General Considerations

Sometimes a decedent’s best laid plans do not materialize. Assets may appreciate or depreciate in value, an unexpected gift may be received, or a loss may occur. Estate adjustments may not have kept pace with fast-moving events. Perhaps the decedent was merely careless or neglectful, and at death it is too late to change his (her) plan for disposing of property. Fortunately, the heirs or legatees often can make certain changes after the decedent’s death through disclaimers, settlements, and the election to take against the will.

Disclaimers

No one is required by law to take what is due to him (her) under another person’s will or by virtue of the State laws of inheritance in the absence of a will. The bequest or legacy can be disclaimed. A qualified disclaimer for estate purposes is defined as the irrevocable and unqualified refusal by a beneficiary to accept property during probate under authority of section 2518 of the Internal Revenue Code (IRC). Disclaimers can be utilized to effectively realize certain postmortem estate planning benefits that were not established prior to the decedent’s death. An example would be a decedent’s child disclaiming a taxable legacy in order to allow it to pass to the surviving spouse, in order to take full advantage of the marital deduction. Another example would be a surviving spouse disclaiming part of his (her) legacy from the decedent so that it will pass to the children and not waste the applicable exclusion amount.

If a qualified disclaimer is made by someone who does not wish to accept an interest in property, the interest disclaimed will be treated for Federal tax purposes as if it had never been transferred to that person. Rather, it is considered as passing directly from the decedent to the person entitled to receive it as a result of the disclaimer. Additionally, the disclaimant will not be treated as having made a gift, for either estate or gift tax purposes, to the person to whom the interest passes by reason of the disclaimer.

Disclaimer Requirements

IRC section 2518 provides a single set of definitive rules for qualified disclaimers for purposes of the estate, gift, and generation-skipping transfer taxes. Four basic requirements must be met:

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Disclaimers, Settlements, and Elections to Take Against the Will

1. The refusal must be in writing.
2. The written refusal must be received by the transferor, his (her) legal representative, the estate representative, or the holder of legal title to the property not later than 9 months after the later of the day on which the transfer creating the interest is made, or the day on which the person making the disclaimer reaches age 21. Estate of Fleming, J.K. [92-2 USTC ¶60,113, 974 F2d 894 (CA-7), affirming TC Memo 1989-675, 58 TCM 1034 (1989)] clarified that a disclaimer by a non-minor of an interest created by a decedent’s will must be made within 9 months of the date of the decedent’s death, not within 9 months after the will was admitted to probate.
3. The disclaiming party must not have accepted the property, any interest in it, or any of its benefits before making the disclaimer.
4. The property disclaimed must pass to someone other than the person making the disclaimer, as a result of the refusal to accept, and without any direction on the part of the disclaimant. However, valid disclaimer may be made by a surviving spouse even though the interest passes to a trust in which he (she) has an income interest—provided that there was no direction on the surviving spouse’s part to do so.

Receipt of consideration—A disclaimer is not qualified if the disclaimant receives consideration in exchange for the disclaimer. A mere expectation or unenforceable hope that something will be received in the future, however, does not rise to the level of consideration. To render the disclaimer invalid, the decision to disclaim must be part of a mutually bargained-for consideration.

Interaction of State and Federal Law

A timely written transfer of the property by the person disclaiming it to the person who would have received it under a disclaimer that is valid under State law also is considered a qualified disclaimer. However, requirements (2) and (3) above must have been met [IRC section 2518(3)].

A qualified disclaimer under Federal law will apply even if State law does not characterize such a refusal as a disclaimer. Also, the Federal time limits prescribed for a qualified disclaimer will supersede the time period prescribed by State law.
Disclaimer Provisions in the Will

In the absence of a contrary provision in the will, disclaimed assets go to those persons who would have received them if the disclaiming party had predeceased the estate owner. If, however, there is a possibility that a disclaimer might be a useful postmortem tool, it would be advisable to make provision for disclaimers in the will. These could include the requirement that a written statement be delivered to the executor within the requisite time limits, stipulations for disposition of disclaimed bequests, and details as to what is required to assure the effectiveness of a disclaimer for Federal and State tax purposes (various States have further requirements of their own in addition to the Federal requirements listed above). The provision in the will that disposes of a disclaimed bequest is extremely important to the disclaimant. As noted above, the disclaimant cannot disclaim in favor of anyone of his (her) choice; all the disclaimant can do is refuse to accept the bequest and allow it to pass under the alternate provision in the will.

Disclaimers by the Surviving Spouse

If the surviving spouse’s marital deduction bequest provides more than he (she) may need or consume, the additional amount will be includable in his (her) estate, which might result in the beneficiaries of the surviving spouse receiving less than they might otherwise receive. In this case, the surviving spouse might choose to disclaim all or part of the bequest. If the disclaimer will result in the disclaimed property passing to those whom it is desired to benefit (for example, the children), the property in question would never be included in the surviving spouse’s taxable estate. It would pass to the intended beneficiaries without gift tax liability and without any added transfer expenses (see chapter 14 for limitations on using a disclaimer for jointly held property).

A point to consider is that a disclaimer of a marital deduction bequest may serve to increase the estate tax liability of the decedent’s estate unless it is made in favor of a charity or the unified credit is available to offset liability. But even if additional estate tax results for the decedent’s estate, the disclaimer could possibly reduce the estate tax and administration costs of the disclaimant’s estate. These factors all have to be considered.

Disclaimers in Favor of a Surviving Spouse

If a surviving spouse is to receive a marital deduction bequest considered to be less than adequate for his (her) needs and there are bequests to others, the other beneficiaries may wish to disclaim their bequests in whole or in part. The effect of this strategy would be to increase the marital deduction and thus reduce estate taxes. IRC section 2056(a) permits an estate tax marital deduction for property disclaimed by a third person that passes in favor of the surviving spouse. If the disclaimed assets are not necessary for the surviving spouse’s needs, gifts in the amount of the disclaimed bequests could later be made to the original beneficiaries in installments that would minimize or eliminate gift taxes.

Charitable Disclaimers

IRC section 2055(a) allows a deduction for a charitable transfer resulting from a disclaimer. For example, if a decedent’s will provides for a charity to receive a disclaimed bequest, a disclaimer may reduce estate taxes and, at the same time, take the bequest out of the disclaimant’s estate. In this situation, however, there are income tax considerations to be taken into account. If the bequest is accepted and then given to charity, the legatee-donor will get an income tax deduction. The value of that deduction must be weighed against any higher estate taxes resulting from acceptance of the bequest.

Will Settlements

A will contest or settlement can result in a shift of property interests from one beneficiary to another or from a beneficiary named in the will to a person not named. The courts have held that no gift results if the contest or settlement is bona fide and at arm’s length. In other words, the shift of property interests has the same effect as a disclaimer.

Election Against the Will

If a will does not give a surviving spouse a prescribed share of the testator’s estate, many States permit the surviving spouse “to take against the will” to make up the difference. If the surviving spouse makes this election, he (she) will get a larger share of the estate. At the same time, the election may increase the marital deduction, thereby reducing the estate tax. Again, as with a disclaimer, the shift of property interests will not result in a gift being made by the surviving spouse.