LAW OFFICES
DAVID L. SILVERMAN, J.D., LL.M.

2001 MARCUS AVENUE
LAKE SUCCESS, NEW YORK 11042
(516) 466-5900

SILVERMAN, DAVID L.
NYTAXATTY@AOL.COM

TELECOPIER (516) 437-7292

AMINOFF, SHIRLEE
AMINOFFS@GMAIL.COM

ESTATE PLANNING MEMORANDUM

TO: CPAs, Clients & Associates

FROM: David L. Silverman, Esq.
Shirlee Aminoff, Esq.

DATE: April 2, 2010

RE: Use of Disclaimers in Pre and Post-Mortem Estate Planning

---

Disclaimers can be extremely useful in estate planning. A person who disclaims property is treated as never having received the property for gift, estate or income tax purposes. This is significant, since the actual receipt of the same property followed by a gratuitous transfer would result in a taxable gift. Although Wills frequently contain express language advising a beneficiary of a right to disclaim, such language is gratuitous, since a beneficiary may always disclaim. For a disclaimer to achieve the intended federal tax result, it must constitute a qualified disclaimer under IRC §2518. If the disclaimer is not a qualified disclaimer, the disclaimant is treated as having received the property and then having made a taxable gift. Treas. Regs. §25.2518-1(b).

Under the EPTL, as well as under most states' laws, the person disclaiming is treated as if he had predeceased the donor, or died before the date on which the transfer creating the interest was made. Neither New York nor Florida is among the ten states which have adopted the Uniform

Disclaimer of Property Interests Act (UDPIA).

II. Qualified Disclaimer Requirements

For a disclaimer to be qualified under IRC § 2518, the disclaimer must be (i) irrevocable and unqualified; (ii) in writing, identify the property disclaimed and be signed by the disclaimant or by his legal representative; (iii) delivered to either the transferor or his attorney, the holder of legal title, or the person in possession; (iv) made within 9 months of the date of transfer or, if later, within 9 months of the date when the disclaimant attains the age of 21; (v) made at a time when the disclaimant had not accepted the interest disclaimed or enjoyed any of its benefits; and (vi) be valid under state law, such that it passes to either the spouse of the decedent or to a person other than the disclaimant without any direction on the part of the person making the disclaimer. Under EPTL § 2-1.11(f) the right to disclaim may be waived if in writing.

With respect to (i), PLR 200234017 ruled that a surviving spouse who had been granted a general power of appointment had not made a qualified disclaimer of that power by making a QTIP election on the estate tax return, since the estate tax return did not evidence an irrevocable and unqualified refusal to accept the general power of appointment. With respect to (iii), copies of the disclaimer must be filed with the surrogates court having jurisdiction of the estate. If the disclaimer concerns nontestamentary property, the disclaimer must be sent via certified mail to the trustee or other person holding legal title to, or who is in possession of, the disclaimed property. With respect to (iv), it is possible that a disclaimer might be effective under the EPTL, but not under the Internal Revenue Code. For example, under EPTL §2-1.11(a)(2) and (b)(2), the time for making a valid disclaimer may be extended until "the date of the event by which the beneficiary is ascertained," which may be more than 9 months of the date of the transfer. In such a case, the disclaimer would be effective under New York law but would result in a taxable gift for purposes of federal tax law.

With respect to (v), consideration received in exchange for making a disclaimer would constitute a prohibited acceptance of benefits under EPTL §2-1.11(f).

With respect to (vi), EPTL §2-1.11(g) provides that a beneficiary may accept one disposition and renounce another, and may renounce a disposition in whole or in part. One must be careful to disclaim all interests, since the disclaimant may also have a right to receive the property by reason of being an heir at law, a residuary legatee or by other means. In this case, if disclaimant does not effectively disclaim all of these rights, the disclaimer will not be a qualified disclaimer with respect to the portion of the disclaimed property which the disclaimant continues to have the right to receive. IRC §2518-2(e)(3).

