



Use of Disclaimers

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Your wealthy Uncle Louie dies leaving a trust. It says, “Nephew, I leave you my \$500,000 diamond.” What response might you have? You most likely will grab the diamond and run. Do you know that you can politely decline to accept the diamond?

Believe it or not, in administering the estate of a deceased person, declining to accept the diamond may be the best choice! In estate planning, this refusal to accept the property is called a “disclaimer.” By disclaiming you are legally saying, “I know you have left me the diamond, but I do not want to accept it. Treat me as though I died before you, and let the diamond pass to the next person in line.”

Disclaimer planning can be used when there is no will or when there is a will or a trust. If there is no will, every state has intestate laws which list the order a person’s assets pass upon death. If you are the person who will receive the assets under the law and you disclaim, the assets go to the next listed person. If the person who dies has a will or a trust, that document, if properly drafted, will specify who receives the assets if you disclaim.

Disclaimers may be used in any situation where a person is left an inheritance. This includes being named in pay-upon-death accounts or as the survivor in property titled “with right of survivorship.” You may also use a disclaimer when you are named as a beneficiary under a life insurance policy or a retirement asset, such as a 401(k) plan or an IRA. You may disclaim all or only a part of what is left to you.

An effective disclaimer is “qualified” under the Internal Revenue Code and satisfies the requirements of state law. Generally, you must deliver a disclaimer in writing to the donor or personal representative of the estate within nine months of the gift or the decedent’s death, respectively, and before you receive benefits from owning the property (e.g., rental or dividend income). You should contact a knowledgeable attorney immediately after the death of an individual to determine if a disclaimer will be helpful, which will prevent you from taking actions that may make it impossible for you to disclaim, and to make sure the disclaimer will be qualified under state and federal law.

Disclaiming may make sense in situations where a husband and wife have provisions

in their will or trust that create a Bypass Trust, passing property to the children at the first death and taking advantage of the federal estate tax exemption, and a Marital Trust, passing property to the surviving spouse and taking advantage of the marital deduction. This approach is used primarily to legally avoid or minimize estate taxes for the children upon the second spouse's death. The Bypass Trust is an irrevocable trust that locks in its terms and beneficiaries such that the surviving spouse can not change them. The Marital Trust usually allows the surviving spouse to change its terms and do whatever he or she wants to do with the assets.

EXAMPLE 1. Assume that on the first death a will or trust provides that the property of the spouse who died will go to the Bypass Trust and the surviving spouse's property will go to the Marital Trust. The will or trust also provides that any assets disclaimed by the beneficiaries of the Bypass Trust will go to the Survivor's Trust and any assets disclaimed by the beneficiaries of the Marital Trust will go to the Bypass Trust. Assume further that each spouse has \$2 million in assets and that the amount each spouse can pass to their children free of estate tax is \$3.5 million. In this example, no disclaimer is necessary as this structure allows the \$2 million on the death of the first spouse and \$2 million on the death of the second spouse to pass to the children free of estate tax.

EXAMPLE 2. Continuing the above example, if the family did not think the surviving spouse had sufficient assets for his or her lifetime or maintaining the Bypass Trust would be problematic, the beneficiaries of the Bypass Trust might disclaim all or part of their interest.

EXAMPLE 3. Again continuing the above example, if the surviving spouse is concerned that the maximum amount allowed (\$3.5 million exemption in 2009) was not passed to the children at the first spouse's death, then the surviving spouse, as Trustee of the Marital Trust, might disclaim some of the property passing to the Marital Trust.

There may be problems associated with disclaiming from a Bypass Trust due to the fiduciary duties owed to the children by the Trustee. In such a situation, a will or trust may be written to provide that both spouses' property will go to the Marital Trust. If the combined estate of both spouses is \$2 million and the amount that can pass free of estate tax on the second death is \$3.5 million, no disclaimer will be filed. If the combined estate is \$5 million and the amount that can pass free of estate tax is \$3.5 million, the surviving spouse, as trustee of the Marital Trust, will disclaim \$1.5 million of the inheritance from the deceased spouse. The amount may be larger or smaller depending on the expected growth in the value of the assets and the spending needs of the surviving spouse, but the property now goes to the Bypass Trust and estate taxes are avoided when the surviving spouse dies. The same result is accomplished without violating any duties owed to the children by the Trustee of the Bypass Trust. The risk is that more estate tax may be owed if the surviving spouse does not want to give up control of the property.

Disclaimer planning between the Bypass Trust and the Marital Trust allows estate

tax planning to occur upon the death of the first spouse when the total estate value and the Congressionally determined estate tax exemption are known. In most cases, this flexibility is lost if the planning documents are not drafted anticipating possible disclaimer planning and an attorney knowledgeable in disclaimer planning is not consulted immediately after the death of the first spouse.

David J. Harowitz, P.C. limits their practice to helping clients plan ownership and distribution of their assets to maximize the clients' goals while minimizing taxes, costs, and risks.

