THANKS BUT NO THANKS – DISCLAIMING ASSETS, INTERESTS, AND POWERS

By: Ann B. Burns

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Thanks But No Thanks – Disclaiming Assets, Interests, and Powers

By: Ann B. Burns

I. Introduction

Disclaimers are used for both tax and non-tax purposes and can provide flexibility in an estate plan and the ability to correct errors that are discovered after the date of death. Fortunately, it is possible to disclaim assets, interests, and powers in both an individual and fiduciary capacity. Unfortunately, the rules can be complex.

The general rule stated in I.R.C. § 2518(a) is that a disclaimed interest is treated as if the interest had never been transferred to the disclaimant. Although the words are different, the principles are the same in state statutes and the Uniform Disclaimer of Property Interests Act (1999). In effect, a disclaimer is a way of declining to accept a gift, bequest, or other transfer with the result that the property passes to the next taker.

Who may disclaim, what is required to make a qualified disclaimer, and what effect is intended by the words "as if the interest had never been transferred" are not simple matters. Regulations, rulings, and court pronouncements provide substantial guidance in the area of qualified disclaimers, although some of the nuances continue to present problems for practitioners. Disclaimers can be used in many creative ways to obtain tax advantages, correct errors in an estate plan, provide flexibility in many estate planning settings, and provide both tax and non-tax benefits to intended beneficiaries. In order to make the fullest use of disclaimers, a practitioner must be familiar with the requirements of both state law and federal tax law for making an effective disclaimer.

II. Internal Revenue Code § 2518

A. Overview

I.R.C. § 2518, although contained in the gift tax section of the tax code, provides the requirements of a qualified disclaimer for purposes of federal gift, estate, and generation-skipping transfer taxes. I.R.C. §§ 2046 and 2654(c), with respect to estate taxes and generation-skipping transfer taxes, respectively, succinctly state that "[f]or provisions relating to the effect of a qualified disclaimer for purposes of this chapter, see section 2518."

Section 2518 spells out the requirements that must be met for a disclaimer to be a qualified disclaimer for tax purposes:

1. The disclaimer must be in writing,

2. The writing must be received by the transferor of the interest or the holder of legal title to the property within nine months after the later of: (a) the date on which the transfer creating the interest was made; or (b) the date on which the disclaiming person attains age 21,

3. The disclaiming person must not have accepted the interest or any of its benefits,

4. As a result of the disclaimer, the interest must pass without any direction on the part of the disclaiming person, and

5. The interest passing as a result of the disclaimer must pass either: (a) to a person other than the disclaiming person; or (b) to the spouse of the decedent.

A power held with respect to property is treated as an interest in the property for purposes of Section 2518 and a disclaimer may be made of an undivided portion of an interest in the property.

With respect to transfers creating an interest in property prior to 1977, Treas. Reg. § 25.2511-1(c)(2) provides that a disclaimer may be made within a reasonable time after knowledge of the existence of the transfer. This outline, generally, is limited to a discussion of disclaimers of post-1976 interests.

B. Timing of the Disclaimer

1. When Does a Transfer Occur?

A qualified disclaimer must be made within nine months after the transfer creating the interest or the day the disclaiming person attains the age of 21. The regulations provide specific guidance with respect to when various types of transfers were made. Treas. Reg. § 25.2518-2(c)(3) provides that the nine-month period is determined with respect to the date of the transfer as follows:

(1) With respect to an *inter vivos* transfer, the transfer occurs when there is a completed gift for federal gift tax purposes, regardless of whether a gift tax is imposed on the completed gift.

(2) With respect to transfers made by a decedent at death, or transfers that become irrevocable at death,

the transfer occurs on the date of the decedent's death, even if no estate tax is imposed.

(3) If an *inter vivos* transfer is later included for estate tax purposes in the gross estate of the transferor, the nine-month period for making the qualified disclaimer is determined with reference to the earlier transfer creating the interest.

(4) The holder of a general power of appointment has nine months from the date of the creation of the power within which to disclaim the power.

(5) The person to whom an interest in property passes by reason of the exercise or lapse of a general power of appointment must make a disclaimer within nine months after the exercise, release, or lapse of the power regardless of whether the exercise, release, or lapse is subject to a gift or estate tax.

(6) The holder, permissible appointees, or takers in default, of a non-general power of appointment must disclaim within nine months after the original transfer that created the non-general power of appointment.

(7) A life tenant or remainder beneficiary (whether their interests are vested or contingent) must disclaim within nine months after the original transfer creating the life income or remainder interest.

(8) In the case of Qualified Terminable Interest Property (QTIP), the remainder beneficiary must disclaim within nine months of the date of the transfer creating the interest.

(9) The recipient of an interest in property resulting from a qualified disclaimer must disclaim the interest within nine months after the date of the transfer creating the interest, not within nine months after the date of the original disclaimer.

2. Gift Included in Gross Estate.

Treas. Reg. § 25.2518-2(c)(3) provides that where a transfer creating an interest for federal gift tax purposes is also later included in the transferor's gross estate for federal estate tax purposes, the nine month period for making a qualified disclaimer begins to run from the earlier date of the transfer creating the interest. Therefore, if a lifetime transfer is later included in the transferor's estate under Sections 2035, 2036, 2038, or 2041, the disclaimer period does not begin to run on the date of the transferor's death but rather begins to run on the date of the original *inter vivos* transfer.

3. Pre-1942 General Power of Appointment.

A 2008 private letter ruling demonstrates the rule as to when a transfer occurs for a lapse of a general power of appointment created prior to October 22, 1942. I.R.S. Priv. Ltr. Rul. 200825037 (June 20, 2008) involved an irrevocable trust created prior to October 22, 1942 in which the grantors created a trust for their child for life with the remainder passing to that child's descendants. The child held a general power of appointment which she had not exercised at the time of her death. After the child's death, the child's daughter, her former spouse, and their children wished to disclaim portions of their interests in the trust. The disclaimants requested rulings that:

(1) The deceased child had a general power of appointment created before October 22, 1942.

(2) The deceased child's power lapsed at her death and the trust was not included in her gross estate.

(3) The successive beneficiaries' powers of appointments over their trust shares were general powers of appointments created before October 22, 1942.

(4) The proposed disclaimers of interests in the trust were qualified disclaimers that would not result in adverse gift, estate, or generation-skipping transfer tax results.

In finding favorably for the taxpayers, the Service determined that under Treas. Reg. § 20.2041-2(d) the lapse of a pre-October 22, 1942 general power of appointment is not an exercise of the power and therefore, the value of the trust is not includable in the deceased child's gross estate for federal estate tax purposes. Because power was not included in her estate

for estate tax purposes, under Treas. Reg. § 25.2518-2(c)(3), the period for making the disclaimers is measured from the date of the deceased child's death, which is the date the interest is deemed to be created. Accordingly, the daughter and other trust beneficiaries were able to disclaim portions of their interests in the trust within the nine month period after the death of the deceased child.

4. Successive Disclaimers.

An interest arising pursuant to a prior disclaimer must still be disclaimed within nine months of the creation of the initial interest. The timing of successive disclaimers was illustrated in I.R.S. Priv. Ltr. Rul. 200442027 (Oct. 15, 2004). In that ruling, a husband created an *inter vivos* trust for the benefit of his wife. The trust agreement provided that the Trust would be administered as a single trust, also referred to as the "Initial Trust," for nine months. During that time, the trustee was required to distribute all income to the wife and had discretion to distribute principal to her as well. At the expiration of the nine-month period, the assets would be distributed to the wife outright or, if she was not living, to her estate. The trust also provided that if the wife disclaimed her interest in the initial trust the disclaimed assets would be held in another trust and if she chose to disclaim her interest in the succeeding trust an additional trust would be created. The trust document provided that up to four successive trusts could be created by disclaimer from the initial trust. The Initial Trust and Trusts 2 and 3 apparently were designed to qualify for the marital deduction, but the terms of Trusts 4 and 5 provided that income and principal could be distributed to the wife and to the husband's descendants.

The wife planned to make four disclaimers successively to allow for the funding, ultimately, of Trust 5. The taxpayers requested a ruling that the proposed series of disclaimers would be qualified disclaimers under Section 2518. With respect to the timing of the disclaimers, the Service ruled that the disclaimers would be qualified disclaimers if they all were made within the nine-month period after the date of death of the husband.

Unfortunately, there may be circumstances in which the holders of the successive interests are not informed or are not aware of their interests that arise as a result of prior disclaimers. In this private letter ruling, for example, the husband's descendants might have been aware of their remainder interests in the Initial Trust well within the nine-month disclaimer period. However, not until after the wife's disclaimers of her interests in the Initial Trust and Trusts 2, 3, 4 and 5 would the husband's descendants have been aware that they were permissible distributees of principal from Trust 5. Nonetheless, any disclaimers by the husband's

descendants of their interests in any of the trusts must be filed within nine months of the date of death of the husband.

C. No Acceptance Allowed

1. What is Acceptance?

An important requirement of Section 2518, but one that is often difficult to meet, is that the person disclaiming an interest may not have accepted any benefit of that interest prior to the disclaimer. This requirement arises from the underlying policy that a qualified disclaimer will result in an interest being treated as if the interest had never been transferred to the disclaiming person. If the disclaiming person had already enjoyed the benefits of the property or had accepted some portion of the interest, the interest could no longer be treated as if it had never been transferred to the disclaiming person.

Treas. Reg. § 25.2518-2(d)(1) provides that acceptance "is manifested by an affirmative act which is consistent with ownership of the interest in property." The regulation describes acts that are indicative of acceptance including: (a) using the property; (b) accepting dividends, interest, or rents from the property; and (c) directing others to act with respect to the property. On the other hand, merely accepting delivery of an instrument of title does not constitute acceptance; nor does the operation of state law that indicates that title vests immediately upon the death of the prior owner. Further, the acceptance of one interest in property will not, in and of itself, constitute an acceptance of other separate property interests created by the same transferor. In the case of a residence held in joint tenancy, continuing to reside in the property is not tantamount to acceptance. The exercise of a power of appointment to any extent is an acceptance of its benefits.

2. Curing Acceptance by Segregating Accounts.

In I.R.S. Priv. Ltr. Rul. 200503024 (Jan. 21, 2005), the Service ruled that a disclaimer by a surviving spouse of a one-half survivorship interest in a joint brokerage account was a qualified disclaimer in spite of the fact that the surviving spouse had made at least one cash withdrawal from the account, had sold some securities in the account and had purchased securities in the account prior to the date of the disclaimer. After the date of the husband's death the wife changed the title on the joint brokerage account to her name alone and bought and sold securities in the account. She also made cash withdrawals from the account and shortly before the expiration of nine months after the husband's death, the wife disclaimed a one-half survivorship interest in the account.

The taxpayer cured the acceptance of benefits problem by having the wife disclaim the husband's share of the account minus the assets in that share of which the wife had previously received benefits. After the disclaimer, the account was divided into three parts. One part, called the "Tenants in Common Account," held the assets that could not be evenly divided. This account did not include any proceeds from the securities sold or any of the securities purchased after the husband's death. The remaining assets were divided between the wife's account and the estate account with the wife's account containing the assets attributable to her contributions to the brokerage account and assets attributable to the husband's contributions over which the wife had either directed sales or purchases after his death. The estate account held only assets attributable to contributions of the husband over which the wife had not accepted any benefits. The wife's disclaimer of the estate account was determined to be a qualified disclaimer. The Service also concluded that merely transferring the account into the wife's name after the husband's death did not amount to acceptance of the interests.