IRC § 2518(c) provides for what is termed a "transfer disclaimer." The statute provides that a written transfer which meets requirements similar to IRC § 2518(b)(2) (timing and delivery) and IRC § 2518(b)(3) (no acceptance) and which is to a person who would have received the property had the transferor made a qualified disclaimer, will be treated as a qualified disclaimer for purposes of IRC §2518. The usefulness of IRC § 2518(c) becomes apparent in cases where federal tax law would permit a disclaimer, yet state law would not. To illustrate, in Estate of Lee, 589 N.Y.S.2d 753 (Surr. Ct. 1992), the residuary beneficiary signed a disclaimer within 9 months, but the attorney neglected to file it with the Surrogates Court. The beneficiary sought permission to file the late renunciation with the court, but was concerned that the failure to file within 9 months would result in a nonqualified disclaimer for federal tax purposes. The Surrogates Court accepted the late filing and opined (perhaps gratuitously, since the IRS is not bound by the decision of the Surrogates Court) that the transfer met the requirements of IRC § 2518(c). [Note that in the converse situation, eleven states, but not New York or Florida, provide that if a disclaimer is valid under IRC § 2518, then it is valid under state law.]

III. <u>Uses of Qualified Disclaimers</u>

A. <u>Charitable Deductions</u>

Treas. Reg. § 20.2055-2(c) provides that a charitable deduction is available for property which passes directly to a charity by virtue of a qualified disclaimer. If the disclaimed property passes to a private foundation of which the disclaimant is an officer, he should resign, or at a minimum not have any power to direct the disposition of the disclaimed property. The testator may wish to give family members discretion to disclaim property to a charity, but yet may not wish to name the charity as a residuary legatee. In this case, without specific language, the disclaimed prope/*rty would not pass to the charity. To solve this problem, the will could provide that if the beneficiary disclaims certain property, the property would pass to a specified charity.

B. <u>Marital Disclaimers</u>

Many wills contain “formula” clauses which allocate to the credit shelter trust — or give outright — the maximum amount of money or property that can pass to beneficiaries (other than the surviving spouse) without the imposition of federal estate tax. With the applicable exclusion amount now $3.5 million, situations will arise where the surviving spouse may be disinherited if the beneficiaries of the credit shelter trust do not renounce part of their interest under such a formula clause. If such an interest is disclaimed and it passes to the surviving spouse, it will qualify for the marital deduction. Another use of the disclaimer in a similar situation is where either the surviving spouse or a trustee renounces a power of appointment so that the trust will qualify as a QTIP trust.

A surviving spouse who is granted a general power of appointment over property intended to qualify for the marital deduction under IRC § 2056(b)(5) may disclaim the general power, thereby enabling the executor to make a partial QTIP election. This ability to alter the amount of the marital deduction allows the executor to finely tune the credit shelter amount. If both spouses die within 9 months of one another, a qualifying disclaimer by the estate of the surviving spouse can effect an equalization of estates, thereby reducing or avoiding estate tax.

Consider the effect of qualified disclaimer executed within nine months by a surviving spouse of her lifetime right to income from a credit shelter trust providing for an outright distribution to the children upon her death. If, within nine months of her spouse’s death, the surviving spouse decides that she does not need distributions during her life from the credit shelter trust, she disclaims, she will treated as if she predeceased her husband. If the will of the predeceasing spouse provides for an outright distribution of the estate to the children if wife does not survive, then the disclaimer will have the effect of enabling the children to receive the property that would have funded the credit shelter trust at the death of the first spouse.

Assume the surviving spouse paid no consideration for certain property held jointly with her predeceasing spouse. If she dies within 9 months and her estate disclaims, then the property would pass through the predeceasing spouse's probate estate. In that case, a full basis step up would become available. If the property would then pass to the surviving spouse under the will of the predeceasing spouse, this planning technique becomes invaluable, as it creates a stepped up basis for assets which would not otherwise receive such a step up if the disclaimer were not made.

A qualifying disclaimer executed by the surviving spouse may also enable the predeceasing spouse to fully utilize the applicable exclusion amount. For example, assume the will of the predeceasing spouse left the entire estate of $10 million to the surviving spouse (and nothing to the children). Although the marital deduction would eliminate any estate tax liability on the estate of the first spouse to die, the eventual estate of the surviving spouse would likely have an estate tax problem. By disclaiming $3.5 million, the surviving spouse would create a taxable estate in the predeceasing spouse, which could then utilize the full applicable exclusion amount of $3.5 million. The taxable estate of the surviving spouse would be reduced to $6.5 million.

