

# Disclaimer Planning

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## Disclaimer Planning

## Overview

**I. Introduction.** Disclaimers can be very powerful tools to accomplish a client's objectives, though it takes a client with unique planning goals for a disclaimer to be helpful. You might even say that a disclaimer is rarely, if ever, helpful to a client at all in the sense that it deprives the client of assets, interests in property or powers over property to which he or she was otherwise entitled and gives the client nothing of value in exchange (no consideration may be given to a disclaimant in connection with his decision to disclaim). However, a disclaimer may nonetheless serve a client's other objectives such as: the minimization of federal transfer taxes, routing assets in a more desirable manner (from the disclaimant's perspective) within the parameters of the estate plan or applicable law, the avoidance of certain (but not all) creditor claims, and the prevention of exposure of other assets to liability risk associated with an undesirable asset.

Disclaimers should be used with extreme caution and *only* after the estate planning attorney has: (1) ensured that the client is well informed of the legal consequences and (2) performed key due diligence in connection with a possible disclaimer, including determining with certainty who will receive the disclaimed property, if the disclaimer is of an interest in property.

Further, if the contemplated disclaimer will be by a fiduciary acting in a fiduciary capacity, it would be advisable for the disclaimant to notify the beneficiaries of the intent to disclaim, to explain the reasons for doing so and to request a release from any liability in connection with doing so, in addition to complying with the legal requirements for disclaimer by a fiduciary, described further in this paper and in the Texas Uniform Disclaimer of Property Interests Act ("Disclaimer Act"), codified in Chapter 240, Texas Property Code, effective as of September 1, 2015.

This paper will attempt to address the following questions:

1. What is a disclaimer?
2. How does disclaimed property pass?
3. Who may disclaim and when is court approval or notice required?
4. What are the remedies for an improper fiduciary disclaimer?
5. What are the key legal requirements of a disclaimer?
6. What are some of the primary goals achieved by disclaimers?

This paper will also attempt to address these additional questions at various points throughout the paper: How might disclaimer provisions be incorporated into estate planning documents to facilitate a client's goals? How might a disclaimer undermine a client's estate planning goals, and when should a disclaimer power potentially be curtailed? How might a disclaimer be used to accomplish the goals of a client who is not the original owner of the assets? What ethical implications arise in the context of disclaimers?

**II. What is a Disclaimer?** There are multiple meanings of a legal "disclaimer" but the topic of this paper is the disclaimer (renunciation) of interests in or powers over property. Black's Law Dictionary (Free Online Legal Dictionary, 2nd Ed.) defines a disclaimer as:

The disavowal, denial, or renunciation of an interest, right, or property imputed to a person or alleged to be his. Also, the declaration, or the instrument, by which such disclaimer is published.... The act by which a party refuses to accept an estate which has been conveyed to him.

State Law Meaning of Disclaimer Under the Disclaimer Act and Applicable Provisions of the Texas Estates Code. Section 240.002(6) of the

Disclaimer Act provides that "[d]isclaimer" means the refusal to accept an interest in or power over property. Section 240.002(2) elaborates on the meaning:

"Disclaim" means to refuse to accept an interest in or power over property, including an interest or power the person is entitled to: (A) by inheritance; (B) under a will; (C) by an agreement between spouses for community property with a right of survivorship; (D) by a joint tenancy with a right of survivorship; (E) by a survivorship agreement, account, or interest in which the interest of the decedent passes to a surviving beneficiary; (F) by an insurance, annuity, endowment, employment, deferred compensation, or other contract or arrangement; (G) under a pension, profit sharing, thrift, stock bonus, life insurance, survivor income, incentive, or other plan or program providing retirement, welfare, or fringe benefits with respect to an employee or a self-employed individual; or (H) by an instrument creating a trust.

Other relevant terms, such as "disclaimed interest" and "disclaimant," are also defined in Section 240.002.

Provisions relating to the disclaimer of property that the disclaimant would be entitled to receive as a result of the death of another person can be found in Chapter 122 of the Texas Estates Code, entitled "Disclaimers and Assignments." Chapter 122 contains two almost identical definitions of the term "beneficiary" as the result of two different bills with the same effective date amending Section 122.001. Both amendments define the term to include a person who would have been entitled, if the person had not made a disclaimer, to receive property as a

result of the death of another person in a manner that corresponds closely to the definition of "disclaim" but omits the reference to an interest the person would be entitled to under an instrument creating a trust. Only one of the two definitions of "beneficiary" refers to property the beneficiary is entitled to under the new transfer on death deed.

Disclaimer Under IRC 2518. Very commonly, especially prior to the enactment of the changes made in the 84<sup>th</sup> Legislature that became effective on Sept. 1, 2015, the term "disclaimer" was used in reference to a "qualified disclaimer" under Section 2518 of the Internal Revenue Code ("IRC") and associated Treasury Regulations. Although disclaimer planning has been used to some degree for non-tax reasons, tax-motivated disclaimers seem to be far more prevalent than other disclaimers. With fewer individuals being subject to federal transfer taxes, tax-motivated disclaimers may become less common. Some of the tax benefits of a qualified disclaimer are discussed further below in this paper.