3. Acceptance of Some Trust Benefits Is Not Acceptance of Others.

In I.R.S. Priv. Ltr. Rul. 200516004 (Apr. 22, 2005), the Service held that a disclaimer of a contingent remainder interest by a beneficiary of a trust was a qualified disclaimer notwithstanding that the beneficiary had accepted discretionary trust distributions because a contingent remainder interest was severable from a discretionary distribution interest under state law. In this ruling, the taxpayer was a beneficiary of trusts that provided that distributions could be made to the taxpayer and others in the event of illness, accident, misfortune, or emergency, or as necessary for comfort, maintenance, support, or education. The taxpayer had received discretionary distributions from one of four trusts. All of the trusts provided that upon termination the trusts would be distributed to the descendants of the taxpayer's grandparent *per stirpes*. The taxpayer, as one of the descendants, had a contingent remainder interest in the trusts.

Within nine months after reaching the age of 21, the taxpayer disclaimed his contingent remainder interest in all of the trusts. Under state law, a contingent remainder interest was severable from the right to receive discretionary distributions and the IRS determined that acceptance of the discretionary distributions did not prohibit the taxpayer from disclaiming the contingent remainder interests.

4. Exercise of Power of Appointment is Acceptance.

In *Estate of Engelman v. Comm'r*, 121 T.C. 54 (2003), the Tax Court determined that the exercise of a power of appointment was tantamount to

acceptance of the underlying property and precluded a qualified disclaimer. Sam and Leona Engelman created a joint revocable trust that provided that on the death of the first spouse all assets would be allocated to Trust A. Any assets disclaimed by the surviving spouse passed to Trust B. The surviving spouse also was granted a testamentary power of appointment over Trust A. Upon Sam's death, Leona exercised by will a power of appointment directing the disposition of the assets of Trust A upon her death. She died approximately one month later. After her death, the special administrator of her estate executed a disclaimer of her interest in Trust A to utilize her estate tax exemption. The disclaimed assets were placed in Trust B.

The IRS determined that the disclaimer was ineffective because Leona's exercise of the power of appointment constituted acceptance of the benefits of the trust assets. The estate argued that the disclaimer related back to the date of Sam's death and accordingly, the power of appointment was ineffective. The Tax Court determined that the exercise of a power of appointment is acceptance under the statute and the subsequent disclaimer was not a qualified disclaimer under Section 2518.

5. No Consideration Found in Implied Promises.

In *Estate of Monroe v. Comm'r*, 124 F.3d 699 (5th Cir. 1997), the Service challenged the disclaimers made by various beneficiaries of the decedent's estate which benefited the decedent's husband based on evidence showing that the decedent's husband had made gifts to the disclaimants previously and had made at least implied promises that he would continue to provide for their needs in the future. The Service argued that this implied agreement provided consideration for the disclaimers and resulted in acceptance of some of the benefits of the disclaimed interest. The court upheld the disclaimers as qualified disclaimers under Section 2518 determining that a mere "expectation of a future benefit in return for executing a disclaimer" did not disqualify the disclaimer. *Id.* at 709.

In *Monroe*, the disclaimant personally asked 29 legatees to relinquish their gifts under the decedent's estate plan in order to significantly reduce the estate taxes on the estate. The will called for each bequest to bear its own portion of estate taxes and in some cases their proportionate share of the generation-skipping transfer taxes. The overall tax liability would be significantly reduced if the legatees disclaimed their legacies. In December 1989, 29 legatees executed disclaimers which were valid under Louisiana law. In late December 1989 and January 1990, the residuary beneficiary of the estate (who benefitted from the disclaimers) wrote each of the disclaimants a personal check in an amount equal to the gross amount of the bequest that had been disclaimed.

The tax court agreed with the Commissioner on 28 of the 29 disclaimers holding that the disclaimers were not qualified disclaimers under Section 2518(b). The Fifth Circuit upheld the disclaimers ruling that the disclaimants' "mere expectation of a future benefit in return for executing a disclaimer" does not amount to consideration for the disclaimer and does not disqualify the disclaimer. *Id.* at 709. Several of the disclaimants testified that they understood that they were under no obligation to renounce the gift and decided to do so for their own personal reasons. The testimony was that the disclaimants were not promised any gifts as a result of their disclaimer, nor were they given any commitment that future gifts would be made.

The circuit court also rejected the Commissioner's arguments that the tax court decision should be affirmed on substance-over-form or step-transaction grounds. The court stated that "while the disclaimants, to varying degrees, may have thought they would eventually receive something from Monroe, even the actual amount of their legacy, the evidence shows that most really believed they were, in fact, giving up their legacy under Louise Monroe's will." *Id.* at 714. The court was influenced also by the fact that some of the legatees sought outside counsel before making their decisions to disclaim.

D. Passage Without Direction By Disclaimant

1. What is Direction?

Treas. Reg. § 25.2518-2(e) provides that a disclaimed interest must pass, without any direction on the part of the disclaimant, to a person other than the disclaimant or to the surviving spouse. This regulation further provides that if "there is an express or implied agreement that the disclaimed interest in property is to be given or bequeathed to a person specified by the disclaimant," the disclaimer will not be a qualified disclaimer. The disclaimant may not direct the redistribution or transfer of the property to another person unless the power to do so is limited by an ascertainable standard. Treas. Reg. § 25.2518-2(e)(1)(i) and (ii).

The regulations further provide that a disclaimer made by a surviving spouse may be a qualified disclaimer as long as the interest passes as a result of the disclaimer without direction on the part of the surviving spouse and the interest passes either to the surviving spouse or to another person. The surviving spouse may not retain the right to direct the beneficial enjoyment of the disclaimed property unless the power is limited by an ascertainable standard. A disclaimer containing precatory language naming takers of the disclaimed property will not be considered to direct the redistribution or transfer of the property if applicable state law gives the language no legal effect. Treas. Reg. § 25.2518-2(e)(4).

Numerous examples set forth in Treas. Reg. § 25.2518-2(e)(5) illustrate the rule that disclaimed property must pass without the direction of the disclaimant and must pass either to the decedent's surviving spouse or to a person other than the disclaimant. One such example involves a will designed to pass the entire estate to D except that if D disclaims one-third of the estate it will pass to E, if D disclaims a second third of the estate it will pass to F, and if D disclaims the final third of the estate it will pass to G. D attempts to disclaim solely the interest passing to E. The regulation states that D has effectively directed that the disclaimed property will pass to E and therefore, D's disclaimer is not a qualified disclaimer under Section 2518(a). Treas. Reg. § 25.2518-2(e)(5) E.g. (9). A following example states the matter somewhat differently. In Example 10, the will provides that D will receive Blackacre and Whiteacre. The will provides that if D disclaims Blackacre it will pass to E, and if D disclaims Whiteacre it will pass to F. D specifically disclaims Blackacre with the intention that it will pass to E. Assuming all other requirements of Section 2518 are met D has made a qualified disclaimer of Blackacre.

2. Disclaimer to Private Foundation.

The question of whether the disclaiming person has the power to direct the passage or subsequent enjoyment of the disclaimed property often arises when the disclaimed property passes to a private foundation in which the disclaiming person has some involvement. In I.R.S. Priv. Ltr. Rul. 200802010 (Jan. 11, 2008), the daughters of a decedent proposed to disclaim certain trust property with the result that the disclaimed property would pass pursuant to the decedent's will to private foundations established or to be established by the daughters. The decedent was survived by two daughters and each proposed to disclaim her entire interest in certain identified securities passing to them with the result that the assets disclaimed by Daughter 1 would pass into a foundation established by her known as Foundation 1 and the assets disclaimed by Daughter 2 would pass to a foundation established by her known as Foundation 2.

Investment decisions for each of the foundations were made by the board of directors for each foundation. Each daughter was a member of the board of directors of her own foundation. The bylaws of the foundations were amended to provide that any assets deposited to the foundation as a result of a qualified disclaimer executed by any director or officer of the foundation were to be segregated and maintained in separate accounts so that the disclaiming director would be excluded from any decisions involving the disclaimed assets. The daughters would have no power to make any determination with respect to distributions of income or principal from the segregated funds.

The Service ruled that the proposed disclaimers to the private foundations would constitute qualified disclaimers under Section 2518 because neither daughter had retained any power to direct the beneficial enjoyment of the disclaimed property.

E. Severable Interests

1. Partial Disclaimers.

Treas. Reg. § 25.2518-3 governs the disclaimer of less than an entire interest in property. Essentially, a qualified disclaimer may be made of an undivided portion of any separate interest in property even if the disclaiming person has another interest in the same property. For example, a person may disclaim an income interest for life in an asset or a trust while retaining the remainder interest in the same asset or trust. Likewise, a person may disclaim the remainder interest and retain the income interest. The regulations do not allow, however, for a person to make a qualified disclaimer of an income interest for a term of years. Treas. Reg. § 25.2518-3(a)(1)(i).

The question of whether a separate interest may be disclaimed depends on whether the interest is severable. Treas. Reg. § 25.2518-3(a)(1)(ii) provides that severable property is property "which can be divided into separate parts each of which, after severance, maintains a complete and independent existence." What interests are severable and may be disclaimed remains a difficult question even today.

2. Disclaimer Cannot Carve Out Income Interest.

The Eighth Circuit in *Estate of Walshire v. U.S.*, 288 F.3d 342 (8th Cir. 2002), upheld the validity of Treas. Reg. § 25.2518-3(b) in determining that a disclaimer could not operate to carve out an income interest in the disclaimed property. In *Walshire*, the taxpayer attempted to disclaim a remainder interest in his share of his brother's estate while retaining an income interest in the disclaimed property. The entire property had been devised to him outright by his brother. The taxpayer argued that the statute allows a disclaimer of "an undivided portion of an interest" in property and the regulation should be read to allow a disclaimer to carve out the income interest from the remainder interest. The taxpayer argued that although the regulation precluded the disclaimer to carve out an income interest, the regulation was contrary to the clear and unambiguous language of Section 2518 and should be held to be invalid.

The court held that a remainder interest is not an undivided portion and upheld the regulation's prohibition on "horizontal" divisions of property. The court's discussion of horizontal versus vertical divisions of property

confirmed that disclaimers may be made of a percentage, a fraction, a dollar amount, or other severable interest, but may not be made to carve out an income interest, or an interest for a term of years. The *Walshire* court determined that the taxpayer had attempted to divide the property into parts that did not maintain a complete and independent existence and therefore, were not severable property. To bootstrap its holding, the court also determined that by accepting the income from the assets the taxpayer had accepted a benefit of the remainder interest with the result that the disclaimer was not a qualified disclaimer.

3. Remainder Interest in Charitable Trust Was Not Severable

The Tax Court wrestled with the definition of a severable interest in *Estate of Christiansen v. Comm'r*, 130 T.C. 1 (2008). Helen Christiansen died leaving her entire estate to her only child, Christine Hamilton. Christiansen's will also provided that if Hamilton disclaimed any portion of the estate, 75% of the disclaimed portion would pass to a charitable lead trust and 25% would pass to Christiansen's private foundation. Christiansen disclaimed by formula a fractional portion of the gift, the details and validity of which are discussed more fully in section IV.C.2. of these materials. The court addressed the question of whether the disclaimer was valid as to the assets passing to the charitable lead trust.

