FROM HOWARD M. ZARITSKY

Disclaimer-Based Estate Planning—A Question of Suitability

The Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act")[1] is likely to spur the interest of estate planners in disclaimer-based estate planning, because it creates a rapidly-changing set of rules that may make it difficult to design an estate plan that will continue to achieve the desired results. The changes in the 2001 Act that will most dramatically affect estate plans include:

1. Increasing the exemption equivalent of the unified credit to $1 million on 1/1/02;
2. Increasing the estate tax applicable exclusion (but not the gift tax exemption equivalent) to $1.5 million in 2004, $2 million in 2006, and $3.5 million in 2009;
3. Increasing the GST exemption to $1.5 million in 2004, $2 million in 2006, and $3.5 million in 2009;
4. Reducing the top estate and gift tax rates and the flat GST tax rate to 50% in 2002, 49% in 2003, 48% in 2004, 47% in 2005, 46% in 2006, and 45% thereafter;
5. Repealing the estate and GST taxes with respect to estates of decedents dying after 12/31/09; and
6. Reversing all of these changes and reinstating the 2001 law on 1/1/11.

These changes mean that almost any estate plan that is fine today may be inappropriate tomorrow. For example, a formula clause that creates a nonmarital share equal to the decedent's applicable exclusion amount will create a $1 million nonmarital share in 2002, a $3.5 million nonmarital share in 2009, and possibly no nonmarital share in 2010. One or two of these results may be entirely unanticipated by the client, and entirely unsatisfactory as a plan to care for the client's family.

Estate planners should, therefore, build as much flexibility as possible into each estate plan, and maximize the use of postmortem adjustments in the estate disposition.[2] For many estate planners, this means using disclaimers to redistribute an estate after the first spouse dies.

A will may, for example, leave the entire estate outright to the surviving spouse, and allow the surviving spouse to disclaim an amount sufficient to establish a reverse QTIP trust to take full advantage of the deceased spouse's GST exemption. The surviving spouse can further disclaim interests in the reverse QTIP trust to create a nonmarital trust to take full advantage of the deceased spouse's estate tax exemption.[3] This enables the surviving spouse to determine the amount of the three shares of the decedent's estate, taking into account facts that would not have been known when the document was drafted, such as the final size of the estate, the needs of the various parties, and the estate tax rules then applicable.

The 2001 Act makes such a plan especially appealing. The increases in the estate tax exemption may make it important to divide the applicable exclusion amount between two or more nonmarital trusts, one of which benefits both the surviving spouse and other family members, and the other of which benefits only the surviving spouse. The precise amount that should go to each trust is difficult to estimate, and may best be determined after the first spouse has died.

Similarly, tying the amount of the GST exemption to the amount of the estate tax applicable exclusion amount after 2004 may make a reverse QTIP entirely unnecessary. A surviving spouse could use disclaimers to create no reverse QTIP trust, where one is no longer appropriate.

Nonetheless, estate planners should be very careful about creating an estate plan that depends for its efficacy on a surviving spouse's disclaimers. Some spouses will find it difficult to understand why they should give up assets that have been left to them. Others will

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understand why they should give up these assets, but will be unwilling to do so. Furthermore, many spouses who are willing to disclaim, render a qualified disclaimer impossible by accepting benefits from the assets.

The *Chamberlain* case

The risks of a disclaimer-based estate plan are illustrated by *Estate of Chamberlain*.[4] In *Chamberlain*, June's will left the residue of her estate to Theodore, her husband, but also created a nonmarital trust to hold any disclaimed assets. After June's death, Theodore discussed with his lawyer disclaiming assets, but first undertook to determine the size of both his own estate and June's estate.

Theodore's lawyer prepared the disclaimer and listed on it the total value of disclaimed assets, but did not list the assets to be disclaimed, because he wanted to wait until there was a determination of the value of the estate assets. Theodore died without signing the disclaimer.

The executor for Theodore's estate contended that he had disclaimed his interest in June's estate, but the Tax Court disagreed, noting that the disclaimer had never been executed. The Tax Court observed that a valid disclaimer under Section 2518 must be written, must irrevocably refuse to accept assets otherwise passing from the decedent's estate, and must specifically identify the disclaimed property interest.[5] The Tax Court concluded that an initialed list of assets, indicating whether assets were held by June or held jointly, was not a description of the assets because it did not state which assets were being disclaimed.

The Ninth Circuit affirmed, in an unpublished order. The appellate court ruled that neither the handwritten, unsigned schedule of assets nor the probate inventory were disclaimers, because neither expressed an intent to disclaim. The court noted that a real disclaimer had been drafted by Theodore's attorney, but that it was—at Theodore's death—sitting unsigned in the attorney's office. Thus, there was no qualified disclaimer, and the nonmarital share was not funded. The assets that would have been disclaimed were includable in Theodore's gross estate.

Chamberlain does not mean that disclaimers should never be used, but merely that they may be inappropriate for certain clients. Disclaimer-based estate planning is best suited for estates in which both spouses are relatively sophisticated and well-organized, because the surviving spouse in such cases is more likely to be willing to disclaim, to take those actions that are necessary to implement the disclaimer, and to resist taking those actions that would make the disclaimer impossible. ■

[1] Pub. L. No. 107-16, 107th Cong., 1st Sess. (6/7/01).

[2] See, generally, Kasner, *Post Mortem Tax Planning* (3rd ed., Warren, Gorham & Lamont).

[3] See Mulligan, "Updated Planning for Marital Dispositions, Lifetime QTIPs and QDOTs," 26 ETPL 395 (Nov 1999).

[4] 87 AFTR2d 2001-2386, 2001 WL 564351 (CA-9, 2001), *aff'g by unpub'd order*, TCM 1999-181.

[5] Section 2518(b); Reg. 25.2518-2(b)(1).

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