Assignment or Disclaimer? The disclaimer provisions under Chapter 122 of the Estate's Code make it clear that "[a] person who is entitled to receive property or an interest in property from a decedent under a will, by inheritance, or as a beneficiary under a life insurance contract, and does not disclaim the property under Chapter 240, Property Code, may assign the property or interest in property to any person." Sec. 122.201. It is perhaps unclear under Chapter 122 whether a disclaimer that does not meet the requirements of the Disclaimer Act is necessarily an assignment. However, the statute is clear that "[a]n assignment under this subchapter is a gift to the assignee and is not a disclaimer under Chapter 240, Property Code." Sec. 122.205. In other words, a beneficiary who fails to comply with the requirements of the Disclaimer Act has not made a disclaimer, may have assigned his property interest, and if he has assigned his interest, he has made a gift. The treatment of a

non-conforming disclaimer as a gift would be consistent with the federal transfer tax treatment of a disclaimer that does not comply with the requirements for a qualified disclaimer.

Disclaimers Apply Not Only to Property But Also to Powers. As is apparent from the definition of the term "disclaimer," disclaimers relate not only to specific interests in property (such as the right to own a particular asset or a right to income or principal distributions under a trust agreement) but also to powers (such as a power of appointment, a withdrawal power, or powers held by a trustee). An attorney who understands the legal and tax consequences of powers over property and how to use disclaimers to negate unintentional consequences can in some cases make important corrections to an estate plan after the estate plan can no longer be changed by the client. For example, a disclaimer of a power as trustee to make distributions in excess of a health, maintenance, support and education standard, which power would inadvertently cause inclusion of the trust property in the trustee's taxable estate or result in taxable gifts in certain situations, can accomplish favorable transfer tax results while facilitating a client's other important objectives, such as allowing the client to retain control over distributions as trustee. Without the disclaimer, the client might otherwise be required to decline to serve as trustee or perhaps seek a more cumbersome remedy, such as a judicial reformation of the trust. It may also be beneficial for a person to disclaim a power for non-tax reasons, such as to prevent creditors from reaching the assets that would be subject to the power.

Partial Disclaimer. The Disclaimer Act expressly permits a partial disclaimer. According to the statute, a partial disclaimer "may be expressed as a fraction, percentage, monetary amount, term of years, limitation of a power, or any other interest or estate in the property." Sec. 240.009(b). Partial disclaimers are appropriate if a person wishes to relinquish only a portion of the interest in property, or to

restrict a power only partially (e.g., by disclaiming a withdrawal right over a trust except to the extent the right can lapse pursuant to the "\$5,000 by 5%" rule of IRC 2514(e)). The current statute includes a rule permitting a surviving spouse to disclaim property passing to the spouse in one form, while retaining other interests that the spouse may have in the disclaimed property. "A disclaimer by a decedent's surviving spouse of an interest in property transferred as the result of the death of the decedent is not a disclaimer by the surviving spouse of any other transfer from the decedent to or for the benefit of the surviving spouse, regardless of whether the interest that would have passed under the disclaimed transfer passes because of the disclaimer to or for the benefit of the surviving spouse by the other transfer." Sec. 240.058. This rule comports with the spousal disclaimer exception under IRC Sec. 2518.

**III. How does disclaimed property pass?** An important rule to remember is that disclaimed property passes without any direction from the disclaimant. Rather, applicable law determines who receives the disclaimed property. The legal effect of a disclaimer depends on the particular circumstances of the disclaimer, but generally speaking, the effect of a disclaimer of an interest in property is that the disclaimed property passes according to the following rules (there are exceptions to some of these rules, so it is imperative that the attorney review the Disclaimer Act in its entirety rather than rely on this list):

- A disclaimed interest passes according to any provision in the instrument creating the interest that provides for the disposition of the interest if the interest were to be disclaimed or the disposition of disclaimed interests in general. Sec. 240.051(d).
- If the instrument creating the disclaimed interest does not contain such a provision, the disclaimed interest passes as

if the disclaimant did not exist (in the case of a non-individual) or as if the disclaimant had died immediately before the time as of which the disclaimer takes effect (in the case of an individual). Sec. 240.051(e).

