



DISCLAIMERS: Creating Flexibility in Uncertain Times

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WHY DISCLAIM? Non-Tax Reasons...

- Undesirable/ Unwanted Assets
- Unforeseen Changes in Wealth or Health of Beneficiary
- Possible “Fix” for Drafting Errors
- Avoid Concentration of Joint Property With One Child
- Possible Settlement of Threatened Will Contest—
Preserve Family Harmony

Medicaid and Creditors

- Disclaimer While Disclaimant is Receiving Benefits or Within 5-Year Lookback Will Create Transfer Penalty. 42 U.S.C. Sec. 1396(e)
- Fraudulent Conveyance Rules Protect Creditors of Disclaimant

WHY DISCLAIM?

Changes in Tax Law/ Poor Tax Planning

- Changes in Tax Law After Estate Planning
- “Sunset” of \$13.7 Million (for 2024) Federal Estate Tax Exemption in January 2026—Down to \$5 Million (indexed)
- Possible Further Reduction of Exemption: Political Changes
- Remember the “Fiscal Cliff”? In January 2013, Congress passed the American Taxpayer Relief Act of 2012 (“ATRA”), Pub.L. 112-240;

The Basics...

- State Law Requirements: PEF Code Chapter 62 (20 Pa.C.S.A. §6201 *et. seq.*)
- Compliance With Statute Does Not Necessarily Create Desired Tax Result— Additional Requirements Apply
- Special Requirements Apply for Disclaimer to Be Effective for PA Inheritance Tax/ Federal Estate and Gift Tax Purposes

Section 6201: The Right to Disclaim

- Right to Disclaim Held by Person to Whom Property Would Have Devolved by “Whatever Means”
- Specifically Includes Beneficiary Under Will, Appointee Under Exercise of Power of Appointment, Intestate Heir, Joint Owner With Right of Survivorship, Donee of Inter Vivos Transfer, Donee Under Third Party Contract

Section 6201: What Does Disclaimant Need to Do?

- Disclaimer Must be in Writing
- Writing Must Describe the Interest Disclaimed
- Writing Must Declare the Disclaimer and the Extent Thereof
- Must Be Signed By Disclaimant
- Right to Disclaim Not Affected By Spendthrift or Similar Provision

Section 6202: Disclaimer By Fiduciary or Agent

- Disclaimer by Personal Representative on Behalf of His Decedent Does Not Require Court Approval *if Authorized By Will*
- If Disclaimant is Agent Under Power of Attorney, POA Must be Durable and Must Confer Authority to Disclaim
- If Disclaimant is Agent or Guardian, Additional Requirement of Court Approval

Section 6202: Disclaimer By Fiduciary or Agent

- Court Must Conclude “In Each Case” that:

Disclaimer is Advisable:

- Disclaimer Will Not Materially Prejudice Rights of Creditors, Heirs or Beneficiaries of Decedent, The Minor or His Creditors
- DRAFTING CONCERNS

Section 6203: Interests Subject to Disclaimer

- Disclaimer May be “In Whole or In Part”
- Interest Disclaimed May Be Future or Present Interest, Vested or Contingent
- Includes Future Right to Take as Appointee Under An Unexercised Power of Appointment or Under a Discretionary Power to Distribute Income or Principal

Section 6204: Filing, Delivery and Recording

- If Transfer By Will or Intestacy: File With Clerk of Orphans' Court in County of Domicile or Where Property Located (i.e., Non-Resident Decedent)
- If By Inter-Vivos Transfer: Deliver to Trustee or Other Person Holding Title or In Possession OR Person Who Is Entitled By Reason of Disclaimer

Section 6204: Filing, Delivery and Recording

If By Third Party Beneficiary Contract: Deliver to
Custodian (i.e. Insurance Company, Employer, Etc.
AND Person Entitled to Interest By Reason of
Disclaimer

Section 6204: Filing, Delivery and Recording

If By Reason of Exercise of Power of Appointment: “As Required By the Above...” If Donor of the Power Is Regarded as Donor or Interest or If Person Who Exercised Power is Regarded as Donor of Interest

Section 6204: Filing, Delivery and Recording

If Interest in Real Estate:

- Disclaimer “MAY” Be Recorded in Recorder of Deeds Where Property is Located
- Not Effective vs. Bona Fide Grantee or Holder of Lien Who Has Given Value Before Disclaimer Recorded

Section 6205: Effect of Disclaimer

- Relates Back to Date of Death or Date of Inter Vivos Transfer
- Disclaimer “Shall Not” Diminish Rights of Another Person Other Than the Disclaimant Under Instrument of Transfer or Intestate Law And Shall Not Diminish Rights of Disclaimant Other Than Those Disclaimed