The charitable lead trust had been designed to provide for payments to charity for 20 years beginning after Christensen's death and at the end of the 20 year term to pay the remaining assets to Hamilton. If Hamilton were not living at the termination of the trust, the property would pass to the foundation. The Service argued the fact that Hamilton did not disclaim her contingent remainder interest in the charitable lead trust failed the tests of Section 2518 because the disclaimed property did not pass solely to a person other than Hamilton. *See* I.R.C. § 2518(b)(4) and Treas. Reg. § 25.2518-2(e)(3).

The estate did not take a charitable deduction for the value of the remainder interest that would pass to Hamilton, but did claim a charitable deduction for the portion of the disclaimed property that would pass to the charitable beneficiary during the 20 year lead term of the trust. The Service argued that the interests were not severable and accordingly no charitable deduction should be allowed.

The Tax Court agreed with the Service's argument relying on Treas. Reg. § 25.2518-2(e)(3) which provides:

> If the portion of the disclaimed interest in property which the disclaimant has a right to receive is not severable property or an undivided portion of the property, then the

> disclaimer is not a qualified disclaimer with respect to any portion of the property. Thus, for example, *if a disclaimant who is not a surviving spouse receives a specific bequest of a fee simple interest in property and as a result of the disclaimer of the entire interest, the property passes to a Trust in which the disclaimant has a remainder interest, then the disclaimer will not be a qualified disclaimer unless the remainder interest in the property is also disclaimed.*

(Emphasis supplied by court). The court discussed at length Hamilton's argument that her remainder interest in the charitable lead trust was severable property and need not be disclaimed.

The court likened the definition of severable property to the definition of a molecule – "the smallest particle of a substance that retains the properties of that substance." *Id.* at 11. Likewise, the court examined the term "an undivided portion of the property" from Treas. Reg. § 25.2518-3(b) which specifically provides an example of a disclaimer of a remainder interest in Blackacre with a retained life estate. The court undertook a discussion of *Walshire* repeating that court's argument that: "[d]isclaiming a vertical slice – from meringue to crust – qualifies; disclaiming a horizontal slice – taking all the meringue, but leaving the crust – does not." *Id.* at 12. The court reasoned that the only difference between *Christiansen* and *Walshire* is that in *Walshire*, the taxpayer disclaimed the remainder interest and kept the income and in this case, Hamilton tried to do the reverse. The court determined that her disclaimer was not a qualified disclaimer.

In lengthy concurring and dissenting opinions, the judges discussed the meaning of "severable property." Judge Kroupa, who had been the trial judge in the case, indicated that she found the charitable intent of Christiansen and Hamilton to be compelling, and she would have allowed a charitable deduction for the portion of the disclaimed property attributable to the charitable interest in the charitable lead trust. Judge Kroupa found persuasive the fact that the annuity interest and contingent remainder interests in the charitable lead trust were created by Christiansen, the transferor, and not as a result of the disclaimer as in *Walshire*. Accordingly, Hamilton "did not create or carve out a particular interest for herself and disclaim the rest." *Id.* at 29. Judge Kroupa also distinguished the holding in *Walshire* because there the interests at issue were an income interest and a remainder interest rather than an annuity interest and a remainder interest.

The dissent argued that the holder of an annuity interest could do nothing to affect the contingent remainder and vice versa, reasoning that the "two separate parts are in no way dependent on one another." *Id.* at 32. The

dissenting rationale rested in part on the fact that the separate interests were created by the transferor and not by operation of the disclaimer.

A separate concurring opinion elaborated on why Hamilton's remainder interest in the charitable lead trust and the charity's 20-year annuity were not severable by discussing two examples. In the first, T devised the income from a farm to A for life, then to B for life, with the remainder passing to A's estate. The concurring opinion stated that A's life estate and remainder interest in the property were "separate transferor-created interests" and that A could make a qualified disclaimer of any portion of either the income interest or the remainder. *See* Treas. Reg. § 25.2518-3(a)(1)(i). The concurring opinion reasoned that although the life estate and the remainder were separate interests they were not severable property, and accordingly, A could not make a qualified disclaimer of the income from the property for a term of years.

By contrast, in the other example, the concurring judges assumed that T devised a fee simple in the farm to A. Neither a life estate or a remainder interest in the farm was a separate transferor-created interest nor were they severable property interests. Accordingly, A could make a qualified disclaimer of all or any portion of the farm but could not retain a life estate under the rational of *Walshire*. By way of these examples, the concurring opinion determined that although an interest may be severable as the term is used in Section 2055, a remainder following a life estate or a term of years, or an annuity is not severable as that term is used for purposes of Section 2518. The concurring opinion concluded that the remainder interest is entirely dependent on the annuity because it is "affected by the amounts distributed to the annuitant, and by the source of those distributions, either from income or corpus." *Id.* at 24.

F. State Law Validity Required.

Section 2518 was enacted to create certainty and uniformity in the federal tax law of disclaimers, with the intention that the effects of the variances among state disclaimer statutes would be minimized. Section 2518(c)(3) is intended to allow disclaimers that fail under state law to be qualified disclaimers for tax law purposes if they otherwise meet the requirements of Section 2518. That section provides that the written transfer of the transferor's entire interest in the property that meets requirements similar to those set forth in Section 2518(b)(2) and (3) and passes to a person who would have received the property had the transferor made a qualified disclaimer will be treated as a qualified disclaimer. The regulations state that a disclaimer of an interest created prior to 1982 may be a qualified disclaimer even though the disclaimer was not effective under local law. Treas. Reg. § 25.2518-1(c)(1)(i). Such a disclaimer that is not effective under applicable local law may be a qualified disclaimer if, under applicable law, the disclaimed interest is transferred, "as a result of attempting the disclaimer, to

another person without any direction on the part of the disclaimant." However, the regulations contain an example of a qualified disclaimer that was not effective because the disclaimer was not made during the nine month period under Section 2518, although it was made within the "reasonable time" period allowed by state statute. Treas. Reg. § 25.2518-2(c)(5) E.g. (5).

Notwithstanding the savings clause of Section 2518(c)(3), other state law requirements must still be followed. For example, a state law requirement that the disclaimer be filed with a court and state laws governing the authority of a fiduciary to disclaim must still be met. Additionally, state law governs the authority of a fiduciary to disclaim and to whom disclaimed property passes.

III. Uniform Disclaimer of Property Interests Act (1999) (UDOPIA)

A. Generally

The National Conference of Commissioners on Uniform State Laws approved the Uniform Disclaimer of Property Interests Act (1999) (UDOPIA) ("the Act") and recommended it for adoption by the states. The 1999 Act updated and replaced three other disclaimer acts: The Uniform Disclaimer of Property Interests Act, the Uniform Disclaimer of Transfers by Will, In Testate or Appointment Act, and the Uniform Disclaimer of Transfers Under Nontestamentary Instruments Act.

The Act provides authority to make disclaimers, describes what interests may be disclaimed, specifies the time when disclaimers are effective, and articulates the effect that a disclaimer has on disclaimed property interests. Additionally UDOPIA contains provisions specifying who may disclaim and what interests may be disclaimed. UDOPIA added express authorization for the disclaimer of powers of appointment, which previously had not been authorized by the Uniform Acts. One of the most significant aspects of UDOPIA is that it does not express any time limits for making an effective disclaimer. The introduction and summary of the Act specifically state that under UDOPIA "there is no link to federal tax law limits, but, of course, federal tax law continues to control the effectiveness of any disclaimer for tax purposes."

The rationale for the decoupling of the Uniform Disclaimer Statute from the requirements of I.R.C. § 2518 is explained in the prefatory note as follows:

> Because a disclaimer is a refusal to accept, the only bar to a disclaimer should be acceptance of the offer. In addition, in almost all jurisdictions disclaimers can be used for more than tax planning. A proper disclaimer will often keep the disclaimed property from the disclaimant's creditors. In

> short, the new Act is an enabling statute which prescribes all the rules for refusing a proffered interest in or power over property and the effect of that refusal on the power or interest while leaving the effect of the refusal itself to other law.

The decision not to include a specific time limit for disclaimers also was designed to reduce confusion. Rather than adopting a "reasonable time" requirement of some prior laws or the "nine month of the creation of the interest" requirement, the Commissioners chose to remove all mention of time limits in order to "clearly signal the practitioner that the requirements for a tax-qualified disclaimer are set by different law."

Additionally, the Act abandons the concept of the relation back of a disclaimer and instead states specifically the date on which each type of disclaimer becomes effective. The Act provides detailed rules for the disclaimer of interests and jointly-held property, disclaimers by trustees of property, disclaimers of powers of appointment and other powers not held in a fiduciary capacity, and disclaimers by appointees. Finally, the Act provides specific rules for the disclaimer of powers held in a fiduciary capacity. UDOPIA is not intended to abrogate fiduciary obligations, and the power of a fiduciary to disclaim is specifically subject to those obligations.

B. Provisions of UDOPIA

1. Interests That May Be Disclaimed.

UDOPIA authorizes a person to disclaim "in whole or part, any interest in or power over property, including a power of appointment." UDOPIA § 5(a). The Act contains a broad definition of "disclaimed interest" as "the interest that would have passed to the disclaimant had the disclaimer not been made." UDOPIA § 2(2). Section 5(d) provides that a disclaimer may be expressed as a fraction, percentage, dollar amount, term of years, limitation of a power, or any other interest or estate in property. Additionally, Section 9 allows the disclaimer of a power of appointment or any other power held in a non-fiduciary capacity and Section 11 governs the disclaimer of fiduciary powers. The broad reach of UDOPIA does not alter the narrower requirements of Section 2518 for a qualified disclaimer for tax purposes, but conversely, UDOPIA does provide in Section 14 that any disclaimer that is qualified for federal tax purposes is a valid disclaimer under the Act even if it does not otherwise meet the Act's requirements.

2. Who May Disclaim?

UDOPIA's definition of a "disclaimant" is the person to whom a disclaimed interest or power would have passed had the disclaimer not been made. The disclaimant is not necessarily the person who makes the disclaimer because a disclaimer may be made by a guardian, custodian, or other fiduciary acting on behalf of the disclaimant or the disclaimant's estate. The definition of "person" includes "an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity." UDOPIA § 2(6). A person is not prohibited from disclaiming an interest or a power if the creator imposed a spend-thrift provision.

A fiduciary is specifically authorized to disclaim unless that right is expressly restricted or limited by statute or by the instrument that created the fiduciary relationship. UDOPIA § 5(b). A trustee is specifically authorized under Section 8 to disclaim an interest in property that otherwise would have become property of the trust as long as the disclaimer is compatible with the trustee's fiduciary obligations. Section 9 authorizes the holder of a non-fiduciary power to disclaim.

The comments to the Act provide examples of the types of fiduciary powers that may be disclaimed including the right to remove and replace a trustee, or the power to make distributions of income or principal. Disclaimers of fiduciary powers had not been contained in prior Uniform Acts. This Act acknowledges that co-fiduciaries, in executing a disclaimer, are bound by the general rules in effect under state law and the governing instrument with respect to the number of trustees who must act to give effect to the disclaimer and further, as with any action by a fiduciary, the disclaimer of fiduciary powers must be compatible with the fiduciary's obligations.

3. Effect of Disclaimers.

Section 6 of UDOPIA imposes the following rules with respect to the effect of a disclaimer of an interest in property:

(1) The disclaimer takes effect when the instrument creating the interest becomes irrevocable or if the interest arose under *intestate* law, as of the time of the intestate's death.