To refine this example, the will of the first spouse to die could provide that if the surviving spouse disclaims, the disclaimed amount would pass to a family trust of which the surviving spouse has a lifetime income interest. The will could further provide that if the spouse were also to disclaim her interest in the family trust, the disclaimed property would pass as if she had predeceased.

C. General Powers of Appointment

The grantor may wish to ensure that the named trustee will be liberal in making distributions to his children. By giving the child beneficiary the unrestricted right to remove the trustee, this objection can be achieved. However, if the child has the ability to remove the trustee, and the trust grants the trustee the power to make distributions to the child that are not subject to an ascertainable standard, this may cause problems, since the IRS may impute to the child a general power of appointment. If the IRS were successful in this regard, the entire trust might be included in the child's taxable estate. To avoid this result, the child could disclaim the power to remove the trustee. This might, of course, not accord with the child's nontax wishes. If a surviving spouse is given a "five and five" power over a credit shelter or family trust, 5 percent of the value of the trust will be included in her estate under IRC §2041. However, if the surviving spouse disclaims within 9 months, nothing will be included in her estate.

D. <u>Eliminating a Trust</u>

At times, all beneficiaries may agree that it would be better if no trust existed. If all current income trust beneficiaries, which might include the surviving spouse and children, disclaim, the trust may be eliminated. In such a case, the property might pass to the surviving spouse and the children outright. Note that if minor children are income beneficiaries, their disclaimers could require the consent of guardians ad litem.

E. <u>Medicaid, Creditor & Bankruptcy</u>

Under New York law, if one disclaims, and by reason of such disclaimer that person retains Medicaid eligibility, such disclaimer may be treated as an uncompensated transfer of assets equal to the value of any interest disclaimed. This could impair Medicaid eligibility. In some states, if a disclaimer defeats the encumbrance or lien of a creditor, it may be alleged that the disclaimer constitutes a fraudulent transfer. Not so in New York and California, where a disclaimer may be used to defeat the claim of a creditor. In Florida, the result in contra: A disclaimer cannot prevent a creditor from reaching the disclaimed property. Will a qualified disclaimer defeat a claim of the IRS? No. Prior to a Supreme Court ruling, there had been a split in the circuits. The 2nd Circuit in United States v. Camparato, 22 F3d. 455, cert. denied, 115 S.Ct. 481 (1994) held that a federal tax lien attached to the “right to inherit” property, and that a subsequent disclaimer did not affect the federal tax lien under IRC §6321. The Supreme Court, in Drye v. United States, 528 U.S. 49 (1999), adopted the view of the Second Circuit, and held that the federal tax lien attached to the property when created, and that any subsequent attempt to defeat the tax lien by disclaimer would not eliminate the lien.

Bankruptcy courts have generally reached the same result as in Drye. The disclaimer of a bequest within 180 days of the filing of a bankruptcy petition has in most bankruptcy courts been held to be a transfer which the trustee in bankruptcy can avoid. Many courts have held that even pre-petition disclaimers constitute a fraudulent transfer which the bankruptcy trustee can avoid. If the Drye rationale were applied to bankruptcy cases, it would appear that pre-petition bankruptcy disclaimers would, in general, constitute transfers which the bankruptcy trustee could seek to avoid. However, at least one court, Grassmueck, Inc., v. Nistler (In re Nistler), 259 B.R. 723 (Bankr. D. Or. 2001) held that Drye relied on language in IRC §6321, and should be limited to tax liens.