- For non-trust property, a disclaimer generally results in the disclaimed property passing by representation to the descendants of the disclaimant who survive the decedent (in the case of property passing because of a decedent's death) or to the descendants of the disclaimant who are living at the time of the event that causes the interest to pass (in the case of property passing because of an event not related to the death of a decedent). Sec. 240.0511(a) and Sec. 240.0512(a). This is true even if the disclaimed interest would have passed to the disclaimant's estate under other provisions of the Disclaimer Act. *Id.*

- For trust property, a disclaimer causes the interest to not pass into the trust. Sec. 240.053(a). If the instrument creating the disclaimed interest does not contain a provision that provides for the disposition of the interest if the interest were to be disclaimed, the disclaimed interest passes as if: (1) all of the current beneficiaries, presumptive remainder beneficiaries, and contingent beneficiaries of the trust affected by the disclaimer who are individuals died before the trust became irrevocable; and (2) all beneficiaries of the trust affected by the disclaimer who are not individuals ceased to exist without successor organizations and without substitution of beneficiaries under the cy pres doctrine before the trust became irrevocable. Sec. 240.053(c).

- On the disclaimer of a preceding interest, a future interest (which is a defined term, *see* Sec. 240.0501) held by a person other than the disclaimant takes effect as if the disclaimant had died immediately before the decedent, but a future interest held by the disclaimant is not accelerated in

possession or enjoyment. Sec. 240.0511(c) and Sec. 240.0512(c).

- An interest in survivorship property disclaimed by a surviving holder of the property passes as if the disclaimant predeceased the holder to whose death the disclaimer relates. Sec. 240.052(c).

- A disclaimed interest that passes by intestacy passes as if the disclaimant died immediately before the decedent. Sec. 240.051(f).

Although the Disclaimer Act expressly addresses when a disclaimer of an interest in property by an appointee of a power of appointment or by an object or taker in default of an exercise of a power of appointment takes effect (in the first case, as of the time the instrument by which the holder exercises the power becomes irrevocable, and in the second case, as of the time the instrument creating the power becomes irrevocable), it does not expressly state what happens to property disclaimed by an appointee or a default taker. Presumably these would be considered to be disclaimers of preceding interests and the holders of future interests in such disclaimed property, as described in the instrument creating such power of appointment, would receive the property.

Mistake as to Effect of Disclaimer. Navigating the rules relating to the disposition of disclaimed property can be challenging, yet the importance of reaching a correct conclusion is paramount. An otherwise valid disclaimer that was made under a mistaken understanding as to who would receive the property disclaimed is nonetheless likely to be considered effective and irrevocable. *Nw. Nat. Cas. Co. v. Doucette*, 817 S.W.2d 396 (Tex. App.—Fort Worth 1991, writ denied). *But see McCuen v. Huey*, 255 S.W.3d 716, 722 (Tex. App.—Waco 2008, no pet.). Section 240.009(c) of the Disclaimer Act provides that a disclaimer is irrevocable on the later of the date the disclaimer is delivered or filed as provided in the Disclaimer Act and the date that it takes effect.

#### **IV. Who May Disclaim and When Is Court Approval or Notice Required?**

Disclaimer by Non-Fiduciary. "A person other than a fiduciary may disclaim, in whole or in part, any interest in or power over property, including a power of appointment." Sec. 240.006. This long-standing rule has traditionally been the primary basis for disclaimers of property interests. The statute does not require court approval of a disclaimer by a non-fiduciary.

Disclaimer by Fiduciary. In addition, Texas law now provides a new statutory framework for disclaimer by a fiduciary (trustee, guardian, executor, etc.) of any interest in or power over property, including a power of appointment and the power to disclaim, that would have passed to the ward, estate, trust, or principal with respect to which the fiduciary was acting had the disclaimer not been made. Sec. 240.008. Disclaimers by certain fiduciaries were permitted under prior law, either with or without court approval. *See, e.g.*, former Texas Probate Code Sec. 37A (2011). However, commentators have said that prior to enactment of the current statute, it was not clear whether Texas law permitted disclaimer by a Trustee. However, in TAM 8549004, the IRS concluded that a trustee had no authority under Texas law to disclaim trust property on behalf of the trust beneficiaries, but rather the beneficiaries themselves held the power to disclaim their interests, which is a view shared by some attorneys in Texas, including the author of this paper.

Curtailing Ability of Fiduciary to Disclaim Property Interests. The Disclaimer Act now authorizes a disclaimer by a fiduciary acting in a fiduciary capacity, including a trustee, *even if* the creator of the interest or power imposed a spendthrift provision 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. Sec. 240.008 (disclaimer of property); Sec.

240.007 (disclaimer of power). However, a fiduciary acting in a fiduciary capacity will not have a power to disclaim if the fiduciary's right to disclaim is expressly restricted or limited by other Texas law (including laws imposing fiduciary duties) or by the instrument creating the fiduciary relationship (e.g., the trust agreement or will that creates the fiduciary relationship prohibits the trustee's or executor's disclaimer). *Id.* Note that the instrument that creates the fiduciary relationship may not be the instrument that creates the property interest. E.g., a decedent's own will appoints his executor and/or trustee, a court appoints a ward's guardian and a power of attorney document appoints the principal's agent. A restriction in a will that prohibits an agent from disclaiming property on behalf of a devisee would not be effective to prevent such a disclaimer. Perhaps provisions in the authorizing documents requiring that fiduciaries obtain court approval in connection with disclaiming property should be more commonplace.