(2) The disclaimed interest passes as directed by the instrument creating the interest.

(3) If the instrument creating the interest does not provide direction, the following rules apply:

a. If the disclaimant is not an individual, the disclaimed interest passes as if the disclaimant did not exist.

b. If the disclaimant is an individual, the disclaimed interest passes as if the disclaimant died immediately before the time when the interest would otherwise have taken effect.

(4) Upon disclaimer of a proceeding interest, a future interest held by a person other than the disclaimant takes effect as if the disclaimant had died immediately before the time when the disclaimed interest would have taken effect, but a future interest held by the disclaimant is not accelerated in possession or enjoyment.

Section 6(a)(3)(C) and (D) also provide specific direction for the passage of property upon disclaimer intended to coordinate distribution with the anti-lapse statutes provided in the UNIFORM PROBATE CODE (UPC) § 2-603(b).

The comments to the Act provide several examples outlining the effects of disclaimers in situations including after-born children, class gifts, and the application of representation statutes such as UPC § 2-707. These rules appear intended to avoid the probate process with the result that a disclaimed interest would avoid a disclaimant's right to direct the passage of the property by will and avoid creditor's claims. With respect to jointly-held property, Section 7 provides that disclaimed property passes "as if the disclaimant predeceased the holder to whose death the disclaimer relates."

With respect to disclaimers by trustees, Section 8 provides that if a trustee disclaims an interest in property that otherwise would have become property of the trust, "the interest does not become trust property." Section 11 indicates that the disclaimer by a fiduciary of a fiduciary power takes effect either as of the time the interest creating the power became irrevocable or if the power has been exercised, immediately after the last exercise of the power.

4. Passage of Disclaimed Interest.

Section 2518 requires that the disclaimed interest pass without any direction on the part of the disclaimant. I.R.C. § 2518(b)(4). State law

dictates how disclaimed property passes and the legal effect of the disclaimer. Generally, under state statutes, a disclaimed interest passes as if the disclaimant had predeceased the creation of the interest. The UDOPIA treats most disclaimed interests as passing as if the disclaimant had predeceased either the creation of the interest or the time of distribution of the interest. Time of distribution is defined in UDOPIA as "the time when a disclaimed interest would have taken effect in possession or enjoyment." UDOPIA § 6(a)(1).

In the simplest case of a disclaimer of a present interest under a will, the passage of disclaimed property is directed in the following order: (1) in accordance with the instrument creating the interest; or (2) in accordance with state anti-lapse statutes. The disclaimer of a future interest can be somewhat more complicated, especially in states that have not adopted anti-lapse statutes with respect to non-probate transfers. Questions can arise, for example, with respect to after-born children.

Professor LaPiana in his article, *Some Property Law Issues in the Law of Disclaimers*, 38 REAL PROP. PROB. & TR. J. 207 (2003-2004) provides an extensive discussion of disclaimers of future interests and the need for states to clearly specify to whom a disclaimed interest passes. In his article, the following example illustrates the issue:

> For example, *T* creates a testamentary trust to pay the income to *A* for life, remainder in equal shares to *T's* son *S* and daughter *D*. Because no explicit requirement exists which states that *S* must survive *A* to receive his share of the remainder, *S's* interest is said to be vested in interest. If *S* dies during *A's* lifetime, his share of the remainder is simply an asset of his estate. As in the example above, *S* has two living children and *D* has one living child. *S* would prefer that his share of the remainder pass to his children at *A's* death. Under the statutes that apply the deemed death rule, *S* has predeceased *T* and therefore *S* cannot receive the remainder interest; however, if the relevant anti-lapse statute applies to future interest, *S's* share of the remainder passes to his issue, which is the result he wants. Under UDOPIA, *S* is deemed to have died immediately before *A*, at which time *S* did own the remainder interest and his death before *A* did not divest him of that interest.

UDOPIA adopts the anti-lapse statutes of the UNIFORM PROBATE CODE and provides that S's remainder interest would pass to his living descendants. Unfortunately, even the UPC fails to provide for the lapse of non-trust interests such as legal life estates and remainder interest in real estate. Likewise, the potential for the acceleration of a remainder interest

as a result of a disclaimer of a preceding interest gives rise to complexities that even the UDOPIA has not fully resolved.

5. Bars to Disclaimers.

Section 13 of the Act provides that a disclaimer is barred or limited:

(1) By a written waiver of the right to disclaim;

(2) By the disclaimant's acceptance of the interest;

(3) If the disclaimant voluntarily assigns, conveys, encumbers, pledges, or transfers the interest or contracts to do so;

(4) By judicial sale of the interest;

(5) If provided by law.

A barred disclaimer is ineffective as a disclaimer but takes effect as a transfer of the interest disclaimed to the persons who would have taken the interest had the disclaimer not been barred. A disclaimer of a fiduciary power is not barred by the fiduciary's previous exercise of the power.

C. States that have Adopted UDOPIA

The following states as of the writing of these materials have adopted the Uniform Disclaimer of Property Interests Act (1999):

Arizona
Arkansas
Delaware
District of Columbia
Florida
Hawaii
Indiana
Iowa
Maryland
Massachusetts
Minnesota
Nevada
New Mexico
North Dakota
Oregon
Virginia
West Virginia

IV. Special Topics

A. Simultaneous Disclaimers of Multiple Interests

1. Generally.

The no-acceptance and no-direction rules of Section 2518 frequently require that multiple disclaimers or serial disclaimers of multiple interests

be executed in order to effect a qualified disclaimer. In circumstances in which the disclaimant might be seen as accepting the benefits of the disclaimed property, the disclaimant must also disclaim any interests that could be tantamount to acceptance. Similarly, a disclaimant must disclaim any powers over the disclaimed property that could be used to or be deemed to direct the beneficial enjoyment of the disclaimed interest. The operation and impact of the rules prohibiting a disclaimant from accepting the benefits of the property or directing the disposition of the disclaimed property can be tricky and must be carefully considered when making a qualified disclaimer.

2. Failure to Disclaim Interest in Resulting Trusts.

In I.R.S. Priv. Ltr. Rul. 200846003 (Nov. 14, 2008), the Service ruled that disclaimers executed by a decedent's children with respect to the decedent's IRA were not qualified disclaimers under Section 2518 because the children failed to disclaim their interests in a trust to which the IRA proceeds were distributable as a result of the disclaimers. During her lifetime, decedent executed a will which created Trust 1 for her surviving spouse. She designated Trust 1 as the beneficiary of her IRA. Trust 1 provided for the surviving spouse during his lifetime and upon his death the trust estate was distributable to decedent's children. Subsequently, decedent transferred her IRA to another custodial account and executed a new beneficiary designation designating her children as beneficiaries of the IRA. The decedent did not designate any contingent beneficiaries on the new IRA. The IRA custodial agreement provided that if the beneficiaries designated on the beneficiary designation form predeceased decedent, the decedent's estate would be the beneficiary of the IRA.

Within nine months after the decedent's death the children disclaimed their interest in the new IRA. As a result of the disclaimers the IRA passed to decedent's estate and into Trust 1. The children did not disclaim their remainder interest in the trust.

The Service ruled that the children's failure to disclaim their remainder interests in the trust meant that the children did not disclaim their entire interest in the IRA and accordingly the children's disclaimers were not qualified disclaimers under Section 2518. The children were treated as making a taxable gift of the fair market value of the IRA and accordingly the trust did not qualify as a QTIP trust because it did not pass from the decedent and the decedent's estate was not entitled to a marital deduction.

3. Serial Disclaimers by Surviving Spouse.

In I.R.S. Priv. Ltr. Rul. 200521033 (May 27, 2005), the surviving spouse of a decedent disclaimed a fractional interest in an IRA and disclaimed her

limited power of appointment over the portion of a trust that received the disclaimed portion of the IRA. In this ruling the decedent's estate plan created a marital trust and a family trust. Decedent designated his spouse as the primary beneficiary of his IRA and provided that if the spouse disclaimed any portion of the IRA the disclaimed portion would pass to the co-trustees of the marital trust. If the spouse disclaimed her interest in the marital trust the disclaimed interest would be paid over to the family trust. Finally, decedent's documents provided that if the spouse disclaimed her interests in the family trust the disclaimed property would pass to the decedent's daughters.

Under the family trust, the spouse had a testamentary power of appointment for the benefit of any issue of the decedent. Additionally, the daughters as co-trustees of the family trust, had the power to make discretionary distributions of income to or for the benefit of the spouse as the trustees deemed to be prudent for her health, support or maintenance. The co-trustees also had the power to make discretionary principal distributions to any one or more members of a group that included the spouse for health, support, maintenance or education.

The spouse proposed to disclaim the following:

(1) A fractional interest in the IRA;

(2) Her entire interest in the marital trust including her rights to receive distributions;

(3). Her testamentary limited power of appointment over the portion of the family trust that was attributable to the disclaimed IRA.

The Service ruled that the spouse's testamentary power of appointment over the family trust was a separate interest in trust property that could be disclaimed and that the series of disclaimers were qualified disclaimers for purposes of Section 2518.

4. Control Over Private Foundation.

In I.R.S. Priv. Ltr. Rul. 200519042 (May 13, 2005), decedent's will provided that his daughter would receive the residue of his estate but any disclaimed interest would pass to a private foundation. Decedent's daughter served as a director and president of the foundation; her husband was also a director and the vice president. The four other directors were children of the daughter and her husband. The daughter and her family proposed to amend the articles of incorporation and bylaws of the corporation to limit the daughter's ability to exercise discretion over the

foundation assets received by reason of the disclaimer. The bylaws would create a separate fund for the disclaimed assets on the account records of the foundation. The daughter would have no involvement in the disposition of any of the assets of the separate fund.

The Service ruled that the disclaimer by the daughter accompanied by the amendment to the governing instruments of the foundation was a qualified disclaimer for purposes of Section 2518 and the disclaimed property would qualify for the charitable deduction under Section 2055. Although in this ruling the daughter was not required to file multiple disclaimers in order to effect the plan, she was required to take additional steps to ensure that her disclaimer would not fail under Section 2518 for gift tax purposes.

B. Jointly-Owned Property

1. Regulations.

Treas. Reg. § 25.2518-2(c)(4) provides that for disclaimers made on or after December 31, 1997 of real estate owned in joint tenancy with right of survivorship or tenancy by the entirety a disclaimer, in order to be a qualified disclaimer, must be made no later than nine months after the creation of the tenancy regardless of whether the interest can be unilaterally severed under local law. A qualified disclaimer of the survivorship interest to which the surviving tenant succeeds by operation of law after the death of the first joint tenant to die must be made no later than the death of the first joint tenant to die regardless of whether the interest can be unilaterally severed under local law. The interest that may be disclaimed is deemed to be a one-half interest in the property regardless of the portion of the property attributable to consideration furnished by the disclaimant and regardless of the portion of the property that is included in the decedent's gross estate under Section 2040. A special rule exists for tenancies created on or after July 14, 1988 where the donor's spouse is not a U.S. citizen. Treas. Reg. § 25.2518-2(c)(4)(ii). In such cases, the surviving spouse may disclaim any portion of the joint interest that is includible in the decedent's gross estate under Section 2040 without regard to the amount of contribution made by each joint tenant.

