceased spouse for the purpose of protecting assets should the surviving spouse end up in a nursing home and need to qualify for Medicaid benefits? The answer is probably no.

4. Shifting of the Malpractice Burden. Note that knowledge of disclaimer rights gives the estate attorney the ability to correct malpractice by the original estate planner. Might the estate attorney become responsible for failing to find ways to correct problems created by the drafting attorney?

5. Do Not Assume. In disclaiming assets which pass by contract, do not assume that you know the proper disposition under the contingent paragraphs in the document. Demand copies of beneficiary designations before making such disclaimers. Consider the example of a proposed disclaimer where the attorney was advised verbally that there was no secondary beneficiary on a life insurance policy thereby causing the assets disclaimed by the primary beneficiary to pass to the estate of the deceased. After the disclaimer is made, it is actually discovered that there was a secondary beneficiary and the secondary beneficiary was not the desired recipient of the disclaimed property.

6. A Final Thought. No review of disclaimers is complete without a warning that state law may impact the disclaimer in unexpected and disastrous ways. The most important issue to be determined is who gets the disclaimed property. Understanding whether the disclaimed property passes under provisions of the will or beneficiary designation or by intestacy is crucial to an effective disclaimer.

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