Price & Farrington's Estate and Tax Planning *Fast*Faxts

September, 2005

Estate, Tax , Business and Wealth Planning for Advisors and Clients

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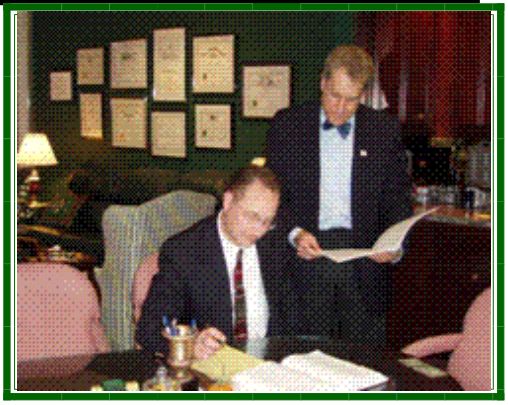
Disclaimers: *The Estate Planning Version of "Just Say No!"*

Best Wishes For Fall, 2005!



Chuck Farrington (seated) and Glenn Price

Will the federal estate tax be repealed? Will the estate tax exclusion amount be increased? Will today's $1.5 million exclusion be rolled back to the $1 million level specified in prior law? Nobody knows. And even if Congress passes a "permanent" change tomorrow, a future Congress can enact yet another change.

Because of the inherent uncertainty in planning for deaths that might not occur for decades, it makes sense to build flexibility into an estate plan that gives your (or your clients') heirs the ability to make informed choices.

How it works. An heir can make a *qualified disclaimer* of inherited property— in other words, refuse all or part of the inheritance. This can be based on personal circumstances, current tax law or potential tax savings. An asset that is disclaimed will pass as though the person making the disclaimer had *predeceased* the actual decedent. A specific provision can also be made for disclaimed property.

Example. Bruce Willis dies and leaves his estate to his daughter, Scout. If Scout disclaims, the estate will pass as though Scout had died before Bruce. As an alternative, Bruce might state in his will that any property disclaimed by Scout will be divided between her children.

For a disclaimer strategy to work, planning is necessary; your will or trust should name contingent beneficiaries. They could be individuals, trusts or charities. Where no successor is named, the distribution of disclaimed property will depend on state law, which might not provide the desired result. Bear in mind that when a disclaimer is made, the assets involved will pass to the backup heir with no gift tax consequences.

A less taxing approach. Why would an heir waive the right to inherited property? Often, because of tax savings.

Example. Joe Blow made a will in 1986 leaving everything to his son, Billy Bob Blow, who had a modest income and two young children. By the time Joe dies in 2006 with a $2 million estate, Billy Bob has become a successful hog farmer worth millions.

Trap. If Billy Bob accepts his father's estate, he'll receive wealth he doesn't really need and increase the risk that his children will have to pay much more in estate tax on his death, losing family wealth. Billy Bob may have to figure out how to dispose of his inheritance while trying to avoid gift tax consequences. If Billy Bob doesn't manage to give away the assets he inherits from Joe by the time he dies, the $2 million inheritance might grow to $5-10 million or more, with millions in estate tax due.

Solution. Suppose Joe Blow's will lists Billy Bob's descendents as the beneficiaries of any assets disclaimed by Billy Bob. If he disclaims, his children will receive the $2 million estate. With the $2 million estate tax exclusion current law will allow in 2006, the entire wealth transfer will avoid estate, gift and generation-skipping transfer tax (GST) while Joe's assets won't be included in Billy Bob's taxable estate at his death.

Formalities. A qualified disclaimer must be in writing. It must be made within nine months of the transfer (typically at death). It must specify the disclaimed property. It must be filed with or delivered to the appropriate person or entity, as set by state law, e.g., the personal representative (executor) of the decedent's estate. A disclaimer can be made in full, proportionately or asset by asset.

We are pleased to announce:

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Examples. Billy Bob could disclaim all of Joe's estate. He could disclaim 75% but keep 25%. He could decide to keep Joe's beach house but disclaim all the other assets.

Disclaimers can involve assets that don't pass under a will, such as an IRA. If Billy Bob is the beneficiary of Joe's IRA, and he disclaims, the IRA will pass to the contingent beneficiaries named in the IRA beneficiary designation. If those beneficiaries are Billy Bob's kids, they can take minimum required distributions over their longer life expectancies and profit dramatically from extended income tax deferral. What's the bottom line? Given today's estate tax uncertainty, disclaimers may be the best way to achieve tax shelter while providing for a surviving spouse.