The rules are different for assets other than real estate, such as joint bank accounts, brokerage accounts and other investment accounts. Treas. Reg. § 25.2518-2(c)(4)(iii) provides that if the transferor to a joint bank, brokerage, or other investment account may unilaterally regain the transferor's own contributions to the account without the consent of the other co-tenant, so that the transfer is not a completed gift under § 25.2511-1(h)(4), the transfer creating the survivor's interest is deemed to occur on the date of death of the deceased co-tenant. Accordingly, a surviving joint tenant may make a qualified disclaimer with respect to the

funds contributed by the deceased co-tenant by making a disclaimer within nine months of the co-tenant's death. The surviving joint tenant may not disclaim any portion of the joint account that is attributable to consideration furnished by the surviving joint tenant.

The regulations provide numerous examples of various types of joint tenancy disclaimers. Example (7) illustrates the situation in which A purchased real estate with A's funds and titled the property in A and B as joint tenants with right of survivorship. Under applicable state law, the joint tenancy is unilaterally severable by either tenant. After B's death, A may disclaim the one-half survivorship interest within nine months after the date of B's death. A may make this disclaimer notwithstanding that A contributed all of the consideration for the purchase of the property and without regard to whether A and B were married. Treas. Reg. § 25.2518-2(c)(5) E.g. (7). By contrast, example (12) involves the creation by A of a bank account held jointly with B. Both A and B are U.S. citizens and are spouses. Under local law, A can regain the entire account without B's consent such that the transfer is not a completed gift under § 25.2511-1(h)(4). Upon A's death B may make a qualified disclaimer of the entire value of the account. The result would be the same if A and B were not married. Treas. Reg. § 25.2518-2(c)(5) E.g. (12). If B died rather than A, A may not make a qualified disclaimer with respect to any of the funds in the bank account because A furnished the funds for the entire account. Treas. Reg. § 25.2518-2(c)(5) E.g. (13).

2. UDOPIA.

Section 7 of UDOPIA provides that on the death of a holder of jointly-held property, a surviving holder may disclaim, in whole or in part, the greater of: (1) a fractional share of the property determined by dividing the number one by the number of joint holders alive immediately before the death of the deceased holder; or (2) all of the property minus the part of the value attributed to the contribution furnished by the disclaimant. Section 7 is intended to apply to all of the various forms of joint property ownership allowed by state laws. Comments to Section 7 indicate that courts have long held that a surviving joint tenant may disclaim the survivorship portion of the jointly held property if the joint tenancy was severable during the life of the joint tenants. *See, e.g., Kennedy v. Comm'r*, 804 F.2d 1332 (7th Cir. 1986), *McDonald v. Comm'r*, 853 F.2d 1494 (8th Cir. 1988), *Estate of Dancy v. Comm'r*, 872 F.2d 84 (4th Cir. 1989). The Uniform Act also recognizes the final regulations to Section 2518 which indicate that the survivorship interest may be disclaimed without regard to whether the interests were unilaterally severable under local law and regardless of the portion of consideration furnished by the disclaimant.

Section 7 allows a surviving holder of jointly held property to disclaim the greater of the fractional share of the property owned by the deceased tenant or the entire interest in the property less the amount of consideration furnished by the disclaimant. The comment indicates that "in the usual joint tenancy or tenancy by the entireties between husband and wife, the survivor will always be able to disclaim one-half of the property." Additionally, the surviving spouse may disclaim all of the property attributable to the decedent's contribution, which provision is intended to allow the non-citizen spouse to take advantage of the contribution rules of the IRS regulations. The rules of disclaimers of joint property under UDOPIA do not dovetail perfectly with the tax regulations, nor are they intended to do so. For example, if A contributes 60% and B contributes 40% to a joint bank account, under UDOPIA, on B's death, A can disclaim up to 50% of the account for state law purposes but only 40% of the account for tax law purposes.

3. New York Law.

A bill (S. 3528) was recently (Mar. 23, 2009) introduced in the New York Assembly that is intended to adopt the special rules provided in Treas. Reg. § 25.2518-2(c)(4)(iii) for joint tenancies of bank, brokerage, and other investment accounts. The rule allowing surviving joint tenants to disclaim the survivorship interest without regard to the consideration furnished by the disclaimant currently is restricted in New York by EPTL 2-1.11(b)(1) which provides:

> Any beneficiary of a disposition may renounce all or part of his interest; provided, however, that a surviving joint tenant or tenant by the entirety may not renounce that portion of an interest in joint property or property held by the entirety which is allocable to amounts contributed by him to the interest in such property.

S. 3528 would instead provide that a beneficiary may disclaim:

> The interest to which such tenant succeeds, by operation of law upon the death of another joint tenant or tenant by the entirety, to the extent such interest could be the subject of a qualified disclaimer under Section 2518 of the United States Internal Revenue Code of 1986, as amended.

This bill, if passed, would allow a surviving joint tenant to disclaim a survivorship interest in property regardless of the survivor's contribution to the property, consistent with federal law.

4. A Roadmap for Disclaiming Interests in Joint Accounts.

I.R.S. Priv. Ltr. Rul. 200832018 (Aug. 8, 2008) provides a detailed roadmap for disclaiming interests in joint accounts at the death of a joint tenant. Here, husband and wife opened two brokerage accounts as joint tenants with rights of survivorship. Husband contributed 100% of the assets to Account One and husband and wife made equal contributions to Account Two.

After the husband's death, wife transferred Account One into a new account in her name alone. She received some distributions from these accounts and deposited the distributions into her own money market account. After appointment as personal representative, wife transferred the account into a new estate account along with the distributions she had previously received. With respect to the second account, to which husband and wife had equally contributed assets, after husband's death, wife transferred the account into a new account in her name alone and subsequently transferred one-half into a new estate account. Prior to the transfer of the assets from the account in the wife's name to the estate account, wife approved the purchase of new securities in the account.

The wife proposed the following:

(1) To disclaim the assets in the first account and all income earned on those assets since husband's date of death, minus any distributions previously received by her and the income earned on those distributions since the husband's date of death calculated as required by Treas. Reg. § 25.2518-3(c).

(2) To disclaim husband's one-half interest in the assets in account two (and the income earned thereon since husband's date of death) minus husband's one-half interest in the new securities purchased and the income earned thereon since husband's date of death calculated as required by Treas. Reg. § 25.2518-3(c).

(3) To disclaim her testamentary limited power of appointment over the marital and family trusts to which the disclaimed property would pass.

The IRS ruled in favor of the taxpayer that:

(1) The disclaimers could be made within nine months after the date of husband's death because under state law each spouse had the unilateral right to regain his or her contribution to the account without the consent of the other

party and therefore the transfers by husband were not completed gifts until the date of his death.

(2) The transfers from the joint accounts into accounts held solely in wife's name did not amount to acceptance by the wife of husband's assets since the mere change of title is not treated as acceptance in accordance with Treas. Reg. § 2518-2(d)(1).

(3) Wife's limited powers of appointment over the marital and family trusts were separate interests in those trusts which could be disclaimed.

(4) The distributions received by wife from the first account were accepted by wife and could not be disclaimed.

(5) The purchase of new securities in the second account amounted to acceptance and accordingly, the new securities could not be disclaimed.

(6) Because the distributions and the new securities are severable assets, wife could make pecuniary disclaimers of the assets originally held in the first account and the husband's one-half interest in the second account, minus the distributions and the husband's one-half interest in the new securities.

(7) Income earned on the accepted distributions and the husband's one-half interest in the new securities must be repaid to wife pursuant to Treas. Reg. § 25.2518-3(c).

(8) With the exceptions described above, wife's proposed disclaimers of the accounts were qualified disclaimers.

5. Joint Revocable Trusts.

Joint revocable trusts are frequently used in community property states to provide for the funding of the credit shelter trust upon the death of the first spouse. The joint trust is a single trust created by, in most cases, a married couple, in which assets generally are co-mingled. The trust benefits both spouses during their lifetimes and they retain the power to amend or revoke the trust either alone or together. On the death of the first spouse, the trust may provide that all or some of the assets stay in trust for the surviving spouse in some combination of a marital or family trust. If the amount of the spouses' combined assets exceeds the estate tax exemption amount, either by use of a formula or by disclaimer, some portion of the

trust assets pass to the credit shelter trust. The validity of a disclaimer of a portion of a joint trust falls within the regulations that apply to joint tenancies.

Although a joint trust is not a true joint tenancy or a tenancy by the entireties Treas. Reg. § 25.2518-2(c)(4)(iii), which provides the rule for joint bank, brokerage, and other investment accounts, appear to be applicable. The regulation provides that if the transferor to the joint account has the ability to regain the contributions unilaterally, the transfer into the joint account is not a completed gift. Similarly, a transfer to a joint trust is not a completed gift if it can be reacquired by the transferor without the consent of the other party by, for example, the power to revoke or power to withdraw. According to the regulation, the survivor should have nine months after the death of the first spouse within which to disclaim but may not disclaim any portion of the account attributable to consideration furnished by the survivor. Depending on the terms of the trust, if the contributing party did relinquish dominion and control over the funds contributed any disclaimer by the other party must be made within nine months of the date of the contribution. If the trust instead provides that each spouse may withdraw one-half of the trust assets, a contributing spouse may be deemed to have relinquished control over the portion of the contribution that the other party can withdraw.

An additional issue that arises with joint trusts is the question of whether the parties' rights to income and to receive distributions of principal of a joint trust constitute acceptance and bar a disclaimer by the surviving party. As with the regulations governing joint tenancies where both joint tenants are entitled to use, possession and enjoyment of the property during their lifetime, similarly the parties' use and enjoyment of a joint revocable trust during their lifetimes should not constitute acceptance prior to the death of the first party to die. For a more complete discussion of disclaimers as they relate to joint revocable trusts, see Martin, *The Joint Trust: Estate Planning in a New Environment*, 39 REAL PROP. PROB. & TR. J. 275 (2004-2005).

C. Formula Disclaimers

1. History of *Procter*.

Disclaimers of less than an entire interest in the property are governed by Treas. Reg. § 25.2518-3. Disclaimers of partial interests in property may be made by fraction by pecuniary amounts. Severable interests and powers of appointment also may be separately disclaimed. Treas. Reg. § 25.2518-3(d) provides an example of a disclaimer of a fractional share of the residuary estate calculated by formula. Example (20) provides as follows:

> A bequeathed his residuary estate to B. B disclaims a fractional share of the residuary estate. Any disclaimed property will pass to A's surviving spouse W. The numerator of the fraction disclaimed is the smallest amount which will allow A's estate to pass free of Federal estate tax and the denominator is the value of the residuary estate. B's disclaimer is a qualified disclaimer.

Formula disclaimers can be useful to fully fund the decedent's credit shelter trust to the fullest federal exemption available and to fully utilize the decedent's generation-skipping transfer tax exemption, particularly with hard to value assets. The use of formula disclaimers, however, requires caution. The Internal Revenue Service generally ignores the price adjustment clauses and, as it did in *Commissioner v. Procter*, refuses to give effect to provisions that it believes impose a condition subsequent and violate public policy.

In *Procter*, the Fourth Circuit held invalid a trust provision that would have returned to the grantor any property that would have been subject to gift tax. The trust provision read as follows:

> The Settlor is advised by counsel and satisfied that the present transfer is not subject to Federal gift tax. However, in the event it should be determined by final judgment or order of a competent federal court of last resort that any part of the transfer in trust hereunder is subject to gift tax, it is agreed by all the parties hereto that in that event the excess property hereby transferred which is decreed by such court to be subject to gift tax, shall automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of Frederic W. Procter free from the trust hereby created.