Section 6205: Effect of Disclaimer

- “Unless Testator or Donor Has Provided for Another Disposition”...
- Disclaimer is Equivalent of Disclaimant Predeceasing Decedent (i.e., Interest Under Will or Intestacy) or Effective Date of Inter Vivos Transfer
- HOWEVER, When Applying Rules of Succession Under PEF Code Sec. 2104(1), Fact That Disclaimant Survived Still Recognized For Determining Whether Parties Take Equally or By Representation
- ALSO, If Disclaimed Property Passes By Reason of Disclaimer to Fund in Which the Disclaimant Has an Interest Which He Has Not Disclaimed, Disclaimant Retains Interest In Fund

Section 6205: Effect of Disclaimer

- Powers of Appointment: Person Exercising Power of Appointment Shall be Regarded as Decedent or Transferor
- “Nothing In This Section” Shall Determine Effect of Disclaimer vs. Creditors of Disclaimant

Section 6206: Bar To Disclaimer

- “Acceptance” By Disclaimant Creates a Bar to Disclaimer
- May be Express or Implied
- Specific Actions Include: (1) Taking Possession or Accepting Delivery, (2) Written Waiver of Right to Disclaim, (3) Assignment, Conveyance, Encumbrance or Pledge or (4) Representation to Person and Detrimental Reliance

Section 6206: Bar To Disclaimer

- “Acceptance” Must Be Affirmatively Proved
- Mere Passage of Time Does Not Constitute Acceptance, Regardless of Knowledge

Section 6206: Bar To Disclaimer

- “Partial Acceptance Within 6 Months”
- Considered Partial and Will Not Bar Disclaimer of Balance of Interest

Section 6206: Bar To Disclaimer

- “Partial Acceptance After 6 Months”
- Considered an Acceptance of Entire Interest and Bar Subsequent Disclaimer, But Shall not be An Acceptance of a Separate Interest Under Same Instrument
- Income for Life or Other Period Separate from Interest in Principal or Future Income Right Conditioned Upon Future Event

PA Inheritance Tax Requirements

- 72 P.S. Section 9116(c)
- “Renunciation” Must Not Be In Exchange for Consideration
- Must Be Made Within 9 Months After Date of Death (Not Filing Deadline, Where Extended)
- Adjudication or Decree of Court Necessary With Prior Notice to Dept. of Revenue

Federal Estate and Gift Tax: The “Qualified Disclaimer”

- I.R.C. Sec 2518; Applies to Transfers After December 31, 1976
- Refusal must be in writing signed by Disclaimant (Sec 2518(b)(1));

Federal Estate and Gift Tax

IRC Section 2518

- Must be Unqualified and Irrevocable
- Writing Must Identify The Interest
- Disclaimed interest must pass to spouse or person other than disclaimant without direction from disclaimant. IRC Sec. 2518(b)(4)(A)-(B)
- Must be valid under state law
- Disclaimant Must NOT Have Accepted

IRC Section 2518 Deadline: 9 Months

- Must be delivered within 9 months after date of death of Transferor, recipient's 21st birthday, or date upon which interest is created.
- Extension to File Form 706 Does Not Extend Deadline for Qualified Disclaimer. PLR 9223051
- Lack of Knowledge Does NOT Extend Deadline/ Date of Distribution Immaterial

IRC Section 2518: Effect of Disclaimer

- Effect of Disclaimer is That Disclaimant Pre-Deceased Decedent or Transferor
- Disclaimant is Not Deemed to Have Made a Taxable Gift. Reg. Section 25.2518-1(b)

IRC Section 2518: Gifted Interests

- Completed Gift Required
- Life Income Beneficiaries, Remaindermen and Contingent Remaindermen Treated the Same— 9 Month Deadline Applies to All
- CAUTION: “Cascading Disclaimers” (i.e., A disclaims to B, who disclaims to C, etc.). All relate back to date of death or transfer.

Special Rules for Minors

- Right to Disclaim Extends to Age 21 Plus 9 Months.
Reg. Sec 25.2518-2(d)(3)-(d)(4)
- State Law Age of Majority Immaterial
- Acceptance By Guardian/ Conservator does not Bar
Otherwise Valid Disclaimer By Minor

IRC Section 2518: What Is “Acceptance”?

- Bargained For Exchange or Contractual Agreement to Disclaim Constitutes Acceptance. Reg. Sec. 25.2518-2(d)(4)
- Receipt of Dividends, Rents or Interest
- Acting As Fiduciary (i.e., Disclaimant is Heir and Executor) is NOT Acceptance. Reg. Sec. 25.2518-2(d)(2)
- Use of Residence By Surviving Joint Tenant Does Not Constitute Acceptance. Reg. Sec 25.2518-2(d)(1), Nor Does Payment of Real Estate Tax. Reg. Sec. 25.2518-2(d)(4).

IRC Section 2518: Partial Interests

- Trust Income and Remainder Interest Are Separate. Reg. Sec. 25.2518-3(d).
- Disclaimer of Severable Interest: i.e. “I Disclaim 50 shares of 100 shares specifically bequeathed”— must be physically segregated. 25.2518-3(c).