It appears to be permissible to prohibit fiduciary disclaimers of property interests generally, or to prohibit disclaimers by a specific person acting as a fiduciary, or to prohibit disclaimers of specific assets, or to prohibit disclaimers of certain beneficiaries' interests. It should also be permissible to restrict a disclaimer by a fiduciary for any reason other than a specifically authorized reason, such as to achieve significant tax savings or to divert problematic assets from a trust or estate. Finally, a disclaimer could be prohibited if the asserted reason for the disclaimer was a specifically prohibited reason, such as to prevent the disqualification of a beneficiary for government benefits such as Medicaid. These alternatives should be taken into consideration when structuring a client's estate plan, or perhaps in determining "default" form provisions applicable to disclaimers by fiduciaries.

Court Approval. With certain exceptions described below, a fiduciary disclaimer does *not*

require court approval to be effective unless the instrument that created the fiduciary relationship requires court approval. Sec. 240.008(b). The specific exceptions requiring court approval of a fiduciary's disclaimer (in the absence of a court approval requirement contained in the instrument that created the fiduciary relationship) include only the following:

- "(1) a disclaimer by a personal representative who is not an independent administrator or independent executor;
- (2) a disclaimer by the trustee of a management trust created under Chapter 1301, Estates Code;
- (3) a disclaimer by the trustee of a trust created under Sec. 142.005; or
- (4) a disclaimer that would result in an interest in or power over property passing to the person making the disclaimer." Sec. 240.008(c).

The Disclaimer Act does not impose any requirement that a guardian, agent, or independent executor or independent administrator seek court approval in connection with a disclaimer. Sec. 240.008(c), Disclaimer Act.

Notice. The Disclaimer Act also does not impose any requirement that a guardian, agent, or independent executor or independent administrator notify the person to whom fiduciary duties are owed of the disclaimer of an interest in property. In the absence of a specific statutory duty to provide notice, it may nonetheless be true that fiduciary duties such as the duty to disclose important information would require a fiduciary to provide the person to whom fiduciary duties are owed with notice of the intent to disclaim, but such is beyond the scope of this paper.

The lack of a notice requirement in these contexts may have been an inadvertent omission rather than an intentional grant of authority to fiduciaries to deprive the persons to whom fiduciary duties are owed of their property interests without informing them of the intent to

disclaim or the fact of the disclaimer. The author has not researched whether that was the case. (Note that, in the case of a disclaimer of a *power* by an agent, the disclaimer of a power must be delivered to the principal or the principal's representative, so the principal will learn that a power granted to the agent has been disclaimed. Sec. 240.110. The author asserts that the principal would be far better served by a requirement that he be provided notice of a disclaimer of property to which the principal is entitled.)

#### Disclaimer by Trustee; Required Notice.

Section 240.053 provides for a trustee's disclaimer of an interest in property that otherwise would have become trust property. Unlike other fiduciaries, a trustee is required by Sec. 240.008(d) to provide written notice of the disclaimer in accordance with Section 240.0081, or to obtain court approval of the disclaimer. "A trustee acting in a fiduciary capacity may disclaim an interest in property that would cause the interest in property not to become trust property without court approval if the trustee provides written notice of the disclaimer to all of the current beneficiaries and presumptive remainder beneficiaries of the trust." Sec. 240.0081(a). Notice must also be given to the attorney general if charities are involved. Sec. 240.0081(c). Notice need not be given to certain persons, including a beneficiary who is a descendant of a beneficiary to whom the trustee has given notice if the beneficiary and the beneficiary's ancestor have similar interests in the trust and no apparent conflict of interest exists between them. Sec. 240.0081(e)(4). The requirements of the notice are set forth in Section 240.0081(f). Among those is the requirement that the notice must be given not later than the 30th day before the date the disclaimer is made. Sec. 240.0081(f)(5).

#### Disclaimer by Parent of Minor Child.

The statutory authority for a parent to disclaim on behalf of a minor child provides a powerful tool for a parent to re-route assets away from his or her children, but this authority could also

create problems for our estate planning clients and their intended devisees/beneficiaries. Section 240.008(e) of the Disclaimer Act authorizes certain disclaimers by parents on behalf of their minor children.

"In the absence of a court-appointed guardian, without court approval, a natural guardian as described by Section 1104.051, Estates Code, may disclaim on behalf of a minor child of the natural guardian, in whole or in part, any interest in or power over property, including a power of appointment, that the minor child is to receive solely as a result of another disclaimer, but only if the disclaimed interest or power does not pass to or for the benefit of the natural guardian as a result of the disclaimer."