142 F.2d 824, 827 (4th Cir. 1944), *cert. denied*, 323 U.S. 756 (1944). The Fourth Circuit determined that the trust condition imposed a provision subsequent on the transfer and that the condition violated public policy. The court was concerned that provisions of this type would discourage tax audits and thereby inhibit the tax collection efforts of the Service.

2. Eighth Circuit Upholds Formula Disclaimer.

The Eighth Circuit squarely addressed the validity of a formula disclaimer in *Estate of Christianson v. Comm'r*, No. 08-3844, 2009 WL 3789908 (8th

Cir. Nov. 13, 2009). In that case, the decedent's daughter, Hamilton, disclaimed a portion of the contingent remainder interest in her mother's estate. The result of the disclaimer was that 75% of the disclaimed property would pass to a charitable lead annuity trust and 25% would pass to her mother's private foundation. The formula disclaimer stated in pertinent part as follows:

> A. Partial Disclaimer of the Gift: Intending to disclaim a fractional portion of the Gift, Christine Christiansen Hamilton hereby disclaims that portion of the Gift determined by reference to a fraction, the numerator of which is the fair market value of the Gift (before payment of debts, expenses and taxes) on April 17, 2001, less Six Million Three Hundred Fifty Thousand and No/100 Dollars ($6,350,000.00) and the denominator of which is the fair market value of the Gift (before payment of debts, expenses and taxes) on April 17, 2001 ("the Disclaimed Portion"). For purposes of this paragraph, the fair market value of the Gift (before payment of debts, expenses and taxes) on April 17, 2001, shall be the price at which the Gift (before payment of debts, expenses and taxes) would have changed hands on April 17, 2001, between a hypothetical willing buyer and a hypothetical willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts for purposes of chapter 11 of the [Internal Revenue] Code, as such value is finally determined for federal estate tax purposes.

Additionally, the disclaimer contained a "savings clause" that:

> to the extent that the disclaimer set forth above in this instrument is not effective to make it a qualified disclaimer, Christine Christiansen Hamilton hereby takes such actions to the extent necessary to make the disclaimer set forth above a qualified disclaimer within the meaning of section 2518 of the Code.

Estate of Christiansen v. Comm'r, 130 T.C. 1, 5 (2008). The tax court held that the formula disclaimer was valid as to the amount that passed to the foundation. On a separate issue, the tax court held that the partial disclaimer was invalid as to the portion that passed to the charitable lead annuity trust because Hamilton had failed to disclaim her remainder interest in the charitable trust. *See*, Section II.E.3. of these materials. The

Commissioner appealed from the tax court's determination that the formula disclaimer was valid as it related to the property passing to the foundation. The taxpayer did not appeal from the ruling that the disclaimer was invalid as to the portion that passed to the charitable lead annuity trust.

The Commissioner challenged the validity of the disclaimer and the amount reported as the estate's overall value. The parties settled the issue of valuation with the result that the corresponding increase in the valuation of the estate assets increased the charitable deduction for assets passing to the charitable foundation. The Commissioner denied the estate an increased charitable deduction as a result of this valuation adjustment arguing that the act of challenging the estate's return and the resulting adjustment in valuation served as a post-death, post-disclaimer contingency that disqualified the disclaimer under Section 2513.

The Commissioner presented two arguments. First, that the transfer of assets to the foundation was "dependent upon the performance of some act or the happening of a precedent event" because it could not be determined until after the Commissioner's challenge to the estate tax return. *Estate of Christianson v. Comm'r*, No. 08-3844, 2009 WL 3789908, at *1 (8th Cir. Nov. 13, 2009). Second, that fractional formula disclaimers should be disallowed for policy reasons because such disclaimers fail to preserve a financial incentive for the Commissioner to audit an estate's return.

The Court of Appeals rejected both arguments. As to the first argument, the court stated that "all that remained uncertain following the disclaimer was the valuation of the estate, and therefore, the value of the charitable donation. The foundation's right to receive 25-percent of those amounts in excess of $6.35 million was certain." *Id.* at *2. The court distinguished between events that occur after the date of death that change the value of an asset and events that occur post-death that are "merely part of the legal or accounting process of determining value at the time of death." *Id.* The court distinguished contingent events from a post-death resolution of the actual value of property. The Court of Appeals quoted the tax court:

> That the estate and the IRS bickered about the value of the property being transferred doesn't mean the transfer itself was contingent in the sense of dependent for its existence on a future event. Resolution of a dispute about the fair market value of assets on the date Christianson died depends only on a settlement or final adjudication of a dispute about the past, not the happening of some event in the future.

Id. at *3. The court recognized that the phrase "as finally determined for federal estate tax purposes" is used in other code sections and is not dependent upon post-death contingencies.

With respect to the public policy arguments, the court took issue with the Commissioner's argument that formula disclaimers reduced the incentive of the Commissioner to enforce the tax laws. The court noted that the Commissioner's role is not dependent upon maximizing tax receipts and that Congress did not appear to intend the tax law to maximize incentives for the Commissioner to audit returns. The court also found that "countless other mechanisms" are in place to promote and police the accurate reporting of estate values without the threat of audit by the Commissioner. The court affirmed the validity of the formula disclaimer and the ruling of the tax court.

3. Formula Disclaimer of Lifetime Gift.

With the Eighth Circuit's approval of a formula disclaimer of a testamentary gift in *Christianson*, planners may be more willing to use formula disclaimers of *inter vivos* gifts as well. A disclaimer of a lifetime gift may be useful in circumstances where the asset is hard to value and an increase in valuation for gift tax purposes may cause gift taxes to be due. If, for example, a donor makes a gift of closely-held stock to an irrevocable trust, the beneficiaries may be able to disclaim by formula that portion of the gift that exceeds the donor's remaining gift or generation-skipping tax exemption. The trust instrument could provide that any disclaimed property would be returned to the donor or would pass outright or in a qualifying trust to charity. The disclaimer could specify that the amount disclaimed is a fractional portion of the gift determined by reference to a fraction, the numerator of which is the fair market value of the gift less the remaining gift tax exemption of the donor and the denominator of which is the fair market value of the gift. In this way, the formula disclaimer will most closely resemble the disclaimer approved by the court in *Christianson.*

Several issues must be carefully considered for this type of formula disclaimer to be fully effective. First, the beneficiary must not have accepted any of the benefits of the property transferred, so the trustees must carefully determine what, if any, distributions may be made from the trust. Particularly where subchapter S stock is held in qualifying subchapter S trusts, distributions of income may be deemed to be acceptance by the beneficiary. Additionally, in the case of a single pot trust for multiple beneficiaries, no one beneficiary may disclaim on behalf of the other beneficiaries unless the trust agreement specifically provides for such disclaimer. The trust agreement must be carefully drafted to assure that the disclaimer of any property will operate to redistribute the

property to the donor rather than having the property pass to a subsequent generation. It may be advisable for the trustee to segregate the property in order to assure that sufficient assets remain for distribution to the donor should the property valuation be adjusted. The separate trust account should be retained until the gift tax statute of limitations has run. Some commentators also suggest that the parties enter into a "refunding agreement" by which the beneficiary agrees to return to the donor any property received from the trust in excess of the stated amount of the donor's gift. Presumably, such a refunding agreement would assure that the beneficiary could not be deemed to have received any benefits from the disclaimed property. Handler and Chen, *Formula Disclaimers: Procter-Proofing Gifts Against Revaluations by the IRS*, J. TAX'N (Apr. 2002).

Although there is no legal requirement that the disclaimer be disclosed on the gift tax return, it may be advisable to report the gift and its valuation as well as the formula disclaimer and its effect in order to commence the running of the statute of limitations with respect to the gift.

D. Creditor Protection

1. History of Relation-back Rule.

Courts have long wrestled with the question of whether a disclaimer can effectively avoid the disclaimant's creditors. Absent statutes to the contrary, an effective disclaimer can prevent creditors of the disclaimant from attaching the disclaimed property. Most cases finding that the disclaimant's creditors cannot reach the disclaimed property rely on the "relation back" doctrine that holds that the disclaimer relates back to the original transfer. The disclaimer acts as a refusal to accept the benefits of the property and, accordingly, is not a transfer from the disclaimant. The fact that the disclaimant has not made a transfer prevents the disclaimer from being a fraudulent transfer under creditor and bankruptcy statutes. UDOPIA takes this same approach and provides in Section 5(f) that a disclaimer is not a transfer, assignment, or release. For a more complete discussion of the "relation back" doctrine and its impact on creditors' claims, see LaPiana, *Some Property Issues in the Law of Disclaimers*, 38 REAL PROP. PROB. & TR. J. 207 (2003-2004).

The UDOPIA does not directly address the effect of disclaimers on state law creditors. Some states allow disclaimers to avoid the claims of creditors. Numerous states have statutes that allow a disclaimer to avoid the claims of creditors. *Eg.*, CAL. PROB. CODE § 281 (West 1991). Other states prohibit the use of disclaimers to avoid creditors or if the disclaimant was insolvent at the time of the disclaimer. *Eg.*, MINN. STAT. § 525.532 and § 501B.86 (1945).

2. Federal Tax Liens.

Until the Supreme Court's decision in *Drye v. United States*, 528 U.S. 49 (1999), the circuit courts were split on the question of whether a taxpayer's disclaimer of an inheritance could defeat a federal tax lien. The court in *Drye* settled the matter by holding that a disclaimer does not avoid a federal tax lien under I.R.C. § 6321.

In that case, the decedent's son was the sole heir of decedent's estate under the *in testate* laws of Arkansas. On the date of decedent's death the son, Drye, was insolvent and owed tax deficiencies of approximately $325,000. The total estate was worth approximately $233,000. Drye filed a disclaimer of his entire interest in the estate that met all of the requirements of state law and I.R.C. § 2518. Under state law the disclaimer operated as if Drye had predeceased his mother and the entire estate instead passed to Drye's daughter. Drye's daughter subsequently created a trust with the estate proceeds for the benefit of herself and her parents. The Internal Revenue Service filed a Notice of Levy on the accounts held in the trust's name. The trustee filed a wrongful levy action and the service counterclaimed against the trust, its trustee, and the beneficiaries. On cross-motions for summary judgment the district court ruled in the government's favor and the matter was appealed to the Eighth Circuit Court of Appeals. The Eighth Circuit affirmed the district court's ruling that the federal tax liens attached to Drye's interest in the estate on the date of decedent's death and that the disclaimer was ineffective to invalidate the federal tax liens. The Eighth Circuit determined that Drye's right to inherit had pecuniary value that was transferrable under Arkansas law and was considered a property right under Section 6321. The result was that the Service's pre-existing federal tax liens attached to Drye's right to inherit at the time of his mother's death.

The United States Supreme Court granted *certiorari* in *Drye* in order to resolve a conflict among the circuits on the question of the impact of a disclaimer on a federal tax lien. For a deeper discussion of the previous rulings in the Eighth, Ninth, Fifth and Second Circuits, *see* Bluestein, *Disclaimers and Federal Tax Liens' Effect on Inheritances*, 36 REAL PROP. PROB. & TR. J. 391 (2001-2002).