IRC Section 2518: Joint Property/ Death of Joint Owner

- Death Creates Survivorship Interest, not Creation of Account. Reg. Sec. 25.2518-2(c)(3).
- Withdrawal From Joint Account Does Not Constitute Acceptance if Survivor Did not Act With Respect to More than $\frac{1}{2}$ of Account. Reg. 25-2518-2(d).
- Disclaimer Applies to Fractional Survivorship Interest – Contribution is Immaterial
- Same Rules for Spouse/Non- Spouse Joint Owner
- Disclaimed Portion is no longer joint and becomes part of estate

Special Rule for Joint Accounts

- PEF Code § 6303(a): During Lifetime, Joint Property Owned in Proportion to Contribution
- Under IRC Sec 2518, Transfer Creating Survivor's Interest Occurs Upon Death. Reg. 25.2518-2(c)(4)(iii).
- Survivor May Disclaim Portion Contributed by First-To-Die Cotenant, even if greater than $\frac{1}{2}$ of Account. Reg. 25.2518-2(c)(4)(iii).
- Survivor May NOT Disclaim His or Her Own Contribution

Powers of Appointment

- General Power of Appointment: (note: Where Granted, Causes Inclusion in Taxable Estate of Donee); Donee Must Disclaim Within 9 Months of Creation of Power.
- If Created Under Will, 9-Month Deadline Runs From Date of Death Because Will is Revocable
- Person to Whom Property Passes By Reason of Exercise, Release of Lapse has Nine Months from Date of Exercise...

Powers of Appointment

Limited Power of Appointment: Holder AND Permissible Appointees/ Takers in Default Must Disclaim Within 9 Months of Original Transfer Creating Interest. Reg. 25-2518-2(c)(3)(i).

Planning Opportunities for Surviving Spouse

- By Thinking About Possibility for Disclaimer by Surviving Spouse, Testator Can Build Flexibility Into Estate Plan.
- Common Technique Provides Outright Disposition to Spouse , but if Spouse Disclaims, Interest Disclaimed Passes to “Credit-Shelter” a/k/a “Bypass Trust”

Benefits of “Credit-Shelter” a/k/a “Bypass” Trust

- Assets and Future Appreciation Excluded from Surviving Spouse’s Estate (But No Step-Up in Basis When SS Dies);
- Unaffected by Changes in the Law;
- Unaffected by Remarriage;
- Exclusion Not Reduced By Gifts in Excess of exclusion.
- Non-Tax benefits (i.e., Asset management, Protection From “Creditors and Predators”)

The “Disclaimer” Trust

- Offers Post-Mortem Flexibility in an Uncertain environment;
- “Survivor’s Choice” Estate Planning– Credit Shelter Trust Funded at the Option of the Surviving Spouse;
- In Absence of Disclaimer, Assets Typically Pass Outright to Spouse.
- Disclaimer to Trust is More Palatable Than Where Disclaimed Assets Go to Children, as Contingent Beneficiaries

Structure of Trust

- Generally structured like Credit Shelter Trust— keeps disclaimed assets out of surviving spouse's taxable estate;
- Inclusion of “5 or 5” permissible under Treasury Regulations.
- Trust can not give spouse a general power of appointment/ must be restricted by ascertainable standard (MESH)

Portability– No Need for Bypass Trust????

- Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 introduced concept of “Portability”;
- Available for Spouse dying in 2011-2012 and extended by ATRA to 2013 and later years;
- Deceased Spouse Unused Exemption Amount (“DSUEA”) is Available to Surviving Spouse;
- Requires timely estate tax return for first-to die spouse (5 Years From Date of Death. Rev.Proc. 2022-32);
- Benefit of Basis Step-Up at Death of Surviving Spouse and Ease of Administration.

Problems With Portability

- Can be Lost Upon Remarriage (i.e. spouse can only use DSUEA of spouse who died most recently);
- Reduced by Lifetime Gifts in Excess of Exclusion;
- GST exemption is Not Portable
- Could be Repealed

Disclaimer Trust: Use With Non-Probate Assets

- Recognized by State Law and IRC
- Creative Planning by Change of Beneficiary Designations on Non-Probate Assets (i.e. IRA, 401(k), Annuity or Life-Insurance contracts). Name Spouse With Trust as Contingent Beneficiary...

Drawbacks of Disclaimer-Based Planning

- Can't count on Spouse to Disclaim (Issues With Grief, Undue Influence, Missed Deadline, New Advisors)
- Inadvertent Acceptance Possible— Especially With Joint or Non-Probate Assets

Other Opportunities...

- Disclaimer by Non-Spouse Heirs Where Non-Marital Share Overfunded – i.e. Valuation Issues, Poor Drafting
- Disclaim General Power of Appointment for Cost Basis Step-Up at Death of Lifetime Beneficiary of Trust
- Disclaim Lifetime Income Interest to Accelerate Termination of Trust to Remainder Beneficiaries

Other Opportunities...

- Disclaimer to Achieve Lower PA Inheritance Tax Rate
- Disclaimer By Heir Who Dies Shortly After Decedent-Avoid Double Taxation Where Will Does Not Contain “Survivorship Requirement”



Thank You!

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