Without meeting any legal requirement such as a fiduciary duty or a conflicts test (*see, e.g.*, Sec. 115.013(c)(3) of the Texas Property Code, which imposes a conflicts test in connection with a minor being legally bound by his parent who represents him), a parent apparently has authority to disclaim his minor children's interests in property so long as the property does not ultimately pass to the disclaiming parent and so long as the interest was a future interest accelerated by another disclaimer. For some planners, the fact that the minor would receive the interest solely as a result of another disclaimer provides adequate protection for the minor child without the need for a conflicts test, the application of fiduciary principles, or court approval. However, there seem to be many fairly routine planning situations, such as a bypass trust funded by a disclaimer, which would open the door to a parent's ability to disclaim assets on behalf of a minor child.

#### **V. What are the remedies for an improper fiduciary disclaimer?**

Remedies for Improper Disclaimer. Section 240.008(g) of the Disclaimer Act provides that "[p]ossible remedies for a breach of fiduciary obligations do not include declaring an otherwise effective disclaimer void or granting other legal or equitable relief that would make the disclaimer ineffective." The exclusion of equitable relief as a possible remedy for an improper disclaimer may have been a response to *Baker Botts, L.L.P. v. Cailloux*, 224 S.W.3d 723 (Tex. App.—San Antonio 2007, pet. denied), which involved an attempt to impose an equitable trust to restore the disclaimant to the financial position she would have been in but for the breach of fiduciary duty. Although subsection (f) of Section 240.008 requires that a disclaimer by a fiduciary acting in a fiduciary capacity must be compatible with the fiduciary's fiduciary obligations – unless a court of competent jurisdiction approves the disclaimer – this requirement cannot be enforced so as to void a disclaimer carried out in breach of fiduciary duties or to secure other equitable relief for a devisee, ward, principal or other party harmed by fiduciary misconduct. Section 240.008(g).

However, under Section 240.0081(h), if a *trustee* makes a disclaimer for which notice is provided under such section, "the beneficiary does not lose the beneficiary's right, if any, to sue the trustee for breach of the trustee's fiduciary obligations in connection with making the disclaimer. Section 240.008(g) applies to remedies sought in connection with the alleged breach." It seems that monetary damages would be available for a person harmed by an improper disclaimer by a fiduciary, but recovery of the disclaimed property (which might be real property important to the family or family business interests, e.g.) appears not to be possible. Considering the severity of the legal consequences of a disclaimer to the person to whom fiduciary duties are owed, it seems especially important that such persons be granted sufficient advance notice by the



fiduciary of the intent to disclaim and/or court oversight of any proposed fiduciary disclaimer.

Interestingly, by implication, the statute validates fiduciary disclaimers that are not compatible with the fiduciary's fiduciary obligations, so long as a court approves the disclaimer. Although it may seem unlikely that a court would sanction such a disclaimer, it is worth noting that the court could do so, if so inclined, or could do so inadvertently by "blessing" a disclaimer that is in violation of fiduciary duties.

Attorneys representing persons entitled to receive property in any of the circumstances described in the Disclaimer Act should promptly notify any fiduciary who proposes to disclaim the property not to proceed if any concerns about the disclaimer exist *and* should promptly seek relief in the courts. It will be important to be diligent in identifying for the court any breach of fiduciary duty arising in connection with the fiduciary's proposed disclaimer and in preventing the court from allowing an improper disclaimer to take effect. Ad litem should be especially diligent in understanding and preventing potential irreparable harm that could be caused by a fiduciary disclaimer.

## **VI. What are the key legal requirements of a disclaimer?**

Disclaimer Requirements. For state law purposes, a disclaimer must meet certain technical requirements, apart from the other requirements discussed in this paper, in order to be effective. Those requirements are set forth in Sec. 240.009(a) and Sec. 240.151 of the Disclaimer Act. Sec. 240.009(a) states that "a disclaimer must: (1) be in writing; (2) declare the disclaimer; (3) describe the interest or power disclaimed; (4) be signed by the person making the disclaimer; and (5) be delivered or filed in the manner provided by Subchapter C." Sec. 240.151 imposes the following further requirements:

"(a) A disclaimer is barred by a [prior] written waiver of the right to

disclaim. (b) A disclaimer of an interest in property is barred if any of the following events occur before the disclaimer becomes effective: (1) the disclaimant accepts the interest sought to be disclaimed by: (A) taking possession of the interest; or (B) exercising dominion and control over the interest; (2) the disclaimant voluntarily assigns, conveys, encumbers, pledges, or transfers the interest sought to be disclaimed or contracts to do so; or (3) the interest sought to be disclaimed is sold under a judicial sale."

Sec. 240.151 might be helpful in preventing a disclaimer when concerns exist whether a disclaimer might be inappropriately made. A written waiver of the right to disclaim may be collected before the disclaimer opportunity arises, which will be effective to prevent a valid disclaimer. For example, a grantor or the beneficiaries of a trust might request a fiduciary's waiver of the right to disclaim.

