

ESTATE PLANNING NEWS



Refusing an Inheritance: Tax and Non-Tax Benefits of Qualified Disclaimers

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I recently spoke with a woman who had a problem with her inheritance: She didn't want it. That's right. I know you may think: *Why would anyone turn down an inheritance?* Believe it or not, a disclaimer can be a great estate planning technique.

What is a Disclaimer?

A disclaimer is a refusal to accept benefits given through a transfer of property. A disclaimer may be made in whole, or in part, but it must be done promptly and in accordance with federal and state law. When the disclaimer rules are followed, the disclaimant is treated as never having received the disclaimed property. Therefore, the disclaimant has not made a transfer for federal gift, estate or generation-skipping transfer tax purposes.

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Announcements

Biggest Income Tax Burdens

If you're still losing sleep over Form 1040, you can commiserate with your neighbors. Based on 2004 federal income tax figures compiled by the Tax Foundation, two Bay Area cities and one county placed in the top 10 list of federal income taxpayers (based on % of AGI).

- #8 -- Marin County -- 16.8%
- #3 -- City of San Francisco -- 16.0%
- #10 -- City of San Jose -- 14.2%



Tip of the Month

Does Your Parent Refuse to Engage in Estate Planning?

Many clients express frustration over the unwillingness of their parents to engage in estate planning. Here are some Techniques to broach the subject in a non-threatening way:

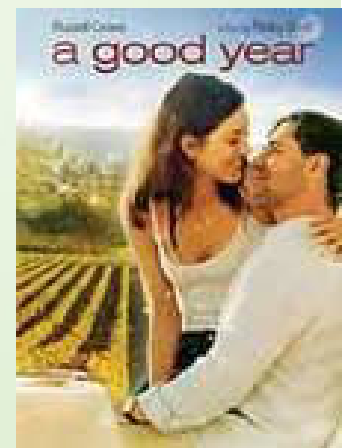
- 1) Talk about friends or friends' parents who had positive experiences as a result of planning or negative experiences because of a failure to plan their estate;
- 2) Talk about your own experience planning your estate;
- 3) If your parents are interested in financial news, talk about scheduled changes in the estate and gift tax law;
- 4) Talk about the need for Advance Health Care Directives in the event of illness.



Entertainment

A Good Year (2006)

This adaptation of Peter Mayle's best-selling novel follows the romantic misadventures of an Englishman in Provence, France. After inheriting a vineyard from his uncle Henry, failed banker Max Skinner (Russell Crowe) moves abroad. Subsequently, he meets a beautiful American woman who claims to be his long-distant cousin -- and his uncle's true heir.



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They tell you that you'll lose your mind when you grow older. What they don't tell you is that you won't miss it very much.

- - MALCOLM COWLEY

Refusing an Inheritance

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Federal Requirements

Internal Revenue Code § 2518 lists the requirements for a "qualified disclaimer":

- 1) An irrevocable & unqualified refusal to accept an interest;
- 2) Made in writing;
- 3) Delivered to the holder of legal title (e.g., trustee, executor, etc.) within 9 months of the decedent's death;
- 4) Without accepting the asset, or any benefit thereof; and
- 5) The disclaimant cannot redirect the interest to another beneficiary.

California State Requirements

Cal. Probate Code § 275 *et seq.* provides:

- 1) The written disclaimer must:
 - a) Identify who created the interest;
 - b) Describe the interest disclaimed;
 - c) State the disclaimer's extent; and
 - d) Be signed by the disclaimant.
- 2) The disclaimer shall be filed with:
 - a) The county court where the estate is (or would have been) administered;
 - b) The trustee, executor, or other person responsible for distributing the interest to the beneficiary;
 - c) Any other person having custody, possession, or legal title to the interest; or
 - d) The creator of the interest.
- 3) The beneficiary has accepted the interest, and may not later disclaim, if the beneficiary (or his/her representative):

- a) Transfers (or contracts to transfer) the interest;
 - b) Executes a written waiver of the right to disclaim the interest;
 - c) Accepts the interest or benefits; or
 - d) Sells the interest at a judicial sale.
- 4) A disclaimer is not a fraudulent transfer (*i.e.*, when filed to avoid creditors).

What Happens to Disclaimed Property?

Disclaimed property passes to the next beneficiary designated by the decedent. However, the property may not pass to a trust for the disclaimant, unless the disclaimant is the decedent's spouse. If the decedent failed to name a contingent beneficiary, intestacy law controls.

Scenarios When Disclaimers Are Used

Example 1 -- Wealthy Beneficiary

Avery built a \$250,000 IRA, naming his father, Bill, as primary beneficiary, and his nephew, Cody, as contingent beneficiary. A retired businessman who has engaged in estate tax planning for the past decade, Bill sends the IRA custodian a disclaimer. Whereas Bill is in a high tax bracket and would have to liquidate the IRA within 10 years, Cody is currently in the lowest tax bracket, will take RMDs over a 50-year period, and can maximize the benefit of tax-deferred growth.

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Example 2 - Accelerate a Gift

Diane is a middle-aged woman saving for retirement. Her 25-year-old, daughter, Evie, has been saving up for her first home down-payment. Diane would like to help Evie. When Diane's mother dies, leaving \$500,000 to "Diane or her issue," Diane asks her attorney for advice structuring a \$100,000 gift to Evie. To avoid adverse tax consequences, the attorney suggests that Diane disclaim 20% of the inheritance, which will pass to Evie and can be used toward a down-payment on her first home.

Example 3 - Use the Marital Deduction

Husband and Wife are in their early 30s and just had their first child. They own a dental practice and expect their incomes and net worth to increase substantially over the years. Ignoring life insurance, their current net worth is \$300,000. Tax considerations aside, Husband and Wife want to leave everything to the surviving spouse, then to their children.

Husband and Wife's ages and financial situation do not presently justify a traditional bypass or credit shelter trust ("A/B Trust"). Even if their estate doubles in the next few years, the trouble and expense of administering Trust B may not be necessary or appropriate. Nevertheless, considering the many uncertainties -- life expectancies, asset growth, estate tax law, and the frequency with which they will review and update their estate plan -- when the first spouse dies, the surviving spouse may want to use some or all of the deceased spouse's estate tax exemption.

Husband and Wife create a Revocable Living Trust with Disclaimer Trust provisions. The Disclaimer Trust serves the same purpose as the traditional bypass or credit shelter trust (*i.e.*, surviving spouse may serve as trustee, income and principal are available to the surviving spouse for health, education, maintenance and support), but it is optional, allowing Husband and Wife a more flexible, wait-and-see approach.

Example 4 - Correct Errors

Maude's parents owned a condo, where Maude's sister, Sally, lived and paid rent to the parents. The parents made a verbal agreement with Sally that her rent would go toward purchasing the condo. By the time the second parent died, Sally had paid rent in excess of the condo's value.

The parents left no other assets and no estate plan. By default, Maude and Sally were to split the parents' estate equally. However, Maude opted to disclaim her interest in the condo, leaving it to Sally as the family intended.

Conclusion

When executed correctly, a disclaimer can be a great tax-savings device or remedy for estate planning errors. Professional advice is important to ensure that disclaimers are appropriate, and if so, correctly filed.