It's never too late for estate planning

How much time passes from the day that a will is signed to the day that it takes effect? Typically, many years. Years in which asset values can change dramatically; some family members are born, and others die. The passage of time can dramatically alter family circumstances and resources, so that a regular will review is as important as a regular medical checkup. What's more, the estate tax law is subject to sudden change so that wills often become less than optimal for tax purposes.

What happens when the review isn't done, and a will proves inadequate? Happily, through a process called *post mortem estate planning*, an experienced executor can provide a remedy. In particular, the executor may be able to recommend the careful use of *disclaimers* so as effectively to amend the estate plan to save taxes, or to meet the needs of the beneficiaries better.

A disclaimer is simply the refusal to accept a gift or bequest. For example, say John leaves his entire estate to his wife, Mary, but after his death Mary believes that a portion of the estate should pass to their children. If Mary disclaims a portion of her interest, the amounts disclaimed will pass under other will provisions or under the laws of intestacy (the state laws that apply in the absence of a will). To the ordinary person, this looks like a gift from Mary to the children out of her inheritance. But if the disclaimer is properly handled, the tax law treats the transfer to the children as coming from John, through the estate, not from Mary. The difference is more than semantics—it eliminates the gift tax on the disclaimer.

Saving taxes

Disclaimers can fine-tune an estate plan after all relevant facts are known, and they can bail out an estate plan that proves to be tax inefficient. The motive for the disclaimer is not important. Here are a few situations culled from IRS Private Letter Rulings, where disclaimers have improved an estate plan:

- A larger marital deduction was created for an estate plan drafted before the advent of the unlimited marital deduction in 1982.
- The marital deduction was reduced to ensure full use of estate tax credits, reducing estate taxes at the death of the surviving spouse.
- A marital trust with general power of appointment was converted to a Qualified Terminable Interest Property (QTIP) trust to save generation-skipping transfer taxes.
- A defective charitable remainder trust was made a "reformable interest" eligible for the estate tax charitable deduction.
- A surviving spouse was made the sole beneficiary of an IRA, permitting the spouse to treat the IRA as her own and extend the life of the IRA.
- A direct bequest to grandchildren, which is subject to the generation-skipping transfer tax, was reduced or increased to an amount equal to the exemption from that tax.

Looking forward

Given the knowledge that the possibility of a disclaimer will be available, it is possible to develop the estate plan contemplating—even inviting—the use of this estate planning tool.

For example, a beneficiary might be given the option to disclaim a portion of his or her inheritance in order to let the amount pass to a designated charity. This will produce an estate tax deduction that can be more valuable than an income tax deduction for the same charitable gift. Nelson Rockefeller's will included provisions of this sort.

Similarly, a surviving spouse may be given the option to disclaim to permit optimal funding of a family trust. Such a trust will bypass the surviving spouse's estate, reducing overall estate taxes for the family. The surviving spouse may even be a beneficiary of the family trust without impairing this strategy. This approach is especially valuable when qualified retirement plan assets or an IRA will make up a substantial part of the estate.

Joint property

What if property is owned jointly, with rights of survivorship? Here the tax rules become more difficult. One cannot disclaim what one already owns in order to dodge the gift tax; that much is certain. But it may be possible to disclaim the survivorship interest, depending upon the state law governing the creation of joint interests. Additionally, different rules may apply to surviving spouses than those that apply to other joint tenants.

Estate planners commonly recommend against excessive use of jointly owned property in the estate plan. The potential loss of post mortem flexibility is one reason for that recommendation.

Formal requirements

Disclaimers are not tools for amateurs. Among the requirements for a tax-qualified disclaimer:

- the disclaimer must be in writing;
- it must be made within nine months of the transfer;
- the disclaimant must not have accepted any benefits (such as an income distribution) from the disclaimed property;
- the disclaimant must not direct the disposition of the disclaimed property; and
- the disclaimant must have no benefit from the disclaimed property after the disclaimer, unless the disclaimant is the surviving spouse.

A lot to think about? To sort through these requirements and identify the opportunities that disclaimers represent calls for the assistance of an experienced estate planning attorney or professionals in estate settlement such as us. Speak with your professional advisors to explore how this planning technique may be useful in your situation.

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Any developments occurring after January 15, 2007, are not reflected in this article.