The Supreme Court interpreted the language of I.R.C. §§ 6321 and 6331(a) to indicate that Congress meant "to reach every interest in property that a taxpayer might have" and noted that inheritances and devises were not included in Section 6334(a)'s list of property that is exempt from tax levy. The court determined that the question of whether a state-law right constitutes "rights to property" under the Section 6321 tax levy statute is a matter of federal law. Although state law determines the rights the taxpayer possesses, federal law determines whether those

rights are taxable. The court concluded that although state law might protect a disclaimant's right vis-à-vis ordinary creditors, only federal law could determine whether a federal tax lien could attach. Although a valid disclaimer under state law might have the effect of circumventing ordinary creditors, the state law could not protect the disclaimed property from a federal tax lien.

The Supreme Court affirmed the Eighth Circuit's ruling that state law inheritance rights have a pecuniary value and are transferrable or assignable and, accordingly, may be attached for federal tax lien purposes. The court indicated that Drye's expectancy interest arose as of the date of his mother's death and at that time could be attached by the Service. Although the Supreme Court's ruling appears to rely more on the ability of the IRS to reach all manner of assets and interests for tax collection purposes, the court also appeared to be swayed by its belief that the disclaimant could, in effect, assign his interest to another by disclaiming the property knowing that it would pass to his daughter. This ability to take action and have the property pass to Drye's daughter was determined by the court to be a valuable property right.

3. Disclaimers in Bankruptcy.

Recently, the Ninth Circuit has declined to extend the holding in *Drye* to the bankruptcy context. *In Re Costas*, 555 F.3d 790 (9th Cir. 2009). The court in *Costas* held that a disclaimer was not a transfer of property within the meaning of the bankruptcy statutes and that the disclaimed property thus was not a part of the bankruptcy estate.

Rachelle Costas executed a valid disclaimer under state law of her share of her father's estate. Shortly after filing her disclaimer, Rachelle filed for bankruptcy under Chapter Seven. The trustee in bankruptcy sought to invalidate the disclaimer under 11 U.S.C. § 548 as a transfer prior to the date of the filing of a bankruptcy petition. The trustee argued that the Supreme Court's decision in *Drye* applied equally to the Federal Bankruptcy Code. The bankruptcy appellate panel determined that the disclaimer was effective and that the disclaimed property was not a part of the bankruptcy estate. The Ninth Circuit affirmed. The court in *Costas* determined that whether a disclaimer constituted a "transfer" under the bankruptcy code was a matter of federal law, although the determination of whether the disclaimant held "an interest in property" was to be determined under state law.

The bankruptcy trustee in *Costas* argued that the court's rationale in *Drye* should be applied because the disclaimant's power to "in effect" guide the disposition of the property should be recognized as an interest in property for bankruptcy purposes. The court in *Costas*, however, distinguished

Drye because there the tax lien had been in place prior to the execution of the disclaimer. In *Costas*, the disclaimer was executed prior to the disclaimant's filing the petition for bankruptcy. Accordingly, the "retroactive divestment of property interests occurred prior to the bankruptcy." *Id.* at 796. The court also pointed out that *Drye* was limited to tax lien cases only. The court reasoned that the collection of taxes was the primary focus in *Drye* and justified the "extraordinary priority accorded federal tax liens." *Id.* The *Costas* court did not extend *Drye* to bankruptcy actions.

4. Disclaimers Avoidable by Creditors.

The question of whether a disclaimant's creditor may reach the disclaimed property is governed by local law. The fact that a disclaimer is voidable by the disclaimant's creditors does not affect the determination of whether the disclaimer is a qualified disclaimer under Section 2518. However, a disclaimer that is wholly void or that is voided by the disclaimant's creditors is not a qualified disclaimer. Treas. Reg. § 25.2518-1(c)(2).

Examples provided in the regulations outline the situation in which the state law disclaimer statute requires that a disclaimer must be made within six months of the death of the testator. A disclaimer made after the six months period has expired is treated under state law as an assignment of the interest disclaimed and thus could be reached by creditors. The regulations indicate that if a disclaimer was made within the period allowed under Section 2518 it would be a qualified disclaimer for tax purposes notwithstanding the fact that the creditors could attach the disclaimed property. Treas. Reg. § 25.2518-1(c)(3) E.g. (1).

E. Disclaimers by Fiduciaries

1. Authority of Trustee to Disclaim.

Section 2518 is silent as to the ability of a fiduciary or trustee to make a qualified disclaimer. Section 2518(a) provides that "a person" may make a qualified disclaimer with respect to any interest in property and the interest will pass "as if the interest had never been transferred to such person." The regulations discuss certain fiduciary powers that cannot be retained by a beneficiary who disclaims an interest in a trust but do not provide direction as to the authority of a trustee to disclaim such offending powers. Treas. Reg. § 25.2518-2(e)(5) E.g. (11) and (12).

The common law did not grant authorization to fiduciaries to refuse selected powers or to decline to accept certain property. Trustees under common law merely had the power to accept or decline the appointment as

fiduciary. The RESTATEMENT (SECOND) OF TRUSTS Section 102 states the following with respect to disclaimers by trustees:

> (1) If a trustee has not accepted the trust either by words or by conduct, he can disclaim.
>
> (2) If a trustee has accepted the trust, whether the acceptance is indicated by words or by conduct, he cannot thereafter disclaim.
>
> (3) In the case of a trust created by a transfer inter vivos if a trustee has disclaimed he cannot thereafter accept; in the case of a testamentary trust a trustee who has disclaimed can thereafter accept, but only by permission of the court.
>
> (4) A trustee cannot accept a trust in part and disclaim in part.

Essentially, the Restatement follows the common law concept that although a trustee cannot be compelled to act as trustee, the trustee may not select some of the assets, duties and powers while rejecting others. Many states now permit a disclaimer by a trustee of discretionary powers or assets although some require court approval or the consent of beneficiaries.

The RESTATEMENT (THIRD) OF TRUSTS (2007) in Comment f. to section 86 acknowledged the authority of a trustee to disclaim property or a fiduciary power to further a trust purpose as long as the action is taken in the interest of the beneficiaries and is consistent with the trustee's other fiduciary duties. The comment provides that a trustee who disclaims or relinquishes trust property or a fiduciary power may serve or continue to serve as trustee but that the action may not be taken merely for the convenience of the trustee or to avoid or lessen the responsibilities of the trustee. Additionally, the trustee must exercise reasonable care and skill in exercising the power to disclaim and should do so with the assistance of competent financial, tax, and legal advice as needed.

The UDOPIA specifically defines "person" to include trusts, estates, partnerships and any other legal entity. UDOPIA Section 2(6). Section 5B provides with respect to a fiduciary's authority to disclaim as follows:

> Except to the extent of fiduciary's right to disclaim is expressly restricted or limited by another statute of this State or by the instrument creating the

> fiduciary relationship, a fiduciary may disclaim, in whole or in part, any interest in or power over property, including any power of appointment, where acting in a personal or representative capacity. A fiduciary may disclaim the interest or power even if its creator imposed a spend thrift provision or similar restriction on transfer, or a restriction or limitation on the right to disclaim, or an instrument other than the instrument that created the fiduciary relationship imposed a restriction or limitation on the right to disclaim.

The comments to subsection (b) indicate that although the Act gives a fiduciary broad authority to disclaim interests and powers, that authority may be restricted by the grantor of the trust because as a policy matter, the creator of the trust should have the ability to prevent a fiduciary "from altering the parameters of the relationship." Likewise, the authority of a fiduciary appointed pursuant to statute such as a conservator or guardian is restricted to the extent of the instrument creating the fiduciary relationship or other state statutes.

As with other factors, the validity of a qualified disclaimer by a fiduciary under Section 2518 will depend on the applicable state law with respect to the authority of the fiduciary to disclaim. Rev. Rul. 90-110, 1990-2 C.B. 209 provides that if a trustee's disclaimer is ineffective under state law it is not a qualified disclaimer for purposes of Section 2518. In Rev. Rul. 90-110, the decedent's will created a trust for the lifetime benefit of decedent's surviving spouse. Under the terms of the trust document the spouse was to receive all of the trust income annually, and the trustee had the power to invade *corpus* for the benefit of the grandchild of the decedent. The trustee executed a disclaimer of the power to invade *corpus* for the benefit of the grandchild. The grandchild neither consented to the trustee's disclaimer nor made an individual disclaimer. The will did not specifically authorize the trustee to make a disclaimer of this discretionary power and the state law required that a trustee's disclaimer of a discretionary power required the written consent of the beneficiary or an express grant of an authority to make such disclaimer in the governing instrument. The Service ruled that because the disclaimer did not qualify under local law it was not a qualified disclaimer within the meaning of Section 2518(b).

2. Guidance on Fiduciary Disclaimers.

a. Conservator of minor.

Qualified disclaimers frequently are used in order to qualify a trust for the marital deduction by eliminating any intervening interests of beneficiaries other than the surviving spouse. In I.R.S. Priv. Ltr. Rul. 200840023 (Oct. 3, 2008), disclaimers were executed by the court-appointed conservators of the estate of minor and unborn grandchildren. In this ruling, decedent's will provided first for the funding of trusts for each grandchild living on the date of her death, and then for the residuary estate to pass outright to her surviving spouse. The conservators each disclaimed a fraction of the minor grandchild's beneficial interest in the grandchild's trust, the numerator of which was the total amount of the trust reduced by one-tenth of the decedent's generation-skipping transfer tax exemption available on the date of her death. The denominator was the value of the grandchild's trust as finally determined for estate tax purposes.

The personal representative of the estate petitioned the state court for an order determining that the disclaimers were in the best interests of the minor grandchildren and that the proposed disclaimers were valid under state law. The court appointed guardians *ad litem* to protect the interests of the minor and unborn grandchildren. The guardians *ad litem* filed a recommendation with the court that the conservators execute disclaimers on behalf of the minor grandchildren. The court issued its order that the disclaimers were valid and were in the best interest of the minor grandchildren conditioned upon the personal representative's receipt of a favorable letter ruling from the Internal Revenue Service. The Service ruled that it expressed no opinion as to whether the proposed disclaimers by the minor grandchildren would be valid under applicable local law, but ruled that "provided the disclaimers are valid under state law, the disclaimers will be qualified disclaimers under Section 2518. *See Estate of Goree v. Commissioner*, T.C. Memo. 1994-331." The result of the qualified disclaimers was that the gift to the grandchildren in excess of the decedent's generating-skipping transfer tax exemption passed to the surviving spouse and qualified for the marital deduction.

b. Express authority to disclaim.

I.R.S. Priv. Ltr. Rul. 200028020 (July 17, 2000) involved a fairly complex series of disclaimers by beneficiaries under a will both individually and as trustees and in their capacity as beneficiaries of

the intestate share that passed by reason of the disclaimers. One child also executed a disclaimer on behalf of the surviving spouse in his capacity as attorney in fact under a durable power of attorney.

Paragraph 4.1(n) of the trust authorized the trustees to disclaim any property or any interest in property if, in the discretion of the trustee, the disclaimer was advisable considering the interests of the beneficiaries as a whole. Section 16 of the durable power of attorney provided that the attorney in fact, was authorized to execute a disclaimer on behalf of the spouse as a beneficiary of any estate or trust if in the agent's discretion the disclaimer was advisable considering all relevant factors. Section 689.21(2)(a)(4) of the State Probate Code provided that a beneficiary may disclaim any interest in property that would pass to the beneficiary under an *inter vivos* trust. Section 689.21(2)(b) provided that a disclaimer may be made for a minor beneficiary by a guardian *ad litem* if the court finds that it is in the best interests of those interested in the estate of the beneficiary and in the best interest of those that take the beneficiary's interest by virtue of the disclaimer and is not detrimental to the best interests of the beneficiary.