Sec. 240.151 also addresses other key questions relating to the acceptance of an interest sought to be disclaimed, which invalidates a subsequent attempted disclaimer as indicated above. First, "[t]he acceptance of an interest in property by a person in the person's fiduciary capacity is not an acceptance of the interest in the person's individual capacity and does not bar the person from disclaiming the interest in the person's individual capacity." Second, "[a] disclaimer, in whole or in part, of the future exercise of a power held in a fiduciary capacity is not barred by the previous exercise of the power." Third, "[a] disclaimer, in whole or in part, of the future exercise of a power not held in a fiduciary capacity is not barred by the previous exercise of the power unless the power is exercisable in favor of the disclaimant."

Finally, Sec. 240.151 explains the effect of an attempted disclaimer of property or powers that is barred by such Section. In the case of a power over property, the barred

disclaimer is ineffective. Sec. 240.151(f)(1). In the case of an interest in property, the barred disclaimer "takes effect as a transfer of the interest [ineffectively] disclaimed to the persons who would have taken the interest under Subchapter B had the disclaimer not been barred." Sec. 240.151(f)(2). In other words, even if the disclaimer is barred by reason of the disclaimant's prior acceptance of the property, the result of the failed disclaimer attempt is that the property is nonetheless transferred, with resulting legal and gift tax consequences, rather than retained by the disclaimant.

Federal Tax Rules Applicable to Disclaimers. Treas. Reg. Sec. 25.2518-2(a) lists some of the basic requirements for a qualified disclaimer, which (paraphrased) are:

- (1) The disclaimer must be irrevocable and unqualified;
- (2) The disclaimer must be in writing (the writing must identify the interest in property disclaimed and be signed either by the disclaimant or by the disclaimant's legal representative);
- (3) The writing must be delivered to the transferor of the interest, the transferor's legal representative, the holder of the legal title to the property to which the interest relates, or the person in possession of such property, no later than the date which is 9 months after the later of (i) the date on which the transfer creating the interest in the disclaimant is made, or (ii) the day on which the disclaimant attains age 21);
- (4) The disclaimant must not have accepted the interest disclaimed or any of its benefits; and
- (5) The interest disclaimed must pass either to the spouse of the decedent or to a person other than the disclaimant without any direction on the part of the person making the disclaimer.

Two other important requirements of Treas. Reg. Sec. 25.2518-2 are:

"A person who receives an interest in property as the result of a qualified disclaimer of the interest must disclaim the previously disclaimed interest no later than 9 months after the date of the transfer creating the interest in the preceding disclaimant." Treas. Reg. Sec. 25.2518-2(c)(3).

"The acceptance of any consideration in return for making the disclaimer is an acceptance of the benefits of the entire interest disclaimed. Treas. Reg. Sec. 25.2518-2 (d)(1)."

This does not constitute an exhaustive list of all the requirements for a qualified disclaimer.

Child Support Obligor Cannot Disclaim.

An important limitation to a disclaimer by a person who is a parent is the Disclaimer Act's prohibition against a child support obligor's disclaimer of property that could be applied to satisfy the disclaimant's child support obligations. Sec. 240.151(g) of the Disclaimer Act. This exception applies to a parent's disclaimer of his own property interests which could be so used and is probably less applicable in the context of disclaimers made by a parent on behalf of his minor children. The parent's obligations must have been reduced to judgment or administratively determined by the Title IV-D agency, as provided in the Family Code. Section 240.151(g).

Section 240.151(h) provides that the child support obligee to whom child support arrearages are owed may enforce the child support obligation against the disclaimant as to disclaimed property by a lien or by any other remedy provided by law. Does this enforcement provision allow a lien to attach to the disclaimed property or only to property that is owned by the disclaimant? Can "any other remedy provided by law" include other legal or equitable relief of the type that Section 240.008(g) of the Disclaimer Act precludes?

The statutory prohibition against disclaimer seems to apply regardless of whether

the child support obligor's resources (disregarding the property the obligor wishes to disclaim) are adequate to meet his or her child support obligations and regardless of whether the property would pass to or for the benefit of the child support obligee if the disclaimer were allowed to take effect. One can imagine a situation in which other creditor claims attached to property that could not be disclaimed, with the result that the children to whom the would-be disclaimant owed child support were deprived of resources that would have passed to them had a disclaimer been permitted. A prior version of the statute required that a disclaimer include a statement whether the disclaimant was a child support obligor in order for a disclaimer to be valid (see former Texas Estates Code Sec. 122.051(b)), but that requirement seems to have been repealed.

## **VII. What are some of the primary goals achieved by disclaimers?**

Avoiding Creditor Claims. When representing a beneficiary who is entitled to receive an interest in property, one factor to consider is whether the beneficiary owes a significant debt to a judgment creditor or other creditor. Generally speaking, non-exempt property owned by a debtor is reachable by a creditor to satisfy the debt owed, with the exception of certain assets that offer some measure of protection for the owner, such as interests in a limited partnership or limited liability company (with such assets, a creditor is likely limited to a charging order).