Problem. Many estate plans are designed so that the first spouse to die leaves the amount of the estate tax exclusion to a family ("credit-shelter") trust and the balance to a marital trust. With the estate tax exclusion amount scheduled to rise to $2 million in 2006 and to $3.5 million in 2009, such a provision might load up the family trust and short change the marital trust, which is to provide for the surviving spouse. Here's an example: Donald Duck has a $2.5 million estate. If he dies in 2006, and the full estate tax exclusion amount is left to the family trust, only $500,000 will be left to the marital trust for Daisy, Donald's surviving spouse. If Donald dies in 2009, his entire estate will go to the family trust while nothing goes to the marital trust. Daisy will be shut out.

Here's the better strategy: Donald can leave all $2.5 million to the marital trust while providing that the trustee can disclaim assets to a family trust. At Donald's death, the trustee of the marital trust can decide what Daisy will need. Above those needs, anything up to $2 million (from 2006 to 2008) can be disclaimed to the family trust tax-free. (In some states, Daisy might be the one who would have to make this disclaimer.)

Other uses. Besides the types of situations we've described, qualified disclaimers may serve many other purposes.

☑ ***Charitable donations.*** If a charity is named as backup beneficiary, some assets can be disclaimed in its favor. The disclaimed property can qualify for the unlimited estate tax charitable deduction.

☑ ***Generation-skipping transfer tax exemption.*** The GST tax, like the federal estate tax, has an exemption scheduled to rise from $1.5 million in 2005 to $2 million in 2006 and $3.5 million in 2009. Disclaimers in favor of grandchildren (or to trusts of which they are beneficiaries) can make sure this exemption is used in full.

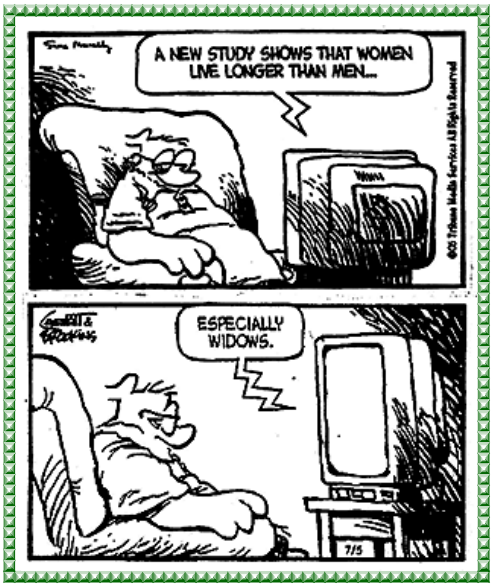
The real world. While on paper a disclaimer plan might look fine, in the real world problems might arise.

☑ ***Reluctance***. A surviving spouse (or any other heir) might not be willing to give up inherited assets, even if they probably won't be needed. CPAs and other tax advisors should emphasize to their clients the importance of such a strategy for family wealth building.

☑ ***Incapacity.*** An heir might not be capable of understanding complex tax law or be able to make the necessary qualified disclaimer. The solution is to be sure that your heirs have a well-drafted durable power of attorney in place naming an agent who is authorized to make a qualified disclaimer for an incapacitated heir.

☑ ***Acceptance of benefits.*** A disclaimer must be made before an heir has accepted any benefits from the property at issue. Cashing a dividend check from inherited stock, for example, would prohibit a disclaimer. Family members should be made aware of the benefits disclaimers can offer as well as the requirements. So warned, the surviving family members can consult with an estate planning attorney or other tax advisor before taking action with respect to the decedent's assets. ■

"Just say no!" can be a good way to say "Yes!" to good estate and tax planning through the effective use of disclaimers. As always, feel free to contact us for your or your clients' planning needs.



Bequests

An Englishman bequeathed 1,000 pounds to his widow, declaring that it would have been 10,000 pounds had she let him read his evening newspaper in peace.
— 15 Green Bag 430 (1903)

"To my wife I leave her lover, and the knowledge that I was not the fool she thought me; to my son I leave the pleasure of earning a living. For twenty years he thought the pleasure mine. He was mistaken."
—40 Case & Comment, No. 1 (1934)

"...fifty cents to my son-in-law to buy a good, stout rope with which to hang himself and thus rid mankind of one of the most infamous scoundrels."
— 8 Temple Law Quarterly (1934)

A Pennsylvania decedent bequeathed "to my son Eugene, five dollars and the world in which to make a living".
— 8 Temple Law Quarterly (1934)