The Service ruled that based on the representations made and facts presented, the disclaimers by the surviving spouse and the children, both in their capacity as beneficiaries and as trustees of the trust, and those of the grandchildren and nieces were qualified disclaimers under Section 2518(b). The result of this series of disclaimers was to pass one-third of the property that had been devised by will to two of decedent's children instead by *intestate* succession to a third child of the decedent.

c. **Trustee may not disclaim beneficiaries' rights.**

In I.R.S. Tech. Adv. Mem. 9818005 (May 1, 1998), the husband's will contained an outdated marital deduction provision that limited the marital bequest to one-half of the adjusted gross estate. The surviving spouse, children and trustee attempted to disclaim certain assets and powers in order to modify the residuary trust to qualify for a QTIP election. The disclaimers included the following:

(1) The children and conservator of minor and unborn children disclaimed all interest in the principal and interest in the residuary trust during the spouse's lifetime, including their rights as a beneficiary under the spouse's *inter vivos* power of appointment and any right to have income withheld from

the income beneficiary or accumulated during the lifetime of the spouse.

(2) The surviving spouse disclaimed her *inter vivos* limited power of appointment over the residuary trust and any right to have the income of the residuary trust withheld from her. The surviving spouse did not disclaim her testamentary limited power of appointment.

(3) The surviving spouse in her capacity as trustee of the residuary trust disclaimed the power to distribute trust property to anyone other than the surviving spouse and the right to withhold any income from the surviving spouse. All the residuary trust beneficiaries consented to the disclaimer by the trustee.

The Service ruled that the disclaimers executed by the decedent's children, the conservator of the minor and unborn children, and the spouse in her individual capacity, purporting to relinquish any right to have income withheld from the income beneficiary, were invalid because "these rights and interests were not granted to the beneficiaries under the terms of A's will. Whether income is to be distributed or accumulated is determined by the terms of the governing instrument, not by the trust beneficiaries." However, to the extent that the disclaimers renounced the right to receive principal and income, the Service concluded that they were effective disclaimers under state law and qualified disclaimers under Section 2518, and the result of the disclaimers was that the surviving spouse was the only permissible distributee of the income of the residuary trust during her lifetime.

As to the disclaimer of the surviving spouse of certain trustee powers and duties, the Service cited RESTATEMENT (SECOND) OF TRUSTS, Sections 35 and 102 (1959) and SCOTT ON TRUSTS, Sections 102.3 and 102.4 (1987) for the proposition that a trustee cannot accept a trust in part and disclaim it in part, and that generally, a disclaimer by a trustee does not extinguish a power except with respect to the disclaiming fiduciary. In this ruling, the state statute allowed a fiduciary acting on behalf of another person to renounce property or an interest in property which was transferred to that other person. The Service stated that it could not read the statute as authorizing a trustee to disclaim powers and duties more generally. In reaching its conclusion, the Service took into consideration a state statute that prohibited a trustee from disclaiming a trusteeship after acceptance of the position. The Service reasoned that because the state statute did not address a

partial disclaimer by a trustee of only certain powers or duties once a trusteeship has been accepted, it cannot be partially disclaimed. The Service determined that based on the state statutes and the fact that no court in the state had ruled on the issue "the Supreme Court of State would find the attempted disclaimer of the trustee powers to be ineffective under local law."

In finding that the disclaimer of the trustee powers was ineffective, the result was that the trustee of the residuary trust had held powers that invalidated the trust as a QTIP trust and the marital deduction was denied. Although the disclaimers by the other income beneficiaries were effective and left the surviving spouse as the only permissible distributee of income during her life, the disclaimers did not change the governing provisions of the residuary trust which did not entitle the surviving spouse to annual or more frequent payments of all of the trust income. The ruling concludes "the disclaimers have only limited effect; they cannot change the dispositive provisions of A's will."

d. **Some fiduciary powers may not be disclaimed.**

In I.R.S. Priv. Ltr. Rul. 8409024 (Nov. 28, 1983) a trustee attempted to disclaim the power to withhold income in order to qualify the trust for the QTIP election. The applicable state law was OHIO REV. CODE section 1339.60(A)(1)(p) which provided that a fiduciary may disclaim rights, privileges, powers, and immunities, but may not disclaim the rights of beneficiaries unless the instrument creating the fiduciary relationship authorizes such a disclaimer. The Service determined that the power to withhold income is not the type of fiduciary power that can be disclaimed under the Ohio statute because it was a power that directly affected the rights of beneficiaries. Certain powers enumerated in the will, such as administrative powers, could be disclaimed without adversely impacting the beneficiary's rights.

The Service determined that unlike a power of appointment, which is personal to the holder, a fiduciary power is held by the fiduciary for the benefit of the recipient of the power. Whereas, the result of a disclaimer of a power of appointment is that the power of appointment "disappears," a fiduciary disclaimer of a power only has the effect of freeing the disclaiming fiduciary from the exercise of the power. The power itself is not extinguished and must "then be exercised by successor fiduciaries, and if none exists, a new fiduciary must be appointed." For example, a fiduciary disclaimer of a power to invade trust principal for the benefit of an income beneficiary is ineffective in eliminating the power from the will.

Only the income beneficiary can extinguish the power through disclaimer.

e. **Disclaimer by executor.**

As with disclaimers by trustees, disclaimers by executors must be authorized by state statute or the governing instrument. In I.R.S. Priv. Ltr. Rul. 9135003 (May 23, 1991), the decedent's will devised 10% of the estate to charitable institutions to be selected by the executors with the express hope that the executors include specifically-named charities located in Israel. The executor created two new charities, one domestic and one foreign, and transferred the assets to the two charities, attempting to take a charitable deduction for the portion of assets passing to the domestic charity. The Service noted that the executor was not in a position to make disclaimers on behalf of all potential foreign charities, and was not able to disclaim his fiduciary powers to choose foreign charities because neither state law nor the governing instrument provided such authority. The charitable deduction was disallowed because the will permitted the executor to designate both domestic and foreign charitable beneficiaries and the power to do so could not be disclaimed.

F. Disclaimers By Trust Beneficiaries

1. Regulatory Guidance.

The regulations provide some guidance with respect to disclaimers by beneficiaries of trusts providing the following specific rules:

(1) If a beneficiary who disclaims an interest in property is also a fiduciary, actions taken by that person in a fiduciary capacity to preserve or maintain the disclaimed property will not be treated as an acceptance of the property or any of its benefits. Treas. Reg. § 25.2518-2(d)(2). The disclaimant, however, may not retain a wholly discretionary fiduciary power to direct the enjoyment of the disclaimed interest such as the power to distribute income or principal to members of a designated class. *See also*, Treas. Reg. § 25.2518-2(e)(5) Ex. (11) and (12) which directs that the fiduciary power may be retained if it is limited by an ascertainable standard.

(2) A disclaimer is not a qualified disclaimer if the beneficiary disclaims income derived from specific property transferred in trust while continuing to accept income derived from the

remaining properties in the same trust unless the disclaimer results in the disclaimed property being removed from the trust and passing (without any direction on the part of the disclaimant) to persons other than the disclaimant or the spouse of the decedent. Treas. Reg. § 25.2518-3(a)(2). Further, a disclaimer of both an income interest and a remainder interest in specific trust assets is not a qualified disclaimer if the beneficiary retains interests in other trust property unless as a result of the disclaimer the assets are removed from the trust and passed as described above.

2. Powers of Appointment.

Generally, the disclaimer of a power of appointment is not considered to be a release of the power if the disclaimer is a qualified disclaimer under Section 2518. Treas. Reg. § 20.2041-3(d)(6). A power of appointment with respect to property is treated as a separate interest in the property. Treas. Reg. § 2518-3(a)(1)(iii). If a person disclaims a power of appointment with respect to property, the disclaimer can be a qualified disclaimer only if any right retained by the disclaimant to direct the beneficial enjoyment of the property is limited by an ascertainable standard. Treas. Reg. § 2518-3(a)(1)(iii).

In I.R.S. Priv. Ltr. Rul. 200832018 (Aug. 8, 2008), a wife proposed to disclaim certain assets held jointly with her husband in order to fund the residuary trust under her husband's revocable trust agreement. The wife had a testamentary limited power of appointment over the marital trust and the family trust and proposed to disclaim the power over both trusts. The wife requested a ruling that the proposed disclaimer of her testamentary limited power of appointment over the marital and family trusts would be a qualified disclaimer under Section 2518. The Service cited Treas. Reg. § 25.2518-3(a)(1)(iii) and applicable state law which allowed the disclaimer of "all or any portion of the transfer" and determined that the wife's proposed disclaimer of her testamentary limited power of appointment over the marital and family trusts were qualified disclaimers under Section 2518(b).

3. Disclaimer of Trust Assets Does Not Substitute Other Property.

The impact of a beneficiary's disclaimer of an interest in a trust must be carefully considered before the disclaimer is made. In some cases, the effect of the disclaimer was not well understood at the time the disclaimer was made. In *Estate of Nix*, T.C. Memo. 1996-109 (Mar. 7, 1996), the disclaimer by a surviving spouse had the effect of reducing the marital deduction and increasing the estate tax due. Mr. Nix's will provided a

marital bequest of the "smallest amount of the assets of my estate that qualify for the marital deduction as will result in the lowest federal estate tax being imposed upon my estate, after allowing for the unified credit, and any other credits and deductions allowable to my estate." Mrs. Nix executed a disclaimer of specified property valued at $394,000. The IRS reduced the amount of the marital deduction by the value of the disclaimed property. Mrs. Nix argued that the affect of the disclaimer was that the disclaimed property passed as if she had predeceased her husband. Therefore, she argued, that the assets became a part of his estate and the marital deduction should be recalculated as a result of the disclaimer. Apparently, her intention was to have other assets substituted for the disclaimed asset in her marital bequest and not to reduce the amount of her marital bequest.

The tax court rejected this argument which would have made the marital deduction formula circuitous. The court interpreted the marital bequest in the will as requiring the following calculation: Step 1 – the credit equivalent would be determined; Step 2 – the marital bequest would be based on the excess of the gross estate over the credit equivalent. The court stated that under the petitioner's approach the calculation would be performed a second time to take into consideration the property disclaimed by the surviving spouse and the effect would be to substitute one property for another in the marital bequest. The court found no authority for this effect of the disclaimer in the decedent's will and held that the disclaimer instead reduced the amount of the pecuniary marital bequest and increased the taxable estate. Another tax court decision to the same effect is *Estate of Katz*, T.C. Memo. 2004-166 (July 14, 2004).

V. Conclusion

The disclaimer is one of the most versatile tools in estate planning. Disclaimers can provide flexibility to allow for changes in valuation, tax legislation, or family relationships. Disclaimers are most useful, however, when the planning has been done on the front end. Properly drafted wills and trust agreements can provide for the ultimate disposition of disclaimed assets and can authorize trustees and other fiduciaries to make effective disclaimers. Every estate plan should contemplate the future use of disclaimers by fiduciaries and beneficiaries.

Although the rules of Section 2518 are fairly clear as to the tax effect of a qualified disclaimer, the validity and effect of the disclaimer is dependent upon state law. A careful understanding of applicable state law including both the authority of a person to disclaim and the effect of the disclaimer on the passage of the property is critical to the practitioner utilizing disclaimers. The Uniform Disclaimer of Property Interests Act (UDOPIA) and its adoption by many states goes a long way to providing the flexibility and certainty required in this area.