Two key features of the Disclaimer Act operate to protect disclaimed property from creditors of the disclaimant. First, Sec. 240.051 of the Disclaimer Act provides that a "disclaimed interest is not subject to the claims of any creditor of the disclaimant." With the exception of a child support claim against a child support obligor (discussed elsewhere herein), disclaimed property is expressly protected from claims. Second, even though a person may be legally entitled to the disclaimed

property in such a manner as to expose it to creditor claims prior to being disclaimed, the relation-back doctrine, now codified in the Disclaimer Act, clarifies that a disclaimer relates back for all purposes to the time of the decedent's death or to the time the instrument creating the disclaimed interest became irrevocable or the time of the irrevocable transfer, as applicable. Sec. 240.051. An important limitation on the protection afforded by the statute is that a disclaimer made after a federal bankruptcy petition has been filed will not be effective to remove the disclaimed property from the reach of creditors. *In re Schmidt*, 362 B.R. 318, 326-27 (Bkrtcy W.D. Tex. 2007).

Achieving Transfer Tax Goals. What are the tax benefits of a qualified disclaimer for federal transfer tax purposes? Generally speaking, properly disclaimed property is treated for federal transfer tax purposes as though it passed directly from the original owner to the ultimate recipient(s) without any disclaimant having acquired ownership. I.e., disclaimed property will not be included in the disclaimant's taxable estate and will not be considered a transfer by gift from the disclaimant to the ultimate recipient(s). For example, if property would pass to a person who is very wealthy in his own right and who has implemented or will need to implement estate planning strategies to minimize federal estate taxation in his own estate, such a person might disclaim the property so that it can pass to the alternate, contingent or remainder beneficiaries without being subject to transfer taxes. Often those beneficiaries are the disclaimant's descendants. Some of the requirements for a qualified disclaimer for transfer tax purposes are discussed in further detail above.

"Decoupling" the State Law Disclaimer from the IRC's Qualified Disclaimer Requirements. Prior versions of the Texas disclaimer laws were often oriented toward preserving the federal transfer tax benefits of disclaimers. One of the most notable tax-

motivated state law requirements was the requirement that a disclaimer be made within nine months of a transfer, although the Texas and IRC nine-month requirements did not correspond perfectly as explained by Glenn M. Karisch and Julia E. Jonas in their paper entitled "Problems with the Texas Disclaimer Statutes and How to Deal with Them", September 19, 2014. The new statute eliminates the nine-month time period and certain other requirements that were designed to sync the state law disclaimer rules with the IRS rules. The "decoupling" of Texas law from the requirements of qualified disclaimers under federal law may have been motivated in part by the expected reduction in the number of tax-motivated, qualified disclaimers as a result of the "permanent" increase in the applicable exclusion amount, as well as by the desire to take advantage of certain other perceived benefits of the Uniform Disclaimer of Property Interests Acts approach. If a qualified disclaimer is needed to accomplish the client's tax goals, the attorney must ensure (as we have always had to do) that the federal law requirements are met and not only the Texas statutory requirements.

Protecting Assets. A disclaimer may be one method to prevent liabilities associated with a "troubled" asset, such as environmentally damaged real property, from attaching to other assets.

Re-Routing Assets. It is sometimes the case that assets would have been structured to pass differently had current facts and circumstances been known by the original owner of assets, or had the disposition been the prerogative of a person other than the original owner of assets. A beneficiary or a fiduciary acting for another person may have some ability to alter certain aspects of the disposition plan for assets by making a disclaimer.

#### **VIII. Disclaimer Planning Examples:**

1. A planning suggestion borrowed from the NCCUSL Comments to the Texas Uniform

Disclaimer of Property Interests Act (Draft dated May 27, 2014) is for a trustee of a trust for the benefit for a surviving spouse who also has the power to invade principal for the decedent's descendants to disclaim the latter power in order to qualify the trust for the marital deduction, if the trust otherwise qualifies. The NCCUSL Comments cite to *Cleveland v. U.S.*, 62 A.F.T.R.2d 88-5992, 88-1 USTC ¶ 13,766 (C.D.Ill. 1988), as an example of an effective use of such a disclaimer.

2. A relatively common planning strategy that utilizes disclaimers is the so-called "disclaimer bypass trust". A testator might typically provide that his estate passes outright to his surviving spouse; however, any property disclaimed by the surviving spouse will pass to the trustee to be held in a "bypass" trust. This strategy was particularly helpful to some clients during 2001-2010, when the applicable credit amount varied greatly from year-to-year, causing potentially large shifts in the value of the shares that a surviving spouse and other recipients (such as the children) might receive if a tax-driven funding formula were used. Now such planning could potentially be effectuated by a surviving spouse's disclaimer, as well as by a trustee's disclaimer.

3. A high net worth client who desires to create a source of funds from which transfers to his children could be made tax-free during his lifetime might consider disclaiming property to which the client would be entitled (and which he is confident that he will never need), if the result is that the client's children would become beneficially entitled to the property following the disclaimer.

4. A client who is insolvent and whose inheritance of property would not result in the satisfaction of all of his creditor claims, leaving him debt-free and perhaps also with additional assets to support his standard of living, may wish to disclaim the property prior to filing a bankruptcy petition, allowing the property to pass free of creditor claims to the alternate recipients (perhaps his descendants). The benefit

of paying one's debts in full should not be undervalued in considering this option.

5. A client who qualifies for Medicaid or other government benefits and who might not benefit from the ability to potentially enjoy a higher standard of living as a result of an inheritance might elect to disclaim the property interest in order to remain eligible for such benefits. However, there are very significant differences in the quality of care that a Medicaid recipient and a person who has adequate resources to pay for his own care typically receive. Accordingly, although a disclaimer by such a person is appropriately such person's decision to make (whether prudent or not), a fiduciary acting for such a person should exercise extreme caution – and make sure the decision to disclaim is truly in the best interests of the disclaimant – before disclaiming property that could provide meaningful help to the person to whom the fiduciary owes duties.

6. A surviving spouse who has adequate financial resources for his own support may wish to disclaim all of his interests in assets passing from his deceased spouse, allowing those assets to pass to or in trust for the benefit of children, grandchildren, or others as the case may be. If the deceased spouse left the assets outright to the surviving spouse, a disclaimer might make better use of the decedent's wasted GSTT exemption, for example.

7. A parent who wishes to prevent his (currently) minor child from receiving assets could disclaim property passing to or for the benefit of his child, if the child would himself receive the interest in the property as a result of another disclaimer. Perhaps the parent has very noble objectives in making a disclaimer, such as a desire to keep the assets from a child with a substance abuse problem or who the parent believes is likely to be dependent on trust money for support. Perhaps the parent has a less noble motive for disclaiming on behalf of his minor children, such as facilitating a distribution to a current spouse who becomes the owner or beneficiary of the assets if the

children's interests are disclaimed. What if the parent's goal is to keep the assets from the control of a former spouse who would be trustee of the assets if not disclaimed and who might be able to use the disclaimed funds to maintain a better lifestyle for himself or herself? It appears that a parent may disclaim property passing to his minor children regardless of whether the disclaimer is self-serving, so long as the parent so disclaiming does not receive the property as a result of the disclaimer.

#### **IX. Summary:**

Throughout this paper are examples of situations in which a disclaimer might be helpful or detrimental to the interests of various individuals who would be affected by a disclaimer. It is incumbent upon us as attorneys to advise our clients competently regarding not only the availability of disclaimers to accomplish a client's articulated goals and the legal consequences of disclaimers, but also regarding the legal duties and procedural requirements such as notice that must be considered and complied with.

Various concerns of the author relating to how disclaimer powers held by a fiduciary could be abused, especially in light of potentially inadequate legal remedies for those harmed by the disclaimer, were also raised. Although the law may grant a fiduciary the power to disclaim, perhaps without notice or court review, and perhaps in a manner that is not entirely consistent with fiduciary duties, the attorney should advise a fiduciary client of the legal risks associated with failing to give notice, get beneficiary consent (and perhaps a release, if such a release does not trigger undesirable tax consequences), confirm the validity of the proposed disclaimer in court or take other steps to ensure the fiduciary's disclaimer is appropriate.

Although the Disclaimer Act clarifies that "[a] disclaimer by a fiduciary acting in a fiduciary capacity is not a per se breach of the fiduciary's fiduciary obligations," it is equally

clear that a disclaimer by a fiduciary will very often (almost always in the author's view) constitute a breach of fiduciary duty. Even if tax savings, avoidance of creditor's claims, qualification for government benefits or some other benefit can be achieved by a disclaimer, the disclaimer may substantially and adversely affect the rights of the (or of a) person to whom the fiduciary owes fiduciary duties. It is perhaps best in most cases to leave the decision whether to disclaim to the disclaimant rather than to disclaim interests as a fiduciary. That being said, a fiduciary who is armed with the reassurance provided by informed consent can wield this powerful tool to great effect.

**This paper is provided for educational purposes only and does not constitute legal advice by the author or the author's law firm.**

**The author would like to acknowledge having studied an excellent paper authored by Glenn M. Karisch and Julia E. Jonas, entitled "Problems with the Texas Disclaimer Statutes and How to Deal with Them", September 19, 2014, as well as materials prepared by other knowledgeable authors or presenters, in connection with writing this paper. The authors of other such materials were not consulted in connection with this paper and have not reviewed or verified the accuracy of its conclusions or suggestions.**