IV. Frequently Litigated Issues

A. Acceptance of Benefits

The acceptance of benefits will preclude a disclaimer under state law. EPTL §2-11(b)(2) provides that “a person accepts an interest in property if he voluntarily transfers or encumbers, or contracts to transfer or encumber all or part of such interest, or accepts delivery or payment of, or exercises control as beneficial owner over all or part thereof . . . ”

Similarly, a qualified disclaimer for purposes of IRC §2518 will not result if the disclaimant has accepted the interest or any of its benefits prior to making the disclaimer. Treas. Regs. §25.2518-2(d)(1) states that acts "indicative" of acceptance include (i) using the property or interest in the property; (ii) accepting dividends, interest, or rents from the property; or (iii) directing others to act with respect to the property or interest in the property. However, merely taking title to property without accepting any benefits associated therewith does not constitute acceptance. Treas. Regs. §25.2518-2(d)(1). Nor will a disclaimant be considered to have accepted benefits merely because under local law title to property vests immediately in the disclaimant upon the death of the decedent. Treas. Regs. §25.2518-2(d)(1).

The acceptance of benefits of one interest in the property will not, alone, constitute an acceptance of any other separate interests created by the transferor and held by the disclaimant in the same property. Treas. Regs. §25.2518-2(d)(1). Thus, TAM 8619002 ruled that surviving spouse who accepted $1.75x in benefits from a joint brokerage account effectively disclaimed the remainder since she had not accepted the benefits of the disclaimed portion which did not include the $1.75x in benefits which she had accepted. The disclaimant's continued use of property already owned is also not, without more, a bar to a qualifying disclaimer. Thus, a joint tenant who continues to reside in jointly held property will not be considered to have accepted the benefit of the property merely because she continued to reside in the property prior to effecting the disclaimer. Treas. Regs. §25.2518-2(d)(1); PLR 9733008.

The existence of an exercised general power of appointment in a will before the death of the testator is not an acceptance of benefits. Treas. Regs. §25.2518-2(d)(1). However, if the powerholder dies having exercised the power, acceptance of benefits has occurred. TAM 8142008. The receipt of consideration in exchange for exercising a disclaimer constitutes an acceptance of benefits. However, the mere possibility that a benefit will accrue to the disclaimant in the future is insufficient to constitute an acceptance. Treas. Regs. §25.2518-2(d)(1); TAM 8701001. Actions taken in a fiduciary capacity by a disclaimant to preserve the disclaimed property will not constitute an acceptance of benefits. Treas. Regs. §25.2518-2(d)(2).

B. Separate & Severable Interests

A disclaimant may make a qualified disclaimer with respect to all or an undivided portion of a separate interest in property, even if the disclaimant has another interest in the same property. Thus, one could disclaim an income interest while retaining an interest in principal. PLR 200029048. So too, the right to remove a trustee was an interest separate from the right to receive principal or a lifetime special power of appointment. PLR 9329025. PLR 200127007 ruled that the benefit conferred by the waiver of the right of recovery under IRC §2207A would constitute a qualified disclaimer. A disclaimant makes a qualified disclaimer with respect to disclaimed property if the disclaimer relates to severable property. Treas. Regs. §25.2518-3(a)(1)(ii). Thus, (i) the disclaimer of a fractional interest in a residuary bequest was a qualified disclaimer (PLR 8326033); (ii) a disclaimer may be made of severable oil, gas and mineral rights (PLR 8326110); and (iii) a disclaimer of the portion of real estate needed to fund the obligation of the residuary estate to pay legacies, debts, funeral and administrative expenses is a severable interest. PLR 8130127.

C. Interest Passing Without Direction

To constitute a qualified disclaimer under federal tax law, the property must pass to someone other than the disclaimant without any direction on the part of the disclaimant. An important exception to this rule exists where the disclaimant is the surviving spouse: In that case the disclaimed interest may pass to the surviving spouse even if she is the disclaimant. Treas. Reg. §25.2518-2(e); EPTL §2-1.11(e). For disclaimants (other than a surviving spouse) who are residuary legatees or heirs at law, the disclaimant must therefore be especially careful not only to disclaim the interest in the property itself, but also to disclaim the residuary interest. If not, the disclaimer will not be effective with respect to that portion of the interest which the disclaimant has the right to receive. §25.2518-2(e)(3). To illustrate, in PLR 8824003, a joint tenant (who was not a surviving spouse) was entitled to one-half of the residuary estate. The joint tenant disclaimed his interest in the joint tenancy, but did not disclaim his residuary interest. The result was that only half of the disclaimed interest qualified under IRC §2518. The half that passed to the disclaimant as a residuary legatee did not qualify.

The disclaimant may not have the power, either alone or in conjunction with another, to determine who will receive the disclaimed property, unless the power is subject to an ascertainable standard. However, with respect to a surviving spouse, the rule is more lax: Estate of Lassiter, 80 T.C.M. (CCH) 541 (2000) held that Treas. Reg. §25.2518-2(e)(2) does not prohibit a surviving spouse from retaining a power to direct the beneficial enjoyment of the disclaimed property, even if the power is not limited by an ascertainable standard, provided the surviving spouse will ultimately be subject to estate or gift tax with respect to the disclaimed property. An impermissible power of direction exists if the disclaimant has a power of appointment over a trust receiving the disclaimed property, or if the disclaimant is a fiduciary with respect to the disclaimed property. §25.2518-2(e)(3). However, merely precatory language which is not binding under state law as to who shall receive the disclaimed property will not constitute a prohibited "direction". PLR 9509003.

E. Disclaimer of Fiduciary Powers

Limits on the power of a fiduciary to disclaim may have profound tax implications. PLR 8409024 stated that the trustees could disclaim administrative powers the exercise of which did not "enlarge or shift any of the beneficial interests in the trust." However, the trustees could not disclaim dispositive fiduciary powers which directly affected the beneficial interest involved. This rule limits the trustee's power to qualify a trust for a QTIP election.

F. Infants, Minors & Incompetents

In some states, representatives of minors, infants, or incompetents may disclaim without court approval. However, EPTL §2-1.11(c), while permitting renunciation on behalf of an infant, incompetent or minor, provides that such renunciation must be "authorized" by the court having jurisdiction of the estate of the minor, infant or incompetent. In Estate of Azie, 694 N.Y.S.2d 912 (Sur. Ct. 1999), two minor children were beneficiaries of a $1 million life insurance policy of their deceased father. The mother, who was the guardian, proposed to disclaim $50,000 of each child. The proposed disclaimer would fund a marital trust and would save $40,000 in estate taxes. The Surrogate, disapproving of the proposed disclaimer, stated that the disclaimer must be advantageous to the children, and not merely to the parent.

I. Timeliness of Disclaimer

Vexing tax issues may arise where a disclaimer would be valid under the EPTL but not under the Internal Revenue Code. EPTL §2-1.11-(b)(2) provides that a renunciation must be filed with the Surrogates court within 9 months after the effective date of the disposition, but that this time may be extended for "reasonable cause." Further, EPTL §2-1.11(a)(2)(C) provides that the effective date of the disposition of a future interest "shall be the date on which it becomes an estate in possession." Since under IRC §2518, a renunciation must be made within 9 months, the grant of an extension by the Surrogates court of the time in which to file a renunciation might result in a valid disclaimer for New York purposes, but not for purposes of federal tax law. Similarly, while the time for making a renunciation of a future interest court may be extended under EPTL §2-1.11(a)(2)(C), such an extension would be ineffective for purposes of IRC §2518.

J. Jointly Owned Property

The rules for disclaiming jointly owned property can generally be divided into two categories: (i) joint bank, brokerage and other investment accounts where the transferor may unilaterally regain his contributions; and (ii) all other jointly held interests. With respect to (i), the surviving co-tenant may disclaim within 9 months of the transferor's death, but only to the extent that the survivor did not furnish consideration. With respect to (ii), for all other interests held jointly with right of survivorship or as tenants by the entirety, a qualified disclaimer of the interest to which the disclaimant succeeds upon creation must be made no later than 9 months after the creation. A qualified disclaimer of an interest to which the disclaimant succeeds upon the death of another (i.e., a survivorship interest) must be made no later than 9 months after the death of the first tenant. This is true (i) regardless of the portion of the property contributed by the disclaimant; (ii) regardless of the portion of the property included in the decedent's gross estate under IRC §2040; and (iii) regardless of whether the property is unilaterally